

American Water Works Company, Inc.

Form 10-Q

August 02, 2012

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 2012

OR

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

For the transition period from            to

Commission file: number 001-34028

**AMERICAN WATER WORKS COMPANY, INC.**

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class                                    | Outstanding at July 26, 2012 |
|--|------------------------------|
| Common Stock, \$0.01 par value per share | 176,430,023 shares           |

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**AMERICAN WATER WORKS COMPANY, INC.**

**REPORT ON FORM 10-Q**

**FOR THE QUARTER ENDED June 30, 2012**

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

|  | June 30,<br>2012     | December 31,<br>2011 |
|--|----------------------|----------------------|
| <b>ASSETS</b>  |                      |                      |
| Property, plant and equipment  |                      |                      |
| Utility plant at original cost, net of accumulated depreciation of \$3,526,087 at June 30 and \$3,360,005 at December 31 | \$ 11,233,630        | \$ 10,872,042        |
| Nonutility property, net of accumulated depreciation of \$180,568 at June 30 and \$164,417 at December 31                | 153,681              | 149,056              |
| <b>Total property, plant and equipment</b>   | <b>11,387,311</b>    | <b>11,021,098</b>    |
| Current assets   |                      |                      |
| Cash and cash equivalents  | 12,919               | 14,207               |
| Restricted funds   | 98,698               | 32,438               |
| Utility customer accounts receivable   | 187,738              | 150,720              |
| Allowance for uncollectible accounts   | (13,140)             | (15,319)             |
| Unbilled utility revenues  | 161,851              | 134,938              |
| Other receivables, net   | 63,195               | 60,413               |
| Income taxes receivable  | 5,822                | 7,672                |
| Materials and supplies   | 31,712               | 28,598               |
| Assets of discontinued operations  | 0                    | 929,858              |
| Other  | 57,579               | 54,134               |
| <b>Total current assets</b>  | <b>606,374</b>       | <b>1,397,659</b>     |
| Regulatory and other long-term assets  |                      |                      |
| Regulatory assets  | 1,139,223            | 1,079,661            |
| Restricted funds   | 13,103               | 25,503               |
| Goodwill   | 1,207,572            | 1,195,069            |
| Other  | 59,178               | 57,401               |
| <b>Total regulatory and other long-term assets</b>   | <b>2,419,076</b>     | <b>2,357,634</b>     |
| <b>TOTAL ASSETS</b>  | <b>\$ 14,412,761</b> | <b>\$ 14,776,391</b> |

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

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

|  | <b>June 30,<br/>2012</b> | <b>December 31,<br/>2011</b> |
|--|--------------------------|------------------------------|
| <b>CAPITALIZATION AND LIABILITIES</b>  |                          |                              |
| Capitalization   |                          |                              |
| Common stock (\$.01 par value, 500,000 shares authorized, 176,317 and 175,664 shares outstanding at June 30 and December 31, respectively) | \$ 1,763                 | \$ 1,757                     |
| Paid-in-capital  | 6,198,594                | 6,180,558                    |
| Accumulated deficit  | (1,785,039)              | (1,848,801)                  |
| Accumulated other comprehensive loss   | (93,890)                 | (97,677)                     |
| Common stockholders' equity  | 4,321,428                | 4,235,837                    |
| Preferred stock without mandatory redemption requirements  | 4,547                    | 4,547                        |
| Total stockholders' equity   | 4,325,975                | 4,240,384                    |
| Long-term debt   |                          |                              |
| Long-term debt   | 5,203,133                | 5,339,947                    |
| Redeemable preferred stock at redemption value   | 19,275                   | 21,137                       |
| Total capitalization   | 9,548,383                | 9,601,468                    |
| Current liabilities  |                          |                              |
| Short-term debt  | 361,972                  | 515,050                      |
| Current portion of long-term debt  | 120,289                  | 28,858                       |
| Accounts payable   | 183,908                  | 243,709                      |
| Taxes accrued  | 39,122                   | 36,606                       |
| Interest accrued   | 57,406                   | 59,067                       |
| Liabilities of discontinued operations   | 0                        | 382,218                      |
| Other  | 255,267                  | 223,597                      |
| Total current liabilities  | 1,017,964                | 1,489,105                    |
| Regulatory and other long-term liabilities   |                          |                              |
| Advances for construction  | 377,769                  | 386,970                      |
| Deferred income taxes  | 1,434,201                | 1,288,797                    |
| Deferred investment tax credits  | 28,668                   | 29,427                       |
| Regulatory liabilities   | 352,550                  | 325,829                      |
| Accrued pension expense  | 391,162                  | 411,998                      |
| Accrued postretirement benefit expense   | 234,678                  | 237,086                      |
| Other  | 38,627                   | 38,963                       |
| Total regulatory and other long-term liabilities   | 2,857,655                | 2,719,070                    |
| Contributions in aid of construction   | 988,759                  | 966,748                      |
| Commitments and contingencies (See Note 10)  |                          |                              |
| <b>TOTAL CAPITALIZATION AND LIABILITIES</b>  | <b>\$ 14,412,761</b>     | <b>\$ 14,776,391</b>         |

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

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

|   | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |              |
|---|--------------------------------|------------|------------------------------|--------------|
|   | 2012                           | 2011       | 2012                         | 2011         |
| Operating revenues  | \$ 745,607                     | \$ 668,873 | \$ 1,364,161                 | \$ 1,265,588 |
| Operating expenses  |                                |            |                              |              |
| Operation and maintenance   | 327,577                        | 327,157    | 637,581                      | 637,978      |
| Depreciation and amortization   | 92,329                         | 87,342     | 184,433                      | 174,220      |
| General taxes   | 55,282                         | 52,951     | 112,403                      | 108,449      |
| (Gain) loss on asset dispositions and purchases   | (213)                          | 28         | (626)                        | 296          |
| Total operating expenses, net   | 474,975                        | 467,478    | 933,791                      | 920,943      |
| Operating income  | 270,632                        | 201,395    | 430,370                      | 344,645      |
| Other income (expenses)   |                                |            |                              |              |
| Interest, net   | (79,730)                       | (78,469)   | (159,384)                    | (154,660)    |
| Allowance for other funds used during construction  | 5,076                          | 2,535      | 9,438                        | 5,363        |
| Allowance for borrowed funds used during construction   | 2,313                          | 1,198      | 4,394                        | 2,402        |
| Amortization of debt expense  | (1,361)                        | (1,255)    | (2,627)                      | (2,547)      |
| Other, net  | 335                            | 680        | (281)                        | (475)        |
| Total other income (expenses)   | (73,367)                       | (75,311)   | (148,460)                    | (149,917)    |
| Income from continuing operations before income taxes   | 197,265                        | 126,084    | 281,910                      | 194,728      |
| Provision for income taxes  | 80,602                         | 51,267     | 115,995                      | 79,212       |
| Income from continuing operations   | 116,663                        | 74,817     | 165,915                      | 115,516      |
| Income (loss) from discontinued operations, net of tax  | (9,637)                        | 6,293      | (17,135)                     | (8,173)      |
| Net income  | \$ 107,026                     | \$ 81,110  | \$ 148,780                   | \$ 107,343   |
| Other comprehensive income, net of tax:   |                                |            |                              |              |
| Pension plan amortized to periodic benefit cost:  |                                |            |                              |              |
| Prior service cost, net of tax of \$28 and \$28 for the three months ended and \$56 and \$56 for the six months ended, respectively       | \$ 44                          | \$ 43      | \$ 88                        | \$ 87        |
| Actuarial loss, net of tax of \$1,167 and \$720 for the three months ended and \$2,334 and \$1,440 for the six months ended, respectively | 1,826                          | 1,126      | 3,651                        | 2,252        |
| Foreign currency translation adjustment   | (211)                          | 93         | 48                           | 411          |
| Other comprehensive income  | 1,659                          | 1,262      | 3,787                        | 2,750        |
| Comprehensive income  | \$ 108,685                     | \$ 82,372  | \$ 152,567                   | \$ 110,093   |
| Basic earnings per common share: (a)  |                                |            |                              |              |
| Income from continuing operations   | \$ 0.66                        | \$ 0.43    | \$ 0.94                      | \$ 0.66      |

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|  |    |         |    |         |    |         |    |         |
|--|----|---------|----|---------|----|---------|----|---------|
| Income (loss) from discontinued operations, net of tax | \$ | (0.05)  | \$ | 0.04    | \$ | (0.10)  | \$ | (0.05)  |
| Net income   | \$ | 0.61    | \$ | 0.46    | \$ | 0.84    | \$ | 0.61    |
| Diluted earnings per common share: (a)                 |    |         |    |         |    |         |    |         |
| Income from continuing operations                      | \$ | 0.66    | \$ | 0.42    | \$ | 0.94    | \$ | 0.66    |
| Income (loss) from discontinued operations, net of tax | \$ | (0.05)  | \$ | 0.04    | \$ | (0.10)  | \$ | (0.05)  |
| Net income   | \$ | 0.60    | \$ | 0.46    | \$ | 0.84    | \$ | 0.61    |
| Average common shares outstanding during the period:   |    |         |    |         |    |         |    |         |
| Basic  |    | 176,331 |    | 175,469 |    | 176,122 |    | 175,364 |
| Diluted  |    | 177,491 |    | 176,419 |    | 177,296 |    | 176,255 |
| Dividends per common share                             | \$ | 0.25    | \$ | 0.45    | \$ | 0.48    | \$ | 0.67    |

(a) Amounts may not sum due to rounding.

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



**Table of Contents****American Water Works Company, Inc. and Subsidiary Companies****Consolidated Statements of Cash Flows (Unaudited)**

(In thousands, except per share data)

|  | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--------------------------------------|-------------|
|  | <b>2012</b>                          | <b>2011</b> |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |                                      |             |
| Net income   | \$ 148,780                           | \$ 107,343  |
| Adjustments  |                                      |             |
| Depreciation and amortization  | 184,433                              | 174,220     |
| Provision for deferred income taxes  | 57,833                               | 69,579      |
| Amortization of deferred investment tax credits  | (759)                                | (771)       |
| Provision for losses on utility accounts receivable  | 7,402                                | 7,774       |
| Allowance for other funds used during construction   | (9,438)                              | (5,363)     |
| (Gain) loss on asset dispositions and purchases  | (626)                                | 296         |
| Pension and non-pension post retirement benefits   | 40,283                               | 35,720      |
| Other, net   | (18,922)                             | 25,475      |
| Changes in assets and liabilities  |                                      |             |
| Receivables and unbilled utility revenues  | (75,541)                             | (44,705)    |
| Income taxes receivable  | 1,850                                | (3,443)     |
| Other current assets   | 665                                  | (35,564)    |
| Pension and non-pension post retirement benefit contributions  | (62,591)                             | (72,006)    |
| Accounts payable   | (43,252)                             | (14,728)    |
| Taxes accrued, including income taxes  | 68,804                               | 15,580      |
| Interest accrued   | (2,051)                              | (1,306)     |
| Change in book overdraft   | 21,515                               | 0           |
| Other current liabilities  | (1,514)                              | 4,295       |
| Net cash provided by operating activities  | 316,871                              | 262,396     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |                                      |             |
| Capital expenditures   | (476,300)                            | (391,792)   |
| Acquisitions   | (44,293)                             | (4,769)     |
| Proceeds from sale of assets and securities  | 560,010                              | 6,657       |
| Removal costs from property, plant and equipment retirements, net  | (24,634)                             | (24,038)    |
| Net restricted funds released  | 14,886                               | 38,517      |
| Net cash provided by (used in) investing activities  | 29,669                               | (375,425)   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |                                      |             |
| Proceeds from long-term debt   | 14,730                               | 12,275      |
| Repayment of long-term debt  | (158,188)                            | (64,208)    |
| Net (repayments) borrowings under short-term debt agreements   | (119,077)                            | 247,946     |
| Proceeds from issuances of employee stock plans and DRIP   | 12,594                               | 8,852       |
| Advances and contributions for construction, net of refunds of \$6,491 and \$8,550 at June 30, 2012 and 2011, respectively | 16,720                               | 11,193      |
| Change in bank overdraft position  | (34,812)                             | (25,411)    |
| Debt issuance costs  | 0                                    | (552)       |
| Redemption of preferred stock  | (1,100)                              | (6)         |
| Dividends paid   | (80,943)                             | (77,105)    |
| Other  | 2,248                                | 399         |

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|  |           |           |
|--|-----------|-----------|
| Net cash (used in) provided by financing activities                | (347,828) | 113,383   |
| Net (decrease) increase in cash and cash equivalents               | (1,288)   | 354       |
| Cash and cash equivalents at beginning of period                   | 14,207    | 13,112    |
| Cash and cash equivalents at end of period                         | \$ 12,919 | \$ 13,466 |
| <b>Non-cash investing activity:</b>                                |           |           |
| Capital expenditures acquired on account but unpaid at quarter-end | \$ 93,783 | \$ 80,573 |
| <b>Non-cash financing activity:</b>                                |           |           |
| Long-term debt   | \$ 68,746 | \$ 0      |
| Dividends accrued  | \$ 44,079 | \$ 40,351 |
| Advances and contributions   | \$ 6,188  | \$ 10,027 |

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

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

(In thousands, except per share data)

|   | Common Stock |              |                    |                        | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury Stock |         | Preferred<br>Stock<br>of<br>Subsidiary<br>Companies<br>Without<br>Mandatory<br>Redemption<br>Requirements | Total<br>Stockholders<br>Equity |
|---|--------------|--------------|--------------------|------------------------|---|----------------|---------|---|---------------------------------|
|   | Shares       | Par<br>Value | Paid-in<br>Capital | Accumulated<br>Deficit |   | Shares         | At Cost |   |                                 |
| <b>Balance at<br/>December 31, 2011</b>                                     | 175,664      | \$ 1,757     | \$ 6,180,558       | \$ (1,848,801)         | \$ (97,677)                                   | 0              | \$ 0    | \$ 4,547  | \$ 4,240,384                    |
| Net income  |              |              |                    | 148,780                |   |                |         |   | 148,780                         |
| Direct stock<br>reinvestment and<br>purchase plan, net of<br>expense of \$6 | 30           | 0            | 1,022              |                        |   |                |         |   | 1,022                           |
| Employee stock<br>purchase plan   | 26           | 0            | 1,056              |                        |   | 31             | 1,046   |   | 2,102                           |
| Stock-based<br>compensation activity  | 597          | 6            | 15,958             | (399)                  |   | (31)           | (1,046) |   | 14,519                          |
| Other comprehensive<br>income, net of tax of<br>\$2,390                     |              |              |                    |                        | 3,787   |                |         |   | 3,787                           |
| Dividends   |              |              |                    | (84,619)               |   |                |         |   | (84,619)                        |
| <b>Balance at June 30,<br/>2012</b>   | 176,317      | \$ 1,763     | \$ 6,198,594       | \$ (1,785,039)         | \$ (93,890)                                   | 0              | \$ 0    | \$ 4,547  | \$ 4,325,975                    |

|  | Common Stock |              |                    |                        | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury Stock |         | Preferred<br>Stock<br>of<br>Subsidiary<br>Companies<br>Without<br>Mandatory<br>Redemption<br>Requirements | Total<br>Stockholders<br>Equity |
|--|--------------|--------------|--------------------|------------------------|---|----------------|---------|---|---------------------------------|
|  | Shares       | Par<br>Value | Paid-in<br>Capital | Accumulated<br>Deficit |   | Shares         | At Cost |   |                                 |
| <b>Balance at<br/>December 31, 2010</b>                                  | 174,996      | \$ 1,750     | \$ 6,156,675       | \$ (1,959,235)         | \$ (71,446)                                   | (1)            | \$ (19) | \$ 4,547  | \$ 4,132,272                    |
| Net income   |              |              |                    | 107,343                |   |                |         |   | 107,343                         |
| Direct stock reinvestment<br>and purchase plan, net of<br>expense of \$9 | 34           | 0            | 948                |                        |   |                |         |   | 948                             |
|  | 59           | 1            | 1,586              |                        |   |                |         |   | 1,587                           |

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|   |         |          |              |                |             |   |      |          |       |              |
|---|---------|----------|--------------|----------------|-------------|---|------|----------|-------|--------------|
| Employee stock purchase plan                      |         |          |              |                |             |   |      |          |       |              |
| Stock-based compensation activity                 | 349     | 3        | 10,838       | (392)          |             | 1 | 19   |          |       | 10,468       |
| Other comprehensive income, net of tax of \$1,496 |         |          |              |                |             |   |      |          | 2,750 | 2,750        |
| Dividends   |         |          |              | (117,456)      |             |   |      |          |       | (117,456)    |
| <b>Balance at June 30, 2011</b>                   | 175,438 | \$ 1,754 | \$ 6,170,047 | \$ (1,969,740) | \$ (68,696) | 0 | \$ 0 | \$ 4,547 |       | \$ 4,137,912 |

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

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### **American Water Works Company, Inc. and Subsidiary Companies**

#### **Notes to Consolidated Financial Statements (Unaudited)**

**(In thousands, except per share data)**

##### **Note 1: Basis of Presentation**

The accompanying Consolidated Balance Sheet of American Water Works Company, Inc. and Subsidiary Companies (the Company) at June 30, 2012, the Consolidated Statements of Operations and Comprehensive Income for the three and six months ended June 30, 2012 and 2011, the Consolidated Statements of Cash Flows for the six months ended June 30, 2012 and 2011, and the Consolidated Statements of Changes in Stockholders' Equity for the six months ended June 30, 2012 and 2011, are unaudited, but reflect all adjustments, which are, in the opinion of management, necessary to present fairly the consolidated financial position, the consolidated changes in stockholders' equity, the consolidated results of operations and comprehensive income, and the consolidated cash flows for the periods presented. All adjustments are of a normal, recurring nature, except as otherwise disclosed. Because they cover interim periods, the unaudited consolidated financial statements and related notes to the consolidated financial statements do not include all disclosures and notes normally provided in annual financial statements and, therefore, should be read in conjunction with the Company's Consolidated Financial Statements and related Notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the year, due primarily to the seasonality of the Company's operations.

During the fourth quarter of 2011, the Company discovered errors in the Company's calculations of gains or losses on discontinued operations that originated in the first and second quarters of 2011. As a result, the Company recorded after-tax charges totaling \$24,555, which included associated parent company goodwill, to reduce the net asset values of those businesses to their net realizable values. These charges were recognized within discontinued operations and net income and included in the operating results for the year ended December 31, 2011. In the footnotes to the Consolidated Financial Statements for the period ended December 31, 2011, the Company corrected the presentation of the first and second quarters of 2011. Additionally the Company reflected this correction in the corresponding prior periods presented in the Consolidated Statements of Operations and Comprehensive Income for the three and six-month periods ended June 30, 2012. The write-downs included in the first and second quarters of 2011 totaled \$21,099 and \$3,456, respectively.

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

The following recently announced accounting standards have been adopted by the Company and have been included in the consolidated results of operations, financial position or footnotes of the accompanying Consolidated Financial Statements:

##### **Fair Value Measurements**

In May 2011, the Financial Accounting Standards Board (FASB) issued updated accounting guidance related to fair value measurements and disclosures that result in common fair value measurements and disclosures between U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards. This new guidance amends current fair value measurement and disclosure guidance to increase transparency around valuation inputs and investment categorization. This guidance is effective for interim and annual periods beginning on January 1, 2012 and is required to be applied prospectively. The adoption of this guidance did not have a significant impact on the Company's results of operations, financial position or cash flows.

##### **Comprehensive Income**

In June 2011, the FASB issued guidance on the presentation of comprehensive income. The new guidance allows an entity to present components of net income and other comprehensive income in either one continuous statement or two separate but consecutive statements. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. While the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income under current accounting guidance. In December 2011, the FASB deferred the requirement to present reclassification adjustments of other comprehensive income on the face of the income statement. The new guidance is effective for the Company beginning on January 1, 2012. As the Company already presents the components of net income and other comprehensive income in one continuous statement, the adoption of the new guidance did not have an impact on its results of operations, financial position or cash flows.



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### **Testing Goodwill for Impairment**

In September 2011, the FASB updated the accounting guidance related to testing goodwill for impairment. This update permits an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test that is currently in place. Under the new guidance, an entity will not be required to calculate the fair value of a reporting unit unless the entity determines, based on the qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This update is effective for annual and interim goodwill impairment tests performed by the Company beginning on January 1, 2012. The adoption of this update is not expected to have a significant impact on its results of operations, financial position or cash flows.

### **Note 3: Acquisitions and Divestitures**

#### *Acquisitions*

As of June 30, 2012, the Company closed on five acquisitions of various regulated water and wastewater systems for a total aggregate purchase price of \$44,293. Included in this total was the Company's May 1, 2012 acquisition of all of the capital stock of Aqua New York, Inc. (the Acquisition) for a total cash purchase price of \$39,273 plus assumed liabilities, subject to post-closing purchase price adjustments that may occur during the second half of 2012. The Acquisition, which expanded the Company's service area in the state of New York, added approximately 50,000 customers to regulated operations.

The Acquisition was accounted for as a business combination; accordingly, operating results from May 1, 2012 were included in the Company's results of operations. The preliminary purchase price was allocated to the net tangible and intangible assets based upon their estimated fair values at the date of acquisition. The Company's regulatory practice has been followed whereby property, plant and equipment (rate base) is considered fair value for business combination purposes. Similarly, regulatory assets and liabilities acquired have been recorded at book value and are subject to regulatory approval where applicable. The acquired debt and employee benefit plans have been fair valued using common valuation techniques. The acquired debt has been valued in a manner consistent with the Company's Level 2 and Level 3 pre-acquisition debt. (See Note 13) The Company has recognized employee benefit plan liabilities on the acquisition date for the funded status of defined-benefit plans assumed as part of the business combination. The pro forma impact of this acquisition would not have been material to the Company's results of operations for the three and six months ended June 30, 2012 and 2011, respectively. Total assets acquired in the Acquisition were \$106,911, including \$58,669 of plant, \$32,884 of regulatory assets, \$2,855 of other assets and \$12,503 of goodwill; liabilities assumed totaled \$67,638, including long-term debt of \$25,215, \$15,377 of regulatory liabilities, \$15,029 of deferred taxes, \$2,307 of other liabilities and \$9,710 of pension and postretirement welfare liabilities.

#### *Divestitures*

As part of the Company's strategic review of its business investments, it has previously entered into agreements to sell assets or stock of certain subsidiaries.

In January 2012, the Company completed the close of the sale of its Arizona and New Mexico subsidiaries. Initial sales proceeds were \$461,057, and the Company recorded no gain or loss at the time of the sale closing. In June 2012, as part of post-closing adjustments to finalize the sale, the Company remitted \$2,448 to the purchaser, and recorded a pretax loss on sale for the same amount.

In May 2012, the Company completed the close of the sale of its Ohio subsidiary. Initial sales proceeds were \$101,083 and are subject to post-closing adjustments. The Company recorded a pretax loss on sale of \$5,166, primarily due to pension settlement costs calculated at closing.

As disclosed in Note 1 included herein, the Company previously revised its 2011 first quarter results for an after-tax impairment charge of \$21,099, which was recorded as an asset impairment charge to reduce parent company goodwill that had been allocated to the Arizona and New Mexico subsidiaries. An additional \$3,456 after-tax asset impairment charge was recorded in the Company's 2011 second quarter results for parent company goodwill allocated to the Ohio subsidiary transaction.

In June 2011, the Company completed the sale of the assets of its Texas subsidiary for sale proceeds of \$6,245. In the first quarter of 2011, the Company had previously recognized an after-tax impairment charge of \$552 for parent company goodwill allocated to the Texas subsidiary.

Charges recorded in connection with the discontinued operations include estimates that are subject to subsequent adjustments.

A summary of discontinued operations presented in the Consolidated Statements of Operations and Comprehensive Income follows:

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|  | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |            |
|--|--------------------------------|-----------|------------------------------|------------|
|  | 2012                           | 2011      | 2012                         | 2011       |
| Operating revenues   | \$ 3,160                       | \$ 45,329 | \$ 19,377                    | \$ 83,456  |
| Total operating expenses, net                                  | 15,465                         | 33,101    | 27,918                       | 81,266     |
| Operating income (loss)  | (12,305)                       | 12,228    | (8,541)                      | 2,190      |
| Other income (expenses), net                                   | (47)                           | 118       | (167)                        | 410        |
| Income (loss) from discontinued operations before income taxes | (12,352)                       | 12,346    | (8,708)                      | 2,600      |
| Provision (benefit) for income taxes                           | (2,715)                        | 6,053     | 8,427                        | 10,773     |
| Income (loss) from discontinued operations, net of tax         | \$ (9,637)                     | \$ 6,293  | \$ (17,135)                  | \$ (8,173) |



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There were no assets or liabilities of discontinued operations at June 30, 2012. Assets and liabilities of discontinued operations at December 31, 2011 include the following:

|  |                   |
|--|-------------------|
| <b>Assets:</b>                                 |                   |
| Total property, plant and equipment            | \$ 833,023        |
| Current assets                                 | 21,906            |
| Regulatory assets                              | 43,849            |
| Goodwill                                       | 29,608            |
| Other  | 1,472             |
| <b>Total assets of discontinued operations</b> | <b>\$ 929,858</b> |

|   |                   |
|---|-------------------|
| <b>Liabilities:</b>                                 |                   |
| Long-term debt                                      | \$ 11,697         |
| Current portion of long-term debt                   | 12,839            |
| Other current liabilities                           | 29,530            |
| Advances for construction                           | 205,034           |
| Regulatory liabilities                              | 4,617             |
| Other   | 15,540            |
| Contributions in aid of construction                | 102,961           |
| <b>Total liabilities of discontinued operations</b> | <b>\$ 382,218</b> |

**Note 4: Goodwill**

The Company's annual goodwill impairment test is conducted at November 30 of each calendar year. Interim reviews are performed when the Company determines that a triggering event that would more likely than not reduce the fair value of a reporting unit below its carrying value has occurred.

In the first quarter of 2011, the Company assessed fair value, including allocated goodwill, and recorded impairments of \$21,099 for the pending sales of its Arizona and New Mexico subsidiaries, and \$552 for the pending sale of the Company's assets of its Texas subsidiary. These impairment charges were included in operating results of discontinued operations. (see Note 3 above)

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

|                                      | Regulated Unit      |                        | Market-Based Operations |                        | Cost                | Consolidated Accumulated Impairment | Total Net           |
|--------------------------------------|---------------------|------------------------|-------------------------|------------------------|---------------------|-------------------------------------|---------------------|
|                                      | Cost                | Accumulated Impairment | Cost                    | Accumulated Impairment |                     |                                     |                     |
| Balance at January 1, 2012           | \$ 3,399,368        | \$ (2,332,670)         | \$ 235,990              | \$ (107,619)           | \$ 3,635,358        | \$ (2,440,289)                      | \$ 1,195,069        |
| Goodwill from acquisitions           | 12,503              | 0                      | 0                       | 0                      | 12,503              | 0                                   | 12,503              |
| <b>Balance at June 30, 2012</b>      | <b>\$ 3,411,871</b> | <b>\$ (2,332,670)</b>  | <b>\$ 235,990</b>       | <b>\$ (107,619)</b>    | <b>\$ 3,647,861</b> | <b>\$ (2,440,289)</b>               | <b>\$ 1,207,572</b> |
| Balance at January 1, 2011           | \$ 3,399,884        | \$ (2,332,670)         | \$ 235,990              | \$ (107,619)           | \$ 3,635,874        | \$ (2,440,289)                      | \$ 1,195,585        |
| Reclassifications and other activity | (75)                | 0                      | 0                       | 0                      | (75)                | 0                                   | (75)                |
| <b>Balance at June 30, 2011</b>      | <b>\$ 3,399,809</b> | <b>\$ (2,332,670)</b>  | <b>\$ 235,990</b>       | <b>\$ (107,619)</b>    | <b>\$ 3,635,799</b> | <b>\$ (2,440,289)</b>               | <b>\$ 1,195,510</b> |

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

**Table of Contents****Note 5: Stockholders Equity****Common Stock**

In March 2010, the Company established American Water Stock Direct, a dividend reinvestment and direct stock purchase plan (the "DRIP"). Under the DRIP, stockholders may reinvest cash dividends and purchase additional Company common stock, up to certain limits, through a transfer agent without commission fees. The Company's transfer agent may buy newly issued shares directly from the Company or shares held in the Company's treasury. The transfer agent may also buy shares in the public markets or in privately negotiated transactions. Purchases generally will be made and credited to DRIP accounts once each week. As of June 30, 2012, there were 4,843 shares available for future issuance under the DRIP. The following table summarizes information regarding issuances under the DRIP for the six months ended June 30, 2012 and 2011:

|                               | 2012     | 2011   |
|-------------------------------|----------|--------|
| Shares of common stock issued | 30       | 34     |
| Cash proceeds received        | \$ 1,028 | \$ 957 |

Cash dividend payments made during the three-month periods ended March 31 and June 30 were as follows:

|   | 2012      | 2011      |
|---|-----------|-----------|
| Dividends per share, three months ended:  |           |           |
| March 31                                  | \$ 0.23   | \$ 0.22   |
| June 30                                   | 0.23      | 0.22      |
| Total dividends paid, three months ended: |           |           |
| March 31                                  | \$ 40,414 | \$ 38,525 |
| June 30                                   | 40,529    | 38,580    |

On May 11, 2012, the Company declared a quarterly cash dividend payment of \$0.25 per share payable on September 3, 2012 to all shareholders of record as of July 6, 2012. As of June 30, 2012, the Company had accrued dividends totaling \$44,079 included in other current liabilities in the accompanying Consolidated Balance Sheets.

**Stock-Based Compensation**

The Company has granted stock option and restricted stock unit awards to non-employee directors, officers and other key employees of the Company pursuant to the terms of its 2007 Omnibus Equity Compensation Plan (the "Plan"). As of June 30, 2012, a total of 10,215 shares were available for grant under the Plan. Shares issued under the Plan may be authorized but unissued shares of Company stock or reacquired shares of Company stock, including shares purchased by the Company on the open market for purposes of the Plan.

The Company recognizes compensation expense for stock awards over the vesting period of the award. The following table presents stock-based compensation expense recorded in operation and maintenance expense in the accompanying Consolidated Statements of Operations and Comprehensive Income for the three and six months ended June 30, 2012 and 2011:

|   | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |          |
|---|--------------------------------|---------|------------------------------|----------|
|   | 2012                           | 2011    | 2012                         | 2011     |
| Stock options   | \$ 860                         | \$ 802  | \$ 1,706                     | \$ 1,628 |
| Restricted stock units  | 2,014                          | 1,699   | 3,304                        | 2,904    |
| Employee stock purchase plan                                  | 121                            | 111     | 253                          | 208      |
| Stock-based compensation in operation and maintenance expense | 2,995                          | 2,612   | 5,263                        | 4,740    |
| Income tax benefit  | (1,169)                        | (1,019) | (2,053)                      | (1,849)  |

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|  |          |          |          |          |
|--|----------|----------|----------|----------|
| After-tax stock-based compensation expense | \$ 1,826 | \$ 1,593 | \$ 3,210 | \$ 2,891 |
|--|----------|----------|----------|----------|

There were no significant stock-based compensation costs capitalized during the six months ended June 30, 2012 and 2011, respectively.

### Stock Options

In the first six months of 2012, the Company granted non-qualified stock options to certain employees under the Plan. The stock options vest ratably over the three-year service period beginning January 1, 2012. These awards have no performance vesting conditions and the grant date fair value is amortized through expense over the requisite service period using the straight-line method. The following table presents the weighted-average assumptions used in the pricing model for 2012 grants and the resulting weighted-average grant date fair value per share of stock options granted:

|                                 |          |
|---------------------------------|----------|
| Dividend yield                  | 2.70%    |
| Expected volatility             | 28.35%   |
| Risk-free interest rate         | 0.78%    |
| Expected life (years)           | 4.4      |
| Exercise price                  | \$ 34.14 |
| Grant date fair value per share | \$ 6.11  |

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Stock options granted under the Plan have maximum terms of seven years, vest over periods ranging from one to three years, and are granted with exercise prices equal to the market value of the Company's common stock on the date of grant. As of June 30, 2012, \$5,243 of total unrecognized compensation cost related to the non-vested stock options is expected to be recognized over the weighted-average period of 1.8 years.

The following table summarizes stock option activity for the six months ended June 30, 2012:

|  | Shares | Weighted-Average Exercise Price (per share) | Weighted-Average Remaining Life (years) | Aggregate Intrinsic Value |
|--|--------|---|---|---------------------------|
| Options outstanding at January 1, 2012 | 3,112  | \$ 22.70                                    |   |                           |
| Granted                                | 649    | 34.14                                       |   |                           |
| Forfeited or expired                   | (68)   | 27.08                                       |   |                           |
| Exercised                              | (457)  | 21.68                                       |   |                           |
| Options outstanding at June 30, 2012   | 3,236  | \$ 25.05                                    | 4.4                                     | \$ 29,876                 |
| Exercisable at June 30, 2012           | 1,921  | \$ 21.96                                    | 3.4                                     | \$ 23,665                 |

The following table summarizes additional information regarding stock options exercised during the six months ended June 30, 2012 and 2011:

|                    | 2012     | 2011     |
|--------------------|----------|----------|
| Intrinsic value    | \$ 5,594 | \$ 1,893 |
| Exercise proceeds  | 9,896    | 6,517    |
| Income tax benefit | 1,443    | 253      |

**Restricted Stock Units**

In the first six months of 2012, the Company granted restricted stock units to certain employees under the Plan. The restricted stock units vest ratably over the three-year performance period beginning January 1, 2012 (the Performance Period); however, distribution of the shares is contingent upon the achievement of internal performance measures and, separately, certain market thresholds over the Performance Period. The restricted stock units granted with performance and service conditions are valued at the market value of the Company's common stock on the date of grant. The restricted stock units granted with market and service conditions are valued using a Monte Carlo model. Weighted-average assumptions used in the Monte Carlo simulation for the 2012 grants are as follows:

|                         |        |
|-------------------------|--------|
| Expected volatility     | 22.47% |
| Risk-free interest rate | 0.43%  |
| Expected life (years)   | 3      |

The grant date fair value of the restricted stock awards that vest ratably and have market and/or performance and service conditions is amortized through expense over the requisite service period using the graded-vesting method. As of June 30, 2012, \$5,948 of total unrecognized compensation cost related to the non-vested restricted stock units is expected to be recognized over the weighted-average remaining life of 1.1 years.

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The following table summarizes restricted stock unit activity for the six months ended June 30, 2012:

|                                    | Shares | Weighted-Average<br>Grant Date<br>Fair Value<br>(per share) |
|------------------------------------|--------|---|
| Nonvested total at January 1, 2012 | 577    | \$ 25.09  |
| Granted                            | 172    | 37.40   |
| Vested                             | (182)  | 23.01   |
| Forfeited                          | (17)   | 29.69   |
| Cancelled                          | (2)    | 22.08   |
| Nonvested total at June 30, 2012   | 548    | \$ 29.51  |

The following table summarizes additional information regarding restricted stock units distributed during the six months ended June 30, 2012 and 2011:

|                    | 2012     | 2011     |
|--------------------|----------|----------|
| Intrinsic value    | \$ 5,804 | \$ 1,695 |
| Income tax benefit | 798      | 99       |

If dividends are declared with respect to shares of the Company's common stock before the restricted stock units are distributed, the Company credits a liability for the value of the dividends that would have been paid if the restricted stock units were shares of Company common stock. When the restricted stock units are distributed, the Company pays the participant a lump sum cash payment equal to the value of the dividend equivalents accrued. The Company accrued dividend equivalents totaling \$399 and \$392 to retained earnings during the six months ended June 30, 2012 and 2011, respectively.

**Employee Stock Purchase Plan**

Under the Nonqualified Employee Stock Purchase Plan (the "ESPP"), employees can use payroll deductions to acquire Company stock at the lesser of 90% of the fair market value of (a) the beginning or (b) the end of each three-month purchase period. As of June 30, 2012 there were 1,535 shares of common stock reserved for issuance under the ESPP. During the six months ended June 30, 2012, the Company issued 57 shares under the ESPP.

**Table of Contents****Note 6: Long-Term Debt**

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

|   | Rate         | Weighted-Average Rate | Maturity Date | June 30, 2012 | December 31, 2011 |
|---|--------------|-----------------------|---------------|---------------|-------------------|
| Long-term debt of American Water Capital Corp. ( AWCC ) |              |                       |               |               |                   |
| (a)   |              |                       |               |               |                   |
| Private activity bonds and government funded debt       |              |                       |               |               |                   |
| Fixed rate  | 4.85%-6.75%  | 5.72%                 | 2018-2040     | \$ 322,610    | \$ 322,610        |
| Senior notes  |              |                       |               |               |                   |
| Fixed rate  | 5.39%-10.00% | 6.25%                 | 2013-2040     | 3,089,409     | 3,089,409         |
| Long-term debt of other subsidiaries                    |              |                       |               |               |                   |
| Private activity bonds and government funded debt       |              |                       |               |               |                   |
| Fixed rate  | 0.00%-6.20%  | 4.77%                 | 2012-2041     | 1,159,519     | 1,206,332         |
| Mortgage bonds  |              |                       |               |               |                   |
| Fixed rate  | 5.48%-9.71%  | 7.40%                 | 2012-2039     | 697,800       | 697,800           |
| Mandatory redeemable preferred stock                    | 8.47%-9.75%  | 8.61%                 | 2019-2036     | 21,001        | 22,101            |
| Notes payable and other (b)                             | 9.49%-12.17% | 11.70%                | 2013-2026     | 1,478         | 1,691             |
| Long-term debt  |              |                       |               | 5,291,817     | 5,339,943         |
| Unamortized debt discount, net (c)                      |              |                       |               | 43,497        | 43,888            |
| Fair value adjustment to interest rate hedge            |              |                       |               | 7,383         | 6,111             |
| Total long-term debt                                    |              |                       |               | \$ 5,342,697  | \$ 5,389,942      |

(a) AWCC, which is a wholly-owned subsidiary of the Company, has a strong support agreement with its parent that, under certain circumstances, is the functional equivalent of a guarantee.

(b) Includes capital lease obligations of \$1,149 and \$1,264 at June 30, 2012 and December 31, 2011, respectively.

(c) Includes fair value adjustments recognized in acquisition purchase accounting.

The following long-term debt was issued in 2012:

| Company                | Type  | Interest Rate | Maturity  | Amount    |
|------------------------|---|---------------|-----------|-----------|
| Other subsidiaries (1) | Private activity bonds and government funded debt<br>fixed rate | 0.00%-5.00%   | 2013-2041 | \$ 83,476 |
| Total issuances        |   |               |           | \$ 83,476 |

(1) Included in the issuance amount above was \$68,746, which was initially kept in Trust pending the Company's certification that it has incurred qualifying capital expenditures. These issuances have been presented as non-cash in the accompanying Consolidated Statements of Cash Flows. Subsequent releases of all or a lesser portion of these funds by the applicable Trust are reflected as the release of restricted funds and are included in investing activities in the accompanying Consolidated Statements of Cash Flows.

The following long-term debt was retired through optional redemption or payment at maturity during 2012:

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| Company                                  | Type   | Interest Rate | Maturity  | Amount            |
|--|--|---------------|-----------|-------------------|
| Other subsidiaries                       | Mortgage bonds fixed rate                                    | 7.95%         | 2012      | \$ 4,200          |
| Other subsidiaries                       | Private activity bonds and government funded debt fixed rate | 0.00%-5.90%   | 2012-2041 | 153,775           |
| Other subsidiaries                       | Mandatory redeemable preferred stock                         | 4.60%-6.00%   | 2013-2019 | 1,100             |
| Other                                    | Capital leases and other                                     |               |           | 213               |
| <b>Total retirements and redemptions</b> |  |               |           | <b>\$ 159,288</b> |

Other activity of long-term debt during the first six months of 2012 includes debt assumed in an acquisition totaling \$25,215 (see Note 3).

On July 2, 2012, the Company redeemed \$86,090 of outstanding bonds maturing in 2028 and 2029 with interest rates ranging from 5.00% to 5.10%. In addition, on July 6, 2012 the Company redeemed \$2,827 of preferred stock without mandatory redemption requirements with interest rates ranging from 5.00% to 5.75%. The redemptions were made using commercial paper borrowings.



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Interest income included in interest, net is summarized below:

|                 | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|-----------------|--------------------------------|----------|------------------------------|----------|
|                 | 2012                           | 2011     | 2012                         | 2011     |
| Interest income | \$ 2,821                       | \$ 2,754 | \$ 5,633                     | \$ 5,403 |

The Company previously entered into an interest-rate swap to hedge \$100,000 of its 6.085% fixed-rate debt maturing 2017. The Company pays variable interest of six-month LIBOR plus 3.422%. This fixed rate and variable rate interest swap is accounted for as a fair value hedge. The swap matures with the fixed-rate debt in 2017. The Company uses a combination of fixed-rate and variable-rate debt to manage interest rate exposure.

At June 30, 2012 and December 31, 2011, the Company had a \$100,000 notional amount variable interest-rate swap fair value hedge outstanding. The following table provides a summary of the derivative fair value balance recorded by the Company and the line item in the Consolidated Balance Sheets in which such amount is recorded:

|                                       | June 30,<br>2012 | December 31,<br>2011 |
|---------------------------------------|------------------|----------------------|
| Regulatory and other long-term assets |                  |                      |
| Other                                 | \$ 7,088         | \$ 5,824             |
| Long-term debt                        |                  |                      |
| Long-term debt                        | 7,383            | 6,111                |

For derivative instruments that are designated as and qualify as fair value hedges, the gain or loss on the hedge instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current net income. The Company includes the gain or loss on the derivative instrument and the offsetting loss or gain on the hedged item in interest expense as follows:

|                          | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|--------------------------|--------------------------------|----------|------------------------------|----------|
|                          | 2012                           | 2011     | 2012                         | 2011     |
| Interest, net            |                                |          |                              |          |
| Gain (loss) on swap      | \$ 1,497                       | \$ 2,767 | \$ 1,263                     | \$ 1,614 |
| Gain (loss) on borrowing | (1,549)                        | (2,420)  | (1,272)                      | (1,433)  |
| Hedge ineffectiveness    | (52)                           | 347      | (9)                          | 181      |

**Note 7: Short-Term Debt**

The components of short-term debt are as follows:

|  | June 30,<br>2012 | December 31,<br>2011 |
|--|------------------|----------------------|
| Commercial paper, net of \$28 and \$52 discount at June 30 and December 31, respectively | \$ 361,972       | \$ 481,048           |
| Bank overdraft   | 0                | 34,002               |
| Total short-term debt  | \$ 361,972       | \$ 515,050           |

Prior to January 1, 2012, the Company had overdraft protection provided by a revolving credit line with PNC Bank, N.A. The Company did not renew this credit line at December 31, 2011. Accordingly, the Company's outstanding checks on its cash accounts with PNC Bank, N.A. are classified, as of January 1, 2012, as other current liabilities in the accompanying Consolidated Balance Sheets, and changes in those accounts are included in operating activities for 2012 in the accompanying Consolidated Statements of Cash Flows.

**Note 8: Income Taxes**

The Company's estimated annual effective tax rate for the six months ended June 30, 2012 was 40.2% compared to 40.5% for the six months ended June 30, 2011, excluding various discrete items. The Company's actual effective tax rates on continuing operations were as follows:

|  | Three Months Ended<br>June 30, |       | Six Months Ended<br>June 30, |       |
|--|--------------------------------|-------|------------------------------|-------|
|  | 2012                           | 2011  | 2012                         | 2011  |
| Actual effective tax rate on continuing operations | 40.9%                          | 40.7% | 41.1%                        | 40.7% |

**Table of Contents****Note 9: Pension and Other Postretirement Benefits**

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

|   | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|---|--------------------------------|-----------|------------------------------|-----------|
|   | 2012                           | 2011      | 2012                         | 2011      |
| Components of net periodic pension benefit cost |                                |           |                              |           |
| Service cost                                    | \$ 8,507                       | \$ 8,411  | \$ 17,014                    | \$ 16,821 |
| Interest cost                                   | 17,521                         | 17,261    | 35,042                       | 34,523    |
| Expected return on plan assets                  | (19,618)                       | (18,027)  | (39,237)                     | (36,054)  |
| Amortization of:                                |                                |           |                              |           |
| Prior service cost                              | 180                            | 181       | 361                          | 361       |
| Actuarial loss                                  | 7,403                          | 4,637     | 14,805                       | 9,275     |
| Net periodic pension benefit cost               | \$ 13,993                      | \$ 12,463 | \$ 27,985                    | \$ 24,926 |

|  | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |           |
|--|--------------------------------|----------|------------------------------|-----------|
|  | 2012                           | 2011     | 2012                         | 2011      |
| Components of net periodic other postretirement benefit cost |                                |          |                              |           |
| Service cost   | \$ 3,525                       | \$ 3,484 | \$ 7,051                     | \$ 6,969  |
| Interest cost  | 7,858                          | 7,804    | 15,716                       | 15,609    |
| Expected return on plan assets                               | (7,141)                        | (7,194)  | (14,281)                     | (14,389)  |
| Amortization of:   |                                |          |                              |           |
| Prior service credit   | (478)                          | (481)    | (957)                        | (962)     |
| Actuarial loss   | 2,385                          | 1,784    | 4,769                        | 3,567     |
| Net periodic other postretirement benefit cost               | \$ 6,149                       | \$ 5,397 | \$ 12,298                    | \$ 10,794 |

The Company contributed \$47,600 to its defined benefit pension plans in the first six months of 2012 and expects to contribute \$49,928 during the balance of 2012. In addition, the Company contributed \$14,991 for the funding of its other postretirement plans in the first six months of 2012 and expects to contribute \$15,083 during the balance of 2012.

**Note 10: Commitments and Contingencies**

The Company is routinely involved in legal actions incident to the normal conduct of its business. At June 30, 2012, the Company has accrued approximately \$3,200 as probable costs and it is reasonably possible that additional losses could range up to \$32,200 for these matters. For certain matters, the Company is unable to estimate possible losses. The Company believes that damages or settlements recovered by plaintiffs in such claims or actions, if any, will not have a material adverse effect on the Company's results of operations, financial position or cash flows.

The Company enters into agreements for the provision of services to water and wastewater facilities for the United States military, municipalities and other customers. The Company's military services agreements expire between 2051 and 2060 and have remaining performance commitments as measured by estimated remaining contract revenue of \$1,986,000 at June 30, 2012. The military contracts are subject to customary termination provisions held by the U.S. Federal Government prior to the agreed upon contract expiration. The Company's Operations and Maintenance agreements with municipalities and other customers expire between 2012 and 2048 and have remaining performance commitments as measured by estimated remaining contract revenue of \$1,032,000 at June 30, 2012. Some of the Company's long-term contracts to operate and maintain a municipality's, federal government's or other party's water or wastewater treatment and delivery facilities include responsibility for certain maintenance for some of those facilities, in exchange for an annual fee. Unless specifically required to perform certain maintenance activities, the maintenance costs are recognized when the maintenance is performed.

**Note 11: Environmental Matters**

The Company's water and wastewater operations are subject to federal, state, local and foreign requirements relating to environmental protection, and as such, the Company periodically becomes subject to environmental claims in the normal course of business. Environmental expenditures that relate to current operations or provide a future benefit are expensed or capitalized as

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appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued, on an undiscounted basis, when it is probable that these costs will be incurred and can be reasonably estimated. Remediation costs accrued amounted to \$4,400 and \$5,500 at June 30, 2012 and December 31, 2011, respectively. The accrual relates to a conservation agreement entered into by a subsidiary of the Company with the National Oceanic and Atmospheric Administration ( NOAA ) requiring the Company to, among other provisions, implement certain measures to protect the steelhead trout and its habitat in the Carmel River watershed in the state of California. The Company has agreed to pay \$1,100 annually from 2010 through 2016. The Company pursues recovery of incurred costs through all appropriate means, including regulatory recovery through customer rates. The Company's regulatory assets at June 30, 2012 and December 31, 2011 include \$9,041 and \$9,187 respectively, related to the NOAA agreement.

**Note 12: Earnings per Common Share**

Earnings per share is calculated using the two-class method. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security. The Company has participating securities related to restricted stock units, granted under the Company's 2007 Omnibus Equity Compensation Plan, that earn dividend equivalents on an equal basis with common shares. In applying the two-class method, undistributed earnings are allocated to both common shares and participating securities. The following is a reconciliation of the Company's income from continuing operations, income (loss) from discontinued operations, and net income and weighted-average common shares outstanding for calculating basic earnings per share:

|   | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |            |
|---|--------------------------------|-----------|------------------------------|------------|
|   | 2012                           | 2011      | 2012                         | 2011       |
| <b>Basic:</b>   |                                |           |                              |            |
| Income from continuing operations   | \$ 116,663                     | \$ 74,817 | \$ 165,915                   | \$ 115,516 |
| Income (loss) from discontinued operations, net of tax                          | (9,637)                        | 6,293     | (17,135)                     | (8,173)    |
| Net income  | 107,026                        | 81,110    | 148,780                      | 107,343    |
| Less: Distributed earnings to common shareholders                               | 40,744                         | 38,810    | 81,308                       | 77,461     |
| Less: Distributed earnings to participating securities                          | 19                             | 19        | 34                           | 35         |
| Undistributed earnings  | 66,263                         | 42,281    | 67,438                       | 29,847     |
| Undistributed earnings allocated to common shareholders                         | 66,235                         | 42,261    | 67,411                       | 29,834     |
| Undistributed earnings allocated to participating securities                    | 28                             | 20        | 27                           | 13         |
| Total income from continuing operations available to common shareholders, basic | \$ 116,616                     | \$ 74,778 | \$ 165,854                   | \$ 115,468 |
| Total income available to common shareholders, basic                            | \$ 106,979                     | \$ 81,071 | \$ 148,719                   | \$ 107,295 |
| Weighted-average common shares outstanding, basic                               | 176,331                        | 175,469   | 176,122                      | 175,364    |
| <b>Basic earnings per share: (a)</b>  |                                |           |                              |            |
| Income from continuing operations   | \$ 0.66                        | \$ 0.43   | \$ 0.94                      | \$ 0.66    |
| Income (loss) from discontinued operations, net of tax                          | \$ (0.05)                      | \$ 0.04   | \$ (0.10)                    | \$ (0.05)  |
| Net income  | \$ 0.61                        | \$ 0.46   | \$ 0.84                      | \$ 0.61    |

(a) Amounts may not sum due to rounding.

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

|   | Three Months Ended<br>June 30, |                  | Six Months Ended<br>June 30, |                   |
|---|--------------------------------|------------------|------------------------------|-------------------|
|   | 2012                           | 2011             | 2012                         | 2011              |
| <b>Diluted:</b>   |                                |                  |                              |                   |
| Total income from continuing operations available to common shareholders, basic   | \$ 116,616                     | \$ 74,778        | \$ 165,854                   | \$ 115,468        |
| Income (loss) from discontinued operations, net of tax                            | (9,637)                        | 6,293            | (17,135)                     | (8,173)           |
| Total income available to common shareholders, basic                              | 106,979                        | 81,071           | 148,719                      | 107,295           |
| Undistributed earnings allocated to participating securities                      | 28                             | 20               | 27                           | 13                |
| Total income from continuing operations available to common shareholders, diluted | \$ 116,644                     | \$ 74,798        | \$ 165,881                   | \$ 115,481        |
| <b>Total income available to common shareholders, diluted</b>                     | <b>\$ 107,007</b>              | <b>\$ 81,091</b> | <b>\$ 148,746</b>            | <b>\$ 107,308</b> |
| Weighted-average common shares outstanding, basic                                 | 176,331                        | 175,469          | 176,122                      | 175,364           |
| <b>Stock-based compensation:</b>  |                                |                  |                              |                   |
| Restricted stock units  | 573                            | 475              | 550                          | 443               |
| Stock options   | 586                            | 473              | 623                          | 446               |
| Employee stock purchase plan  | 1                              | 2                | 1                            | 2                 |
| <b>Weighted-average common shares outstanding, diluted</b>                        | <b>177,491</b>                 | <b>176,419</b>   | <b>177,296</b>               | <b>176,255</b>    |
| <b>Diluted earnings per share: (a)</b>  |                                |                  |                              |                   |
| Income from continuing operations   | \$ 0.66                        | \$ 0.42          | \$ 0.94                      | \$ 0.66           |
| Income (loss) from discontinued operations, net of tax                            | \$ (0.05)                      | \$ 0.04          | \$ (0.10)                    | \$ (0.05)         |
| <b>Net income</b>   | <b>\$ 0.60</b>                 | <b>\$ 0.46</b>   | <b>\$ 0.84</b>               | <b>\$ 0.61</b>    |

(a) Amounts may not sum due to rounding.

The following potentially dilutive common stock equivalents were not included in the earnings per share calculations because they were anti-dilutive:

|  | Three Months Ended<br>June 30, |      | Six Months Ended<br>June 30, |      |
|--|--------------------------------|------|------------------------------|------|
|  | 2012                           | 2011 | 2012                         | 2011 |
| Stock options  | 634                            | 729  | 634                          | 729  |
| Restricted stock units where certain performance conditions were not met | 63                             | 139  | 63                           | 140  |

**Note 13: Fair Value of Assets and Liabilities****Fair Value of Financial Instruments**

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

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

**Preferred stock with mandatory redemption requirements and long-term debt:** The fair values of preferred stock with mandatory redemption requirements and long-term debt are categorized within the fair value hierarchy based on the inputs that are used to value each instrument. The fair value of long-term debt classified as Level 1 is calculated using quoted prices in active markets. Level 2 instruments are valued using observable inputs and Level 3 instruments are valued using observable and unobservable inputs. The fair values of instruments classified as Level 2 and 3 are determined by a valuation model that is based on a conventional discounted cash flow methodology and utilizes assumptions of current market rates. The Company calculated a base yield curve using a risk-free rate (a U.S. Treasury securities yield curve) plus a credit spread that is based on the following two factors: an average of the Company's own publicly-traded debt securities and the current market rates for U.S. Utility BBB+ debt securities. The Company used these yield curve assumptions to derive a base yield for the Level 2 and Level 3 securities. Additionally, the Company adjusted the base yield for specific features of the debt securities including call features, coupon tax treatment and collateral for the Level 3 instruments.

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

| Recurring Fair Value Measures                           | Carrying Amount | At Fair Value as of June 30, 2012 |           |           | Total     |
|---|-----------------|-----------------------------------|-----------|-----------|-----------|
|   |                 | Level 1                           | Level 2   | Level 3   |           |
| Preferred stocks with mandatory redemption requirements | \$ 20,925       | \$ 0                              | \$ 0      | \$ 27,013 | \$ 27,013 |
| Long-term debt (excluding capital lease obligations)    | 5,320,623       | 2,375,384                         | 1,623,486 | 2,686,345 | 6,685,215 |

| As of December 31, 2011                                 | Carrying Amount | Fair Value |
|---|-----------------|------------|
| Preferred stocks with mandatory redemption requirements | \$ 22,036       | \$ 26,458  |
| Long-term debt (excluding capital lease obligations)    | 5,366,642       | 6,230,547  |

**Recurring Fair Value Measurements**

The following table presents assets and liabilities measured and recorded at fair value on a recurring basis and their level within the fair value hierarchy as of June 30, 2012 and December 31, 2011, respectively:

| Recurring Fair Value Measures    | At Fair Value as of June 30, 2012 |            |         |            |
|----------------------------------|-----------------------------------|------------|---------|------------|
|                                  | Level 1                           | Level 2    | Level 3 | Total      |
| <b>Assets:</b>                   |                                   |            |         |            |
| Restricted funds                 | \$ 111,801                        |            |         | \$ 111,801 |
| Rabbi trust investments          |                                   | \$ 501     |         | 501        |
| Deposits                         | 1,866                             |            |         | 1,866      |
| Mark-to-market derivative asset  |                                   | 7,088      |         | 7,088      |
| Total assets                     | \$ 113,667                        | \$ 7,589   |         | \$ 121,256 |
| <b>Liabilities:</b>              |                                   |            |         |            |
| Deferred compensation obligation |                                   | \$ 9,342   |         | \$ 9,342   |
| Total liabilities                |                                   | \$ 9,342   |         | \$ 9,342   |
| Total net assets (liabilities)   | \$ 113,667                        | \$ (1,753) |         | \$ 111,914 |

| Recurring Fair Value Measures    | At Fair Value as of December 31, 2011 |          |         |           |
|----------------------------------|---------------------------------------|----------|---------|-----------|
|                                  | Level 1                               | Level 2  | Level 3 | Total     |
| <b>Assets:</b>                   |                                       |          |         |           |
| Restricted funds                 | \$ 57,941                             |          |         | \$ 57,941 |
| Rabbi trust investments          |                                       | \$ 518   |         | 518       |
| Deposits                         | 2,287                                 |          |         | 2,287     |
| Mark-to-market derivative asset  |                                       | 5,824    |         | 5,824     |
| Total assets                     | \$ 60,228                             | \$ 6,342 |         | \$ 66,570 |
| <b>Liabilities:</b>              |                                       |          |         |           |
| Deferred compensation obligation |                                       | \$ 9,036 |         | \$ 9,036  |



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|                                |           |            |           |
|--------------------------------|-----------|------------|-----------|
| Total liabilities              | \$ 9,036  | \$ 9,036   |           |
| Total net assets (liabilities) | \$ 60,228 | \$ (2,694) | \$ 57,534 |

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

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

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

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

**Mark-to-market derivative asset** The Company utilizes fixed-to-floating interest-rate swaps, typically designated as fair value hedges, to achieve a targeted level of variable-rate debt as a percentage of total debt. The Company uses a calculation of future cash inflows and estimated future outflows, which are discounted, to determine the current fair value. Additional inputs to the present value calculation include the contract terms, counterparty credit risk, interest rates and market volatility.

**Note 14: Segment Information**

The Company has two operating segments which are also the Company's two reportable segments, referred to as Regulated Businesses and Market-Based Operations.

The following table includes the Company's summarized segment information from continuing operations, except as noted below:

|   | <b>As of or for the Three Months Ended<br/>June 30, 2012</b> |                                    |              |                     |
|---|--|------------------------------------|--------------|---------------------|
|   | <b>Regulated<br/>Businesses</b>                              | <b>Market-Based<br/>Operations</b> | <b>Other</b> | <b>Consolidated</b> |
| Net operating revenues  | \$ 667,601   | \$ 82,795                          | \$ (4,789)   | \$ 745,607          |
| Depreciation and amortization                                       | 84,702   | 1,649                              | 5,978        | 92,329              |
| Total operating expenses, net                                       | 406,417  | 73,982                             | (5,424)      | 474,975             |
| Income (loss) from continuing operations before income taxes        | 204,874  | 9,738                              | (17,347)     | 197,265             |
| Total assets  | 12,434,806   | 281,572                            | 1,696,383    | 14,412,761          |
| Assets of discontinued operations (included in total assets above)  | 0  | 0                                  | 0            | 0                   |
| Capital expenditures  | 242,859  | 75                                 | 0            | 242,934             |
| Capital expenditures of discontinued operations (included in above) | 185  | 0                                  | 0            | 185                 |

|   | <b>As of or for the Three Months Ended<br/>June 30, 2011</b> |                                    |              |                     |
|---|--|------------------------------------|--------------|---------------------|
|   | <b>Regulated<br/>Businesses</b>                              | <b>Market-Based<br/>Operations</b> | <b>Other</b> | <b>Consolidated</b> |
| Net operating revenues  | \$ 594,441   | \$ 82,424                          | \$ (7,992)   | \$ 668,873          |
| Depreciation and amortization                                       | 79,797   | 1,727                              | 5,818        | 87,342              |
| Total operating expenses, net                                       | 400,719  | 75,753                             | (8,994)      | 467,478             |
| Income (loss) from continuing operations before income taxes        | 138,020  | 7,259                              | (19,195)     | 126,084             |
| Total assets  | 12,537,877   | 264,985                            | 1,519,416    | 14,322,278          |
| Assets of discontinued operations (included in total assets above)  | 906,547  | 7,188                              | 4,428        | 918,163             |
| Capital expenditures  | 214,045  | 1,336                              | 0            | 215,381             |
| Capital expenditures of discontinued operations (included in above) | 5,139  | 26                                 | 0            | 5,165               |

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|   | As of or for the Six Months Ended<br>June 30, 2012 |                            |            |              |
|---|--|----------------------------|------------|--------------|
|   | Regulated<br>Businesses                            | Market-Based<br>Operations | Other      | Consolidated |
| Net operating revenues  | \$ 1,209,476                                       | \$ 163,376                 | \$ (8,691) | \$ 1,364,161 |
| Depreciation and amortization                                       | 169,490  | 3,330                      | 11,613     | 184,433      |
| Total operating expenses, net                                       | 801,059  | 144,747                    | (12,015)   | 933,791      |
| Income (loss) from continuing operations before income taxes        | 295,290  | 20,208                     | (33,588)   | 281,910      |
| Total assets  | 12,434,806   | 281,572                    | 1,696,383  | 14,412,761   |
| Assets of discontinued operations (included in total assets above)  | 0  | 0                          | 0          | 0            |
| Capital expenditures  | 476,057  | 243                        | 0          | 476,300      |
| Capital expenditures of discontinued operations (included in above) | 2,884  | 0                          | 0          | 2,884        |

|   | As of or for the Six Months Ended<br>June 30, 2011 |                            |             |              |
|---|--|----------------------------|-------------|--------------|
|   | Regulated<br>Businesses                            | Market-Based<br>Operations | Other       | Consolidated |
| Net operating revenues  | \$ 1,122,722                                       | \$ 157,806                 | \$ (14,940) | \$ 1,265,588 |
| Depreciation and amortization                                       | 158,377  | 3,496                      | 12,347      | 174,220      |
| Total operating expenses, net                                       | 795,066  | 144,027                    | (18,150)    | 920,943      |
| Income (loss) from continuing operations before income taxes        | 215,082  | 14,933                     | (35,287)    | 194,728      |
| Total assets  | 12,537,877   | 264,985                    | 1,519,416   | 14,322,278   |
| Assets of discontinued operations (included in total assets above)  | 906,547  | 7,188                      | 4,428       | 918,163      |
| Capital expenditures  | 390,017  | 1,775                      | 0           | 391,792      |
| Capital expenditures of discontinued operations (included in above) | 11,019   | 84                         | 0           | 11,103       |

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

Certain matters within this Quarterly Report on Form 10-Q include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements included in this Form 10-Q, other than statements of historical fact, may constitute forward-looking statements. Forward-looking statements can be identified by the use of words such as may, should, will, could, estimates, predicts, potential, continue, anticipates, believes, plans, expect, and similar expressions. Forward-looking statements may involve known and unknown risks, uncertainties and other factors that may cause the actual results or performance to differ from those projected in the forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. Factors that could cause or contribute to differences in results and outcomes from those in our forward-looking statements include, without limitation, those items discussed in the Risk Factors section or other sections in the Company's Form 10-K for the year ended December 31, 2011 filed with the Securities and Exchange Commission (SEC), as well as in Item IA of Part II of this Quarterly Report. We undertake no obligation, other than as required by law, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

**General**

American Water Works Company, Inc. (herein referred to as American Water or the Company) is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial, industrial and other customers. Our Regulated Businesses that provide these services are generally subject to economic regulation by state regulatory agencies (PUCs) in the states in which they operate. We report the results of these businesses in our Regulated Businesses segment. We also provide services that are not subject to economic regulation by state regulatory agencies. We report the results of these businesses in our Market-Based Operations segment. For further description of our businesses see the Business section found in our Form 10-K for the year ended December 31, 2011 filed with the SEC.

You should read the following discussion in conjunction with our Consolidated Financial Statements and related Notes included elsewhere in this Quarterly Report on Form 10-Q and in our Form 10-K for the year ended December 31, 2011 filed with the SEC.

**Overview**

All financial information in this Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A), reflects only continuing operations. As previously disclosed in our Form 10-K for the year ended December 31, 2011, as part of our portfolio optimization initiative, we entered into agreements to sell our regulated subsidiaries in Arizona, New Mexico, Ohio and our regulated water and wastewater systems in Texas. The sale of the Texas subsidiary assets was completed in June 2011. In the first quarter of 2012, we completed the divestiture of the Arizona and New Mexico subsidiaries, and on May 1, 2012, we completed the divestiture of our Ohio subsidiary. Also, on December 31, 2011, we completed the sale of Applied Water Management, Inc. (AWM), which was part of our Contract Operations line of business within our Market-Based Operations segment. Therefore, the financial results of these entities have been presented as discontinued operations for all periods, unless otherwise noted. Additionally, during the fourth quarter of 2011, we discovered errors in our calculations of gains or losses on discontinued operations that originated in the first and second quarters of 2011. As a result, we recorded after-tax charges totaling \$24.6 million, which included associated parent company goodwill, to reduce the net asset values of those businesses to their net realizable values. These charges were recognized within discontinued operations and net income and included in the operating results for the year ended December 31, 2011. The write-down included in the first and second quarters of 2011 totaled \$21.1 million and \$3.5 million, respectively, and are reflected, where necessary, in the amounts reported for the three and six months ended June 30, 2011.

*Financial Results.* For the three months ended June 30, 2012, we reported net income of \$107.0 million, or diluted earnings per share (EPS) of \$0.60 compared to \$81.1 million, or diluted EPS of \$0.46 for the comparable period in 2011. Income from continuing operations was \$116.7 million for the second quarter of 2012 compared to \$74.8 million in the second quarter of 2011. Diluted income from continuing operations per average common share was \$0.66 for the second quarter of 2012 as compared to \$0.42 for the second quarter of 2011.

For the six months ended June 30, 2012, our net income amounted to \$148.8 million, or diluted earnings per share of \$0.84 compared to \$107.3 million, or diluted EPS of \$0.61 for the comparable period in 2011. Income from continuing operations was \$165.9 million for the six months ended June 30, 2012 compared to \$115.5 million for the same period in 2011. Diluted income from continuing operations per average common share was \$0.94 for the six months ended June 30, 2012 as compared to \$0.66 for the first six months of 2011.



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The primary drivers contributing to these increases in net income from continuing operations for both the three and six months ended June 30, 2012 were increased revenues in our Regulated Businesses resulting from rate increases and higher demand, as well as slightly higher revenues in our Market-Based Operations segment. Partially offsetting these increases were higher depreciation and amortization expense and general taxes. For further details, see *Consolidated Results of Operations and Variances* and *Segment Results* below.

In 2012, our focus is on executing our portfolio optimization initiative, actively addressing regulatory lag and declining usage, continuing to make efficient use of capital and continuing to improve our regulated operation and maintenance ( O&M ) efficiency ratio. Also, in 2012, we look to grow our Market-Based Operations with a focus on the Homeowners Services Group and Military Contract Operations and to optimize our municipal contract operations business model to provide for value creation for both American Water and the municipality. The progress that we have made in the first six months of 2012 with respect to three of these objectives is described below. In regards to our other 2012 goals not explicitly outlined below, we continue to make progress.

*Portfolio Optimization Initiative.* We continue to execute our plan for optimizing our Regulated Businesses portfolio. In the first quarter of 2012, we completed the sale of our regulated operations in Arizona and New Mexico. On May 1, 2012, we completed the divestiture of our Ohio subsidiary, which served approximately 58,000 customers.

Also, on May 1, 2012, we completed our purchase of seven regulated water systems in New York, for \$39.3 million in cash plus assumed liabilities of \$67.6 million. This acquisition added approximately 50,000 customers to our New York regulated operations.

*Addressing Regulatory Lag and Declining Usage.* During the second quarter of 2012, we filed a general rate case in Tennessee requesting additional annualized revenues of approximately \$10.6 million. Also, during the three months ended June 30, 2012, we were granted additional annualized revenues from general rate cases totaling \$60.4 million.

On May 1, 2012, our New Jersey rate case, which we filed in the third quarter of 2011, was approved by the Board of Public Utilities. The new rates were effective May 1, 2012. On June 6, 2012, the Indiana Utility Regulatory Commission ( IURC ) issued an order adjusting rates on a statewide basis for Indiana American Water. The IURC order became effective June 15, 2012. On June 7, 2012, our California general rate case was approved by California's Public Utilities Commission ( CPUC ), authorizing a total of approximately \$28.5 million in additional annualized revenues for 2012. The increased revenue requirement was retroactively effective back to January 1, 2012.

Also, in April, 2012, additional annualized revenues of \$1.7 million resulting from infrastructure charges for our Pennsylvania subsidiary became effective.

The table below provides further details of annualized revenues, assuming a constant volume, resulting from rate authorizations granted:

| <b>State</b>                    | <b>Annualized Rate Increases Granted</b>            |   |
|---------------------------------|---|---|
|                                 | <b>For the three months ended<br/>June 30, 2012</b> | <b>For the six months ended<br/>June 30, 2012</b> |
|                                 | <b>(In millions)</b>                                |   |
| <b>General Rate Cases:</b>      |   |   |
| New Jersey                      | \$ 30.0   | \$ 30.0   |
| Missouri                        |   | 24.0  |
| New York (a)                    |   | 5.6   |
| Iowa                            |   | 2.8   |
| Indiana                         | 1.9   | 1.9   |
| California                      | 28.5  | 28.5  |
| Other                           |   | 0.2   |
| <i>Total General Rate Cases</i> | \$ 60.4   | \$ 93.0   |
| <b>Infrastructure Charges</b>   |   |   |
| Pennsylvania                    | \$ 1.7  | \$ 1.7  |
| Other                           | \$ 0.3  | \$ 0.3  |

|                                     |        |    |     |
|-------------------------------------|--------|----|-----|
| <i>Total Infrastructure charges</i> | \$ 2.0 | \$ | 2.0 |
|-------------------------------------|--------|----|-----|

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a) Amount includes \$3.0 million increase effective April 1, 2012. The remainder of the \$5.6 million annualized revenue increase of \$1.4 million and \$1.2 million will become effective April 1, 2013 and April 1, 2014, respectively.

On July 1, 2012, additional annualized revenue of \$3.0 million resulting from infrastructure charges in our Pennsylvania subsidiary became effective. Also on July 20, 2012, our New Jersey subsidiary filed a Foundational Filing for a Distribution System Improvement Charge.

On July 12, 2012, the CPUC approved California's cost of capital application. This approval is retroactive to January 1, 2012 and is estimated to provide additional annualized revenues of \$4.4 million. Also, on July 12, 2012, interim rates which would provide for an additional \$6.0 million of annualized revenues, including \$5.7 million of jurisdictional revenue under bond and subject to refund, were put into effect for our Virginia subsidiary. There is no assurance that the bonded amount, or any portion thereof, will be approved.

As of July 31, 2012, we are awaiting final orders in three states, requesting additional annualized revenues of \$54.1 million. There is no assurance that all, or any portion of any requested increase, will be granted.

In regards to another regulatory matter, in June 2012, the CPUC approved our request to permanently remove the San Clemente Dam from the Carmel River on the Monterey Peninsula. The estimated project construction cost is \$83 million, of which \$49 million will be recovered from rate payers and \$34 million will come from the State Coastal Conservancy. This decision also permitted California-American Water Company rate recovery of approximately \$27 million in historical costs.

*Continue Improvement in O&M Efficiency Ratio for our Regulated Businesses.* Our O&M efficiency ratio (a non-GAAP measure) is calculated only on our Regulated operations and is defined as operation and maintenance expense divided by operating revenues where both operation and maintenance expense and operating revenues are adjusted for purchased water expense. Our operating efficiency ratio was 37.9% for the three months ended June 30, 2012 compared to 43.2% for the three months ended June 30, 2011. Our operating efficiency ratio was 41.2% for the six months ended June 30, 2012 compared to 45.5% for the same period in 2011.

The improvement in our O&M efficiency ratio was driven by our continued focus on operating expense control as well as an increase in revenue relating to rate cases and increased customer usage. We evaluate our operating performance using this measure because management believes it is one measure of the efficiency of our regulated operations. This information is intended to enhance an investor's overall understanding of our operating performance. The O&M efficiency ratio is not a measure defined under GAAP and may not be comparable to other companies' operating measures and should not be used in place of the GAAP information provided elsewhere in this report. The following table provides a reconciliation that compares operation and maintenance expense and operating revenues, as determined in accordance with GAAP, to Adjusted Regulated O&M expense and Adjusted Regulated Operating Revenues, and also shows our operating efficiency ratio for the three and six months ended June 30, 2012 as compared to the same periods in 2011:

## Regulated O&amp;M Efficiency Ratio (a Non-GAAP Measure)

|  | For the three months ended<br>June 30, |            | For the six months ended<br>June 30, |              |
|--|--|------------|--------------------------------------|--------------|
|  | 2012                                   | 2011       | 2012                                 | 2011         |
|  | (In thousands)                         |            |                                      |              |
| Total O&M expense                            | \$ 327,577                             | \$ 327,157 | \$ 637,581                           | \$ 637,978   |
| Less:  |  |            |                                      |              |
| O&M expense - Market-Based Operations        | 71,118                                 | 72,702     | 138,891                              | 137,238      |
| O&M expense - Other                          | (13,572)                               | (16,928)   | (29,272)                             | (35,596)     |
| Total Regulated O&M expense                  | 270,031                                | 271,383    | 527,962                              | 536,336      |
| Less: Regulated purchased water              | 27,597                                 | 25,565     | 50,007                               | 46,380       |
| Adjusted Regulated O&M expense(a)            | \$ 242,434                             | \$ 245,818 | \$ 477,955                           | \$ 489,956   |
| Total Operating Revenues                     | \$ 745,607                             | \$ 668,873 | \$ 1,364,161                         | \$ 1,265,588 |
| Less:  |  |            |                                      |              |
| Operating revenues - Market-Based Operations | 82,795                                 | 82,424     | 163,376                              | 157,806      |



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|  |       |            |            |              |              |
|--|-------|------------|------------|--------------|--------------|
| Operating revenues                       | Other | (4,789)    | (7,992)    | (8,691)      | (14,940)     |
| Total Regulated operating revenues       |       | 667,601    | 594,441    | 1,209,476    | 1,122,722    |
| Less: Regulated purchased water expense* |       | 27,597     | 25,565     | 50,007       | 46,380       |
| Adjusted Regulated operating revenues(b) |       | \$ 640,004 | \$ 568,876 | \$ 1,159,469 | \$ 1,076,342 |
| Regulated O&M efficiency ratio(a)/(b)    |       | 37.9%      | 43.2%      | 41.2%        | 45.5%        |

\* Calculation assumes purchased water revenues approximate purchased water expenses.

**Table of Contents***Other Matters**Business Transformation Project*

On August 1, 2012, our new business systems associated with Phase I of our business transformation project went live. Phase I consisted of the roll-out of the Enterprise Resource Planning systems, which encompass applications that will handle human resources, finance, and supply chain/procurement management. Phase II consists of the roll-out of a new Enterprise Asset Management system, which will manage an asset's lifecycle, and a Customer Information system, which contains all billing and data pertaining to American Water's customers for our Regulated segment. Phase II is expected to be completed by December 31, 2013. As we make adjustments to our operations as a result of this project, we may incur incremental expenses prior to realizing the benefits of a more efficient workforce and operating structure. A project of this size will have an impact on our control environment. Although efforts have been made to minimize any adverse impact, we cannot assure that all such impacts have been mitigated. Through June 30, 2012, we have spent \$211.5 million on the project with \$71.7 million spent in 2012.

Expenditures associated with the project are included in the estimated capital investment spending of \$900 million for 2012 and \$800 million to \$1 billion in 2013.

**Consolidated Results of Operations and Variances**

| (In thousands)   | For the three months ended<br>June 30, |            |                                      | For the six months ended<br>June 30, |              |                                      |
|--|--|------------|--------------------------------------|--------------------------------------|--------------|--------------------------------------|
|  | (In thousands, except per share data)  |            |                                      |                                      |              |                                      |
|  | 2012                                   | 2011       | Favorable<br>(Unfavorable)<br>Change | 2012                                 | 2011         | Favorable<br>(Unfavorable)<br>Change |
| Operating revenues                                     | \$ 745,607                             | \$ 668,873 | \$ 76,734                            | \$ 1,364,161                         | \$ 1,265,588 | \$ 98,573                            |
| Operating expenses                                     |  |            |                                      |                                      |              |                                      |
| Operation and maintenance                              | 327,577                                | 327,157    | (420)                                | 637,581                              | 637,978      | 397                                  |
| Depreciation and amortization                          | 92,329                                 | 87,342     | (4,987)                              | 184,433                              | 174,220      | (10,213)                             |
| General taxes  | 55,282                                 | 52,951     | (2,331)                              | 112,403                              | 108,449      | (3,954)                              |
| (Gain) loss on asset dispositions and purchases        | (213)                                  | 28         | 241                                  | (626)                                | 296          | 922                                  |
| Total operating expenses, net                          | 474,975                                | 467,478    | (7,497)                              | 933,791                              | 920,943      | (12,848)                             |
| Operating income                                       | 270,632                                | 201,395    | 69,237                               | 430,370                              | 344,645      | 85,725                               |
| Other income (expenses)                                |  |            |                                      |                                      |              |                                      |
| Interest, net  | (79,730)                               | (78,469)   | (1,261)                              | (159,384)                            | (154,660)    | (4,724)                              |
| Allowance for other funds used during construction     | 5,076                                  | 2,535      | 2,541                                | 9,438                                | 5,363        | 4,075                                |
| Allowance for borrowed funds used during construction  | 2,313                                  | 1,198      | 1,115                                | 4,394                                | 2,402        | 1,992                                |
| Amortization of debt expense                           | (1,361)                                | (1,255)    | (106)                                | (2,627)                              | (2,547)      | (80)                                 |
| Other, net   | 335                                    | 680        | (345)                                | (281)                                | (475)        | 194                                  |
| Total other income (expenses)                          | (73,367)                               | (75,311)   | 1,944                                | (148,460)                            | (149,917)    | 1,457                                |
| Income from continuing operations before income taxes  | 197,265                                | 126,084    | 71,181                               | 281,910                              | 194,728      | 87,182                               |
| Provision for income taxes                             | 80,602                                 | 51,267     | (29,335)                             | 115,995                              | 79,212       | (36,783)                             |
| Income from continuing operations                      | 116,663                                | 74,817     | 41,846                               | 165,915                              | 115,516      | 50,399                               |
| Income (loss) from discontinued operations, net of tax | (9,637)                                | 6,293      | (15,930)                             | (17,135)                             | (8,173)      | (8,962)                              |
| Net income   | \$ 107,026                             | \$ 81,110  | \$ 25,916                            | \$ 148,780                           | \$ 107,343   | \$ 41,437                            |
| Basic earnings per common share:(a)                    |  |            |                                      |                                      |              |                                      |
| Income from continuing operations                      | \$ 0.66                                | \$ 0.43    |                                      | \$ 0.94                              | \$ 0.66      |                                      |

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|   |           |         |           |           |
|---|-----------|---------|-----------|-----------|
| Income from discontinued operations, net of tax             | \$ (0.05) | \$ 0.04 | \$ (0.10) | \$ (0.05) |
| Net income  | \$ 0.61   | \$ 0.46 | \$ 0.84   | \$ 0.61   |
| <b>Diluted earnings per common share:(a)</b>                |           |         |           |           |
| Income from continuing operations                           | \$ 0.66   | \$ 0.42 | \$ 0.94   | \$ 0.66   |
| Income from discontinued operations, net of tax             | \$ (0.05) | \$ 0.04 | \$ (0.10) | \$ (0.05) |
| Net income  | \$ 0.60   | \$ 0.46 | \$ 0.84   | \$ 0.61   |
| <b>Average common shares outstanding during the period:</b> |           |         |           |           |
| Basic   | 176,331   | 175,469 | 176,122   | 175,364   |
| Diluted   | 177,491   | 176,419 | 177,296   | 176,255   |

(a) Amounts may not sum due to rounding

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The following is a discussion of the consolidated results of operations for the three and six months ended June 30, 2012 compared to the three and six months ended June 30, 2011:

*Three Months Ended June 30, 2012 Compared To Three Months Ended June 30, 2011*

**Operating revenues.** Consolidated operating revenues for the three months ended June 30, 2012 increased \$76.7 million, or 11.5%, compared to the same period in 2011 and is mainly attributable to a \$73.2 million increase in our Regulated Businesses segment mainly as a result of rate increases as well as increased usage in the second quarter of 2012. For further information, see the respective Operating Revenues discussions within the Segment Results.

**Operation and maintenance.** Consolidated operation and maintenance expense for the three months ended June 30, 2012 increased by \$0.4 million, or 0.1%, compared to the same period in 2011. For further information, see the respective Operation and Maintenance discussions within the Segment Results.

**Depreciation and amortization.** Depreciation and amortization expense increased by \$5.0 million, or 5.7%, for the three months ended June 30, 2012 compared to the same period in the prior year as a result of additional utility plant placed in service.

**General taxes.** General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, increased by \$2.3 million, or 4.4%, for the three months ended June 30, 2012 compared to the three months ended June 30, 2011. This increase was principally due to higher property taxes of \$1.8 million, primarily related to our recently acquired New York properties.

**Other income (expenses).** Other expenses decreased by \$1.9 million, or 2.6%, for the three months ended June 30, 2012 compared to the same period in the prior year. This decrease is attributable to an increase in allowance for funds used during construction ( AFUDC ) of \$3.7 million, which is mainly attributable to increased construction activity, including the replacement of a water treatment facility in our New Jersey regulated subsidiary. Partially offsetting this decrease was an increase in interest expense, net of interest income, of \$1.3 million, or 1.6%, for the three months ended June 30, 2012 compared to the same period in the prior year, primarily attributable to higher interest expense associated with our interest rate swap and incremental interest expense on borrowings associated with certain restricted funds in 2012.

**Provision for income taxes.** Our consolidated provision for income taxes increased \$29.3 million, or 57.2%, to \$80.6 million for the three months ended June 30, 2012. The effective tax rates for the three months ended June 30, 2012 and 2011 were 40.9% and 40.7%, respectively.

**Income (loss) from discontinued operations, net of tax.** As noted above, the financial results of our regulated water and wastewater systems in Arizona, New Mexico, Texas and Ohio, as well as those of our AWM subsidiary within the Market-Based Operations segment, have been classified as discontinued operations for all periods presented. The increase in the loss from discontinued operations, net of tax is primarily attributable to the disposition of our Ohio subsidiary, which accounted for \$5.2 million, and a \$2.4 million pre-tax sales price adjustment in connection with the disposition of our Arizona and New Mexico subsidiaries. Additionally, the 2011 amount included net income associated with the discontinued operations for the period and a benefit of \$3.2 million related to the cessation of depreciation for our Arizona, New Mexico, and Texas subsidiaries offset by \$3.5 million after-tax write-down recorded in the second quarter of 2011 to reduce the net asset values of certain of the discontinued operations. Under GAAP, operations that are considered discontinued operations cease to depreciate their assets.

*Six Months Ended June 30, 2012 Compared To Six Months Ended June 30, 2011*

**Operating revenues.** Consolidated operating revenues for the six months ended June 30, 2012 increased \$98.6 million, or 7.8%, compared to the same period in 2011. This change reflects an \$86.8 million increase in our Regulated Businesses segment, which was mainly attributable to rate increases and usage, and a \$5.6 million increase in our Market-Based Operations segment, which was due to contract growth and price increases in homeowner services, and incremental revenues associated with military construction and operations. For further information, see the Operating Revenues discussions within the Segment Results.

**Operation and maintenance.** Consolidated operation and maintenance expense for the six months ended June 30, 2012 decreased \$0.4 million, or 0.1%, compared to the same period in 2011. For further information, see the Operation and Maintenance discussions within the Segment Results.

**Depreciation and amortization.** Depreciation and amortization expense increased by \$10.2 million, or 5.9%, for the six months ended June 30, 2012 compared to the same period in the prior year as a result of additional utility plant placed in service.

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**General taxes.** General taxes expense increased by \$4.0 million, or 3.6%, for the six months ended June 30, 2012 compared to the six months ended June 30, 2011. This increase was principally due to higher property taxes of \$2.2 million, which is primarily related to our recently acquired New York properties, as well as higher payroll and gross receipt taxes.

**Other income (expenses).** Other expenses decreased by \$1.5 million, or 1.0%, for the six months ended June 30, 2012 compared to the same period in the prior year and is primarily attributable to an increase in AFUDC of \$6.1 million related to increased construction activity,

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including the water treatment facility replacement project in our New Jersey subsidiary. Partially offsetting this decrease was an increase in interest expense, net of interest income, of \$4.7 million, or 3.1%, for the six months ended June 30, 2012 compared to the same period in the prior year. This increase is mainly attributable to accelerated amortization recorded in 2011 of \$3.1 million in unamortized debt discounts associated with debt that was redeemed during the first quarter of 2011, as well as higher interest expense associated with our interest rate swap and incremental interest expense on borrowings associated with certain restricted funds.

**Provision for income taxes.** Our consolidated provision for income taxes increased \$36.8 million, or 46.4%, to \$116.0 million for the six months ended June 30, 2012. The effective tax rates for the six months ended June 30, 2012 and 2011 were 41.1% and 40.7%, respectively.

**Income (loss) from discontinued operations, net of tax.** As noted above, the financial results of our regulated water and wastewater systems in Arizona, New Mexico, Texas and Ohio as well as those of our AWM subsidiary within the Market-Based Operations segment, have been classified as discontinued operations for all periods presented. The increase in loss from discontinued operations, net of tax is primarily related to the disposition of our Ohio subsidiary, \$9.7 million in charges for income taxes resulting from the divestiture of our Arizona and New Mexico subsidiaries and the \$2.4 million pre-tax sales price adjustment in connection with the disposition of our Arizona and New Mexico subsidiaries. Additionally, the 2011 amount included net income as a result of the operations of those subsidiaries and an after-tax benefit of \$7.9 million related to the cessation of depreciation for our Arizona, New Mexico, and Texas subsidiaries. Under GAAP, operations that are considered discontinued operations cease to depreciate their assets. Partially offsetting the 2011 income (loss) from discontinued operations, net of tax amount was \$24.6 million after-tax write-downs recorded in 2011 to reduce the net asset values of certain of our discontinued operations.

**Segment Results**

We have two operating segments that are also our reportable segments: the Regulated Businesses and the Market-Based Operations. We evaluate the performance of our segments and allocate resources based on several factors, with the primary measure being income from continuing operations before income taxes.

**Regulated Segment**

The following table summarizes certain financial information for our Regulated Businesses for the periods indicated:

|   | For the three months ended<br>June 30, |            |  | For the six months ended<br>June 30, |              |                        |
|---|--|------------|--|--------------------------------------|--------------|------------------------|
|   | 2012                                   | 2011       | Increase<br>(Decrease)<br>(In thousands) | 2012                                 | 2011         | Increase<br>(Decrease) |
| Operating revenues                                    | \$ 667,601                             | \$ 594,441 | \$ 73,160                                | \$ 1,209,476                         | \$ 1,122,722 | \$ 86,754              |
| Operation and maintenance expense                     | 270,031                                | 271,383    | (1,352)                                  | 527,962                              | 536,336      | (8,374)                |
| Operating expenses, net                               | 406,417                                | 400,719    | 5,698                                    | 801,059                              | 795,066      | 5,993                  |
| Income from continuing operations before income taxes | 204,874                                | 138,020    | 66,854                                   | 295,290                              | 215,082      | 80,208                 |

**Operating revenues.** Our primary business involves the ownership of water and wastewater utilities that provide services to residential, commercial, industrial and other customers. This business is generally subject to state regulation and our results of operations are impacted significantly by rates authorized by the regulatory commissions in the states in which we operate.

Operating revenues increased by \$73.2 million, or 12.3%, for the three months ended June 30, 2012 and \$86.8 million, or 7.7%, for the six months ended June 30, 2012, respectively, as compared to the same periods in 2011. The increase in revenues was primarily due to rate increases obtained through rate authorizations for a number of our operating companies, higher demand, additional revenues associated with acquisitions and a retroactive adjustment in the second quarter of 2012 totaling \$7.2 million resulting from the issuance of a final rate order in California.

The impact of rate increases on revenues was approximately \$32.0 million and \$52.2 million for the three and six months ending June 30, 2012, respectively. The increase in revenues associated with higher demand amounted to approximately \$27 million and \$21 million for the three and six months ended June 30, 2012, respectively, which is attributable to increased customer consumption in 2012 compared to 2011, which we believe is primarily attributable to the warmer/drier weather in the second quarter of 2012. Lastly, revenues were higher by \$7.9 million and \$8.5 million for the three and six months ended June 30, 2012, respectively, compared to the same period in 2011 as a result of acquisitions, with the most significant being our New York acquisition in the second quarter of 2012.



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The following table provides information regarding the Regulated Businesses' revenues and billed water sales volume by customer class:

| Customer Class       | For the three months ended June 30,          |        |            |        | 2011   |        |        |        |
|----------------------|--|--------|------------|--------|--|--------|--------|--------|
|                      | 2012   |        | 2011       |        | 2012   |        | 2011   |        |
|                      | Operating Revenues<br>(Dollars in thousands) |        |            |        | Billed Water Sales Volume<br>(Gallons in millions) |        |        |        |
| Water service:       |  |        |            |        |  |        |        |        |
| Residential          | \$ 383,879                                   | 57.5%  | \$ 335,772 | 56.5%  | 45,304   | 51.0%  | 42,473 | 51.0%  |
| Commercial           | 130,917                                      | 19.6%  | 117,829    | 19.8%  | 20,371   | 23.0%  | 19,103 | 22.9%  |
| Industrial           | 35,860                                       | 5.4%   | 30,391     | 5.1%   | 9,754  | 11.0%  | 9,491  | 11.4%  |
| Public and other     | 79,567                                       | 11.9%  | 74,796     | 12.6%  | 13,353   | 15.0%  | 12,193 | 14.7%  |
| Other water revenues | 7,960  | 1.2%   | 6,020      | 1.0%   |  |        |        |        |
| Total water revenues | 638,183                                      | 95.6%  | 564,808    | 95.0%  | 88,782   | 100.0% | 83,260 | 100.0% |
| Wastewater service   | 19,669                                       | 2.9%   | 19,411     | 3.3%   |  |        |        |        |
| Other revenues       | 9,749  | 1.5%   | 10,222     | 1.7%   |  |        |        |        |
|                      | \$ 667,601                                   | 100.0% | \$ 594,441 | 100.0% |  |        |        |        |

| Customer Class       | For the six months ended June 30,            |        |              |        | 2011   |        |         |        |
|----------------------|--|--------|--------------|--------|--|--------|---------|--------|
|                      | 2012   |        | 2011         |        | 2012   |        | 2011    |        |
|                      | Operating Revenues<br>(Dollars in thousands) |        |              |        | Billed Water Sales Volume<br>(Gallons in millions) |        |         |        |
| Water service:       |  |        |              |        |  |        |         |        |
| Residential          | \$ 689,776                                   | 57.0%  | \$ 633,217   | 56.4%  | 83,779   | 50.7%  | 81,610  | 50.7%  |
| Commercial           | 237,589                                      | 19.6%  | 219,069      | 19.5%  | 37,656   | 22.8%  | 36,453  | 22.7%  |
| Industrial           | 62,788                                       | 5.2%   | 57,049       | 5.1%   | 18,729   | 11.3%  | 18,761  | 11.7%  |
| Public and other     | 150,848                                      | 12.5%  | 144,842      | 12.9%  | 25,079   | 15.2%  | 24,026  | 14.9%  |
| Other water revenues | 10,699                                       | 0.9%   | 11,318       | 1.0%   |  |        |         |        |
| Total water revenues | 1,151,700                                    | 95.2%  | 1,065,495    | 94.9%  | 165,243  | 100.0% | 160,850 | 100.0% |
| Wastewater service   | 38,790                                       | 3.2%   | 37,902       | 3.4%   |  |        |         |        |
| Other revenues       | 18,986                                       | 1.6%   | 19,325       | 1.7%   |  |        |         |        |
|                      | \$ 1,209,476                                 | 100.0% | \$ 1,122,722 | 100.0% |  |        |         |        |

**Water Services** Water service operating revenues from residential customers for the three months ended June 30, 2012 increased by \$48.1 million, or 14.3%, compared to the three months ended June 30, 2011. For the six months ended June 30, 2012 these revenues increased by \$56.6 million, or 8.9%, over the same period in 2011. The increases are primarily due to rate increases as well as increased sales volumes. For the three months ended June 30, 2012, the volume of water sold to residential customers increased by 6.7% compared to the same period in 2011. For the six months ended June 30, 2012, the volume sold to these customers increased by 2.7% as compared to the same period in 2011. We believe this higher consumption for both the three and six month periods is driven by the warmer/drier weather in June 2012 in our eastern and midwestern operating states as compared to June 2011. Also contributing to the increased sales volumes was the additional consumption resulting from our New York acquisition.

Water service operating revenues from commercial water customers for the three months ended June 30, 2012 increased by \$13.1 million, or 11.1%, compared to the same period in 2011. For the six months ended June 30, 2012, these revenues increased by \$18.5 million, or 8.5%, to \$237.6 million, compared to June 30, 2011. These increases were mainly due to rate increases as well as increased sales volume. The volume of



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water sold to commercial customers increased by 6.6% and 3.3% for the three and six months ended June 30, 2012, respectively, compared to the same periods in 2011.

Water service operating revenues from industrial customers, increased \$5.5 million, or 18.0%, for the three months ended June 30, 2012 compared to those recorded for the same period of 2011, mainly due to rate increases and an increase in sales volume. For the three months ended June 30, 2012, the volume of water sold to industrial customers increased by 2.8% compared to the same

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period in 2011. For the six months ended June 30, 2012, water service operating revenues from industrial customers increased \$5.7 million, or 10.1%, compared to the same period of 2011 and is primarily due to rate increases. The volume of water sold to industrial customers for the six months ended June 30, 2012 decreased 0.2% compared to the six months ended June 30, 2011.

Water service operating revenues from public and other customers, including municipal governments, other governmental entities and resale customers increased \$4.8 million, or 6.4%, and \$6.0 million, or 4.1%, for the three and six months ended June 30, 2012, respectively, mainly due to increased sale volumes.

*Wastewater services* Our subsidiaries provide wastewater services in nine states. Revenues from these services increased by \$0.3 million, or 1.3%, to \$19.7 million for the three months ended June 30, 2012, compared to the same period of 2011. Revenues from these services for the six months ended June 30, 2012 increased by \$0.9 million, or 2.3%, to \$38.8 million, compared to the same period of 2011. The increases in both periods were primarily attributable to rate increases in a number of our operating companies.

*Operation and maintenance.* Operation and maintenance expense decreased \$1.4 million, or 0.5%, for the three months ended June 30, 2012, compared to the three months ended June 30, 2011. Operation and maintenance expense decreased \$8.4 million, or 1.6%, for the six months ended June 30, 2012, compared to the same period in the prior year. The following table provides information regarding operation and maintenance expense for the three and six months ended June 30, 2012 and 2011, by major expense category:

|                                    | For the three months ended June 30, |                   |                        |               | For the six months ended June 30, |                   |                        |               |
|------------------------------------|-------------------------------------|-------------------|------------------------|---------------|-----------------------------------|-------------------|------------------------|---------------|
|                                    | 2012                                | 2011*             | Increase<br>(Decrease) | Percentage    | 2012                              | 2011*             | Increase<br>(Decrease) | Percentage    |
|                                    | (Dollars in thousands)              |                   |                        |               |                                   |                   |                        |               |
| Production costs                   | \$ 67,427                           | \$ 65,711         | \$ 1,716               | 2.6%          | \$ 125,887                        | \$ 124,284        | \$ 1,603               | 1.3%          |
| Employee-related costs             | 117,647                             | 119,909           | (2,262)                | (1.9%)        | 233,008                           | 242,491           | (9,483)                | (3.9%)        |
| Operating supplies and services    | 46,294                              | 47,475            | (1,181)                | (2.5%)        | 94,869                            | 96,302            | (1,433)                | (1.5%)        |
| Maintenance materials and services | 15,922                              | 16,187            | (265)                  | (1.6%)        | 32,056                            | 33,642            | (1,586)                | (4.7%)        |
| Customer billing and accounting    | 10,337                              | 12,761            | (2,424)                | (19.0%)       | 19,407                            | 20,859            | (1,452)                | (7.0%)        |
| Other                              | 12,404                              | 9,340             | 3,064                  | 32.8%         | 22,735                            | 18,758            | 3,977                  | 21.2%         |
| <b>Total</b>                       | <b>\$ 270,031</b>                   | <b>\$ 271,383</b> | <b>\$ (1,352)</b>      | <b>(0.5%)</b> | <b>\$ 527,962</b>                 | <b>\$ 536,336</b> | <b>\$ (8,374)</b>      | <b>(1.6%)</b> |

\* Certain reclassifications have been made between categories in order for 2011 to conform with 2012 presentation. Production costs and employee-related costs, which account for approximately 70% of the total Regulated Businesses operation and maintenance expense, are discussed in more detail below.

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Production costs by major expense type were as follows:

|                 | For the three months ended June 30, |                  |                        |             | For the six months ended June 30, |                   |                        |             |
|-----------------|-------------------------------------|------------------|------------------------|-------------|-----------------------------------|-------------------|------------------------|-------------|
|                 | 2012                                | 2011             | Increase<br>(Decrease) | Percentage  | 2012                              | 2011              | Increase<br>(Decrease) | Percentage  |
|                 | (Dollars in thousands)              |                  |                        |             |                                   |                   |                        |             |
| Fuel and power  | \$ 21,008                           | \$ 21,401        | \$ (393)               | (1.8%)      | \$ 41,108                         | \$ 41,470         | \$ (362)               | (0.9%)      |
| Purchased Water | 27,597                              | 25,565           | 2,032                  | 7.9%        | 50,007                            | 46,380            | 3,627                  | 7.8%        |
| Chemicals       | 12,522                              | 11,728           | 794                    | 6.8%        | 22,030                            | 22,005            | 25                     | 0.1%        |
| Waste disposal  | 6,300                               | 7,017            | (717)                  | (10.2%)     | 12,742                            | 14,429            | (1,687)                | (11.7%)     |
| <b>Total</b>    | <b>\$ 67,427</b>                    | <b>\$ 65,711</b> | <b>\$ 1,716</b>        | <b>2.6%</b> | <b>\$ 125,887</b>                 | <b>\$ 124,284</b> | <b>\$ 1,603</b>        | <b>1.3%</b> |

Overall production costs increased for the three and six months ended June 30, 2012 compared to the same periods in the prior year, resulting from increased production and sales during the second quarter of 2012. This increase was partially offset by lower fuel and power costs attributable to favorable pricing in 2012 compared to 2011 in one of our regulated operating subsidiaries.

Employee-related costs, including salaries and wages, group insurance, and pension expense, decreased \$2.3 million, or 1.9%, for the three months ended June 30, 2012 compared to the same period in the prior year. These employee-related costs represent approximately 44% of operation and maintenance expense for the three months ended June 30, 2012 and 2011. Employee related costs also decreased \$9.5 million, or 3.9%, for the six months ended June 30, 2012 compared to the same period in the prior year. These employee-related costs represent approximately 44% and 45%, of operation and maintenance expense for the six months ended June 30, 2012 and 2011, respectively. The following table provides information with respect to components of employee-related costs for the three and six months ended June 30, 2012 and 2011:

|                    | For the three months ended June 30, |                   |                        |               | For the six months ended June 30, |                   |                        |               |
|--------------------|-------------------------------------|-------------------|------------------------|---------------|-----------------------------------|-------------------|------------------------|---------------|
|                    | 2012                                | 2011              | Increase<br>(Decrease) | Percentage    | 2012                              | 2011              | Increase<br>(Decrease) | Percentage    |
|                    | (In thousands)                      |                   |                        |               |                                   |                   |                        |               |
| Salaries and wages | \$ 82,530                           | \$ 81,227         | \$ 1,303               | 1.6%          | \$ 160,918                        | \$ 161,876        | \$ (958)               | (0.6%)        |
| Pensions           | 14,484                              | 15,685            | (1,201)                | (7.7%)        | 27,823                            | 32,841            | (5,018)                | (15.3%)       |
| Group insurance    | 16,562                              | 18,550            | (1,988)                | (10.7%)       | 35,431                            | 38,719            | (3,288)                | (8.5%)        |
| Other benefits     | 4,071                               | 4,447             | (376)                  | (8.5%)        | 8,836                             | 9,055             | (219)                  | (2.4%)        |
| <b>Total</b>       | <b>\$ 117,647</b>                   | <b>\$ 119,909</b> | <b>\$ (2,262)</b>      | <b>(1.9%)</b> | <b>\$ 233,008</b>                 | <b>\$ 242,491</b> | <b>\$ (9,483)</b>      | <b>(3.9%)</b> |

For the three months ended June 30, 2012, the overall decrease in employee-related costs was primarily driven by decreased group insurance and pension expense partially offset by an increase in salaries and wages. For the six months ended June 30, 2012, the decrease was driven by lower pension and group insurance expense. The reduction in group insurance costs for the three and six months ended June 30, 2012 compared to the same periods in 2011 is mainly attributable to lower headcount as a result of vacancies, a decrease in the overall cost per person as well as higher capitalization rates. The decrease in pension expense for both the three and six months ended June 30, 2012 was primarily due to decreased contributions in certain of our regulated operating companies whose costs are recovered based on our funding policy, which is to fund at least the minimum amount required by the Employee Retirement Income Security Act of 1974. This was partially offset by a \$1.7 million incremental charge resulting from the finalization of our California rate case.

Operating supplies and services include the day-to-day expenses of office operation, legal and other professional services, transportation expenses, information systems rental charges and other office equipment rental charges. These costs decreased \$1.2 million, or 2.5%, and \$1.4 million, or 1.5%, for the three and six months ended June 30, 2012, respectively. The overall decrease was primarily due to lower transportation expenses due to a reduction in leased vehicle costs and \$2.1 million in credit adjustments resulting from the finalization of our California rate case. These decreases were offset by higher contracted services for the three and six months ended June 30, 2012, respectively, mainly as a

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result of backfilling positions, including those left open by employees who are working on our transformation project as well as the use of contractors for other specific projects.

Customer billing and accounting expenses, which includes uncollectible accounts expense, postage and collection agency fees, decreased by \$2.4 million, or 19.0%, and \$1.5 million, or 7.0%, for the three and six months ended June 30, 2012, respectively, and is mainly the result of reductions in uncollectible accounts expense, reflecting improved collections in our receivables aged in excess of 120 days.

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Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. The increase in these costs was driven by higher insurance costs for the three and six months ended June 30, 2012, as 2012 insurance costs reflected incremental expense resulting from the resolution of prior years' claims.

**Operating expenses.** The increase in operating expenses for the three and six months ended June 30, 2012 is primarily due to higher depreciation expense of \$4.9 million and \$11.1 million, respectively, resulting from additional utility plant placed in service, and increased general taxes of \$2.2 million and \$3.4 million, respectively, principally attributable to higher property taxes, which are primarily related to our recently acquired New York properties, and higher payroll taxes. These increases were partially offset by the decrease in operation and maintenance expense for both the three and six months ended June 30, 2012 as explained above.

**Market-Based Operations**

The following table provides financial information for our Market-Based Operations segment for the periods indicated:

|   | For the three months ended<br>June 30, |           |                        | For the six months ended<br>June 30, |            |                        |
|---|--|-----------|------------------------|--------------------------------------|------------|------------------------|
|   | 2012                                   | 2011      | Increase<br>(Decrease) | 2012                                 | 2011       | Increase<br>(Decrease) |
|   | (In thousands)                         |           |                        |                                      |            |                        |
| Operating revenues                                    | \$ 82,795                              | \$ 82,424 | \$ 371                 | \$ 163,376                           | \$ 157,806 | \$ 5,570               |
| Operation and maintenance expense                     | 71,118                                 | 72,702    | (1,584)                | 138,891                              | 137,238    | 1,653                  |
| Operating expenses, net                               | 73,982                                 | 75,753    | (1,771)                | 144,747                              | 144,027    | 720                    |
| Income from continuing operations before income taxes | 9,738                                  | 7,259     | 2,479                  | 20,208                               | 14,933     | 5,275                  |

**Operating revenues.** Revenues for the three months ended June 30, 2012 increased \$0.4 million compared to the same period in 2011 and is primarily attributable to an increase in the Homeowner Services Group revenues of \$3.1 million partially offset by decreases in Contract Operations Group revenues of \$1.5 million and in Carbon Services Group revenues of \$1.8 million.

The net increase in revenues for the six months ended June 30, 2012 compared to the same period in 2011 is primarily attributable to a \$2.7 million increase in our Homeowner Services Group revenues associated with continued contract growth, a price increase and a \$3.5 million increase in our Contract Operations Group revenues, which is mainly due to incremental revenues associated with military construction and operation and maintenance projects.

**Operation and maintenance.** Operation and maintenance expense decreased \$1.6 million, or 2.2%, for the three months ended June 2012, and increased \$1.7 million, or 1.2%, for the six months ended June 30, 2012 compared to the same periods in the prior year.

The following table provides information regarding categories of operation and maintenance expense for the three and six months ended June 30, 2012 and 2011:

|  | For the three months ended June 30, |           |                        |            | For the six months ended June 30, |            |                        |            |
|--|-------------------------------------|-----------|------------------------|------------|-----------------------------------|------------|------------------------|------------|
|  | 2012                                | 2011      | Increase<br>(Decrease) | Percentage | 2012                              | 2011*      | Increase<br>(Decrease) | Percentage |
|  | (Dollars in thousands)              |           |                        |            |                                   |            |                        |            |
| Production costs                       | \$ 11,479                           | \$ 12,329 | \$ (850)               | (6.9%)     | \$ 23,518                         | \$ 24,670  | \$ (1,152)             | (4.7%)     |
| Employee-related costs                 | 18,964                              | 18,705    | 259                    | 1.4%       | 36,482                            | 36,266     | 216                    | 0.6%       |
| Operating supplies and services        | 28,303                              | 28,899    | (596)                  | (2.1%)     | 56,107                            | 52,181     | 3,926                  | 7.5%       |
| Maintenance materials and services     | 9,826                               | 10,556    | (730)                  | (6.9%)     | 18,834                            | 19,913     | (1,079)                | (5.4%)     |
| Other, including uncollectible expense | 2,548                               | 2,213     | 335                    | 15.1%      | 3,950                             | 4,208      | (258)                  | (6.1%)     |
| Total                                  | \$ 71,120                           | \$ 72,702 | \$ (1,582)             | (2.2%)     | \$ 138,891                        | \$ 137,238 | \$ 1,653               | 1.2%       |

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\* Certain reclassifications have been made between categories in order for 2011 to conform with 2012 presentation.

As noted in the table above, total operation and maintenance expense decreased for the three months ended June 30, 2012 as compared to the same period in 2011, with the main contributors being lower production costs and maintenance materials and supplies. For the six months ended June 30, 2012, an increase in operating supplies and services was partially offset by decreases in production costs and maintenance materials and supplies. The increase in operating supplies and services is attributable to increased construction activity for our military contracts. The decrease in production costs for the six months ended June 30, 2012 compared to the same period in 2011 is primarily due to a decrease in waste disposal costs, while the decrease in maintenance materials and services is due to reduced tank painting costs in 2012.

**Operating expense.** The change in operating expenses for the three and six months ended June 30, 2012 compared to 2011 is primarily due to the variances in the operation and maintenance expense for those respective periods and is explained above.

**Table of Contents****Liquidity and Capital Resources**

For a general overview of our sources and uses of capital resources, see the introductory discussion under Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources, contained in part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2011.

We believe that our ability to access the capital markets, our revolving credit facility and our cash flows from operations will generate sufficient cash to fund our short-term capital requirements. We fund liquidity needs for capital investment, working capital and other financial commitments through cash flows from operations, public and private debt offerings, commercial paper markets and a revolving credit facility with \$840.0 million in aggregate total commitments from a diversified group of banks. We closely monitor the financial condition of the financial institutions associated with its credit facility.

In order to meet our short-term liquidity needs, we, through American Water Capital Corp. (AWCC), our financing subsidiary, issue primarily commercial paper, which is supported by the revolving credit facility. The revolving credit facility is also used, to a limited extent, to support our issuance of letters of credit. AWCC had no outstanding borrowings and \$35.2 million of outstanding letters of credit under the revolving credit facility as of June 30, 2012. As of June 30, 2012, AWCC had \$804.8 million available under our credit facility that we can use to fulfill our short-term liquidity needs, to issue letters of credit and support our \$362.0 million outstanding commercial paper. We can provide no assurances that our lenders will meet their existing commitments or that we will be able to access the commercial paper or loan markets in the future on terms acceptable to us or at all.

**Cash Flows from Operating Activities**

Cash flows from operating activities primarily result from the sale of water and wastewater services and, due to the seasonality of demand, are generally greater during the third quarter of each fiscal year. Cash flows from operating activities for the six months ended June 30, 2012 were \$316.9 million compared to \$262.4 million for the six months ended June 30, 2011.

The following table provides a summary of the major items affecting our cash flows from operating activities for the six months ended June 30, 2012 and 2011:

|   | <b>For the six months ended</b> |             |
|---|---------------------------------|-------------|
|   | <b>June 30,</b>                 |             |
|   | <b>2012</b>                     | <b>2011</b> |
|   | <b>(In thousands)</b>           |             |
| Net income  | \$ 148,780                      | \$ 107,343  |
| Add (subtract):                                     |                                 |             |
| Non-cash operating activities(1)                    | 260,206                         | 306,930     |
| Changes in working capital(2)                       | (29,524)                        | (79,871)    |
| Pension and postretirement healthcare contributions | (62,591)                        | (72,006)    |
| Net cash flows provided by operations               | \$ 316,871                      | \$ 262,396  |

(1) Includes, depreciation and amortization, provision for deferred income taxes, amortization of deferred investment tax credits, provision for losses on utility accounts receivable, allowance for other funds used during construction, (gain) loss on asset dispositions and purchases, pension and non-pension post retirement benefits expense and other non-cash items. Details of each component can be found in the Consolidated Statements of Cash Flows.

(2) Changes in working capital include changes to accounts receivable and unbilled utility revenue, taxes receivable including income taxes, other current assets, accounts payable, taxes accrued (including income taxes), interest accrued, book overdraft and other current liabilities. The increase in cash flows from operations for the six months ended June 30, 2012 compared to the same period in 2011 is primarily driven by the increase in operating revenues and the changes in working capital.

*Cash Flows from Investing Activities*

The following table provides information regarding cash flows used in investing activities for the periods indicated:



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|  | For the six months ended<br>June 30, |                     |
|--|--------------------------------------|---------------------|
|  | 2012                                 | 2011                |
|  | (In thousands)                       |                     |
| Net capital expenditures   | \$ (476,300)                         | \$ (391,792)        |
| Proceeds from sale of assets and securities                      | 560,010                              | 6,657               |
| Acquisitions   | (44,293)                             | (4,769)             |
| Other investing activities, net(1)                               | (9,748)                              | 14,479              |
| <b>Net cash flows provided by (used in) investing activities</b> | <b>\$ 29,669</b>                     | <b>\$ (375,425)</b> |

(1) Includes removal costs from property, plant and equipment retirements, net and net funds released.

Cash flows provided by investing activities for the six months ended June 30, 2012 was \$29.7 million compared to cash flows used in investing activities of \$375.4 million for the six months ended June 30, 2011. The variance from 2011 to 2012 is mainly attributable to the proceeds received from the sale of our Arizona and New Mexico subsidiaries in January 2012. The increase of \$84.5 million in net capital expenditures from 2011 to 2012 is attributable to increased spending on infrastructure replacement programs due to the milder winter weather in the first quarter of 2012 as compared to 2011, an increase in capital spending for our business transformation project and expenditures associated with the replacement of one of our New Jersey water treatment facilities.

**Cash Flows from Financing Activities**

Our financing activities, primarily focused on funding capital expenditures, include the issuance of long-term and short-term debt, primarily through AWCC. We intend to access the capital markets on a regular basis, subject to market conditions. In addition, new infrastructure may be financed with customer advances and contributions for construction (net of refunds).

The following table provides information on long-term debt that was issued during the first six months of 2012:

| Company                | Type   | Interest Rate   | Maturity      |     | Amount<br>(In thousands) |
|------------------------|--|-----------------|---------------|-----|--------------------------|
| Other subsidiaries     | Private activity bonds and<br>government funded debt | 0.00%-<br>5.00% | 2013-<br>2041 | (a) | \$ 68,746                |
| Other subsidiaries     | Private activity bonds and<br>government funded debt | 1.00%-<br>2.41% | 2029-<br>2032 | (b) | \$ 14,730                |
| <b>Total issuances</b> |  |                 |               |     | <b>\$ 83,476</b>         |

(a) Proceeds from these issuances were received from New Jersey Environmental Infrastructure Trust and will be used to fund certain specific projects. The proceeds are kept in Trust pending our certification that we have incurred qualifying expenditures. These issuances have been presented as non-cash on the Consolidated Statements of Cash Flows. Subsequent releases of all or a lesser portion of the funds by the Trust are reflected as the release of restricted funds and are included in investing activities in the Consolidated Statements of Cash Flows.

(b) Proceeds from these issuances were received from the Pennsylvania Infrastructure Investment Authority and funded specified projects.

Also, in the second quarter of 2012, and in connection with the acquisition of our additional subsidiaries in New York, we assumed debt of \$25.2 million with coupon rates of 5.00% to 6.00% and maturity dates ranging from 2015 to 2035.

The following long-term debt was retired through optional redemption, sinking fund provisions or payment at maturity during the first six months of 2012:

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| <b>Company</b>                           | <b>Type</b>                                       | <b>Interest Rate</b> | <b>Maturity</b> | <b>Amount<br/>(In thousands)</b> |
|--|---|----------------------|-----------------|----------------------------------|
| Other subsidiaries                       | Mortgage bonds fixed rate                         | 7.95%                | 2012            | \$ 4,200                         |
| Other subsidiaries                       | Private activity bonds and government funded debt | 0.00%-5.90%          | 2012-2041       | 153,775                          |
| Other subsidiaries                       | Mandatory redeemable preferred stock              | 4.60%-6.00%          | 2013-2019       | 1,100                            |
| Other                                    | Capital leases and other                          |                      |                 | 213                              |
| <b>Total retirements and redemptions</b> |   |                      |                 | <b>\$ 159,288</b>                |

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Included in the long-term debt redemptions/retirements is \$4.2 million related to our previously held Ohio subsidiary, which was classified in discontinued operations prior to its divestiture.

During the second quarter of 2012, we issued notices of redemption for \$150.4 million of outstanding bonds with original maturity dates ranging from 2026 to 2038 and interest rates ranging from 5.25% to 5.90%. These bonds were redeemed at various dates in the second quarter. Additionally, on July 2, 2012, we redeemed \$86.1 million of outstanding bonds with original maturity dates of 2028 to 2029 and interest rates ranging from 5.00% to 5.10%. In addition, on July 6, 2012 we redeemed \$2.8 million of preferred stock without mandatory redemption requirements with interest rates ranging from 5.00% to 5.75%. Both the July, 2012 redemptions as well as those occurring in the second quarter were made using commercial paper borrowing.

From time to time, and as market conditions warrant, we may engage in additional long-term debt retirements via tender offers, open market repurchases or other viable transactions.

**Credit Facilities and Short-Term Debt**

The components of short-term debt at June 30, 2012 were as follows:

|                       | Amount<br>(In thousands) |
|-----------------------|--------------------------|
| Commercial paper, net | \$ 361,972               |
| Total short-term debt | \$ 361,972               |

The following table provides information as of June 30, 2012, regarding letters of credit sub-limits under our revolving credit facility and available funds under the revolving credit facility, as well as outstanding amounts of commercial paper and borrowings under the revolving credit facilities.

|               | Credit Facility<br>Commitment | Available<br>Credit Facility<br>Capacity | Letter of Credit<br>Sub-limit | Available<br>Letter of Credit<br>Capacity | Outstanding<br>Commercial<br>Paper<br>(Net of Discount) | Credit<br>Line<br>Borrowings |
|---------------|-------------------------------|--|-------------------------------|---|---|------------------------------|
|               | (In thousands)                |  |                               |   |   |                              |
| June 30, 2012 | \$ 840,000                    | \$ 804,845                               | \$ 150,000                    | \$ 114,845                                | \$ 361,972  | \$ 0                         |

Interest rates on advances under the revolving credit facility are based on either prime rate or LIBOR, plus an applicable margin based upon our credit ratings, as well as total outstanding amounts under the facility at the time of the borrowing. The current spread over LIBOR is 22.5 basis points and the maximum spread over LIBOR under our revolving credit facility is 55 basis points.

The weighted-average interest rate on short-term borrowings for the six months ended June 30, 2012 was approximately 0.51% compared to 0.39% for the six months ended June 30, 2011.

**Capital Structure**

The following table provides information regarding our capital structure for the periods presented:

|  | At<br>June 30, 2012 | At<br>December 31, 2011 |
|--|---------------------|-------------------------|
| Common stockholders equity and preferred stock without mandatory redemption rights | 43%                 | 42%                     |
|  | 52%                 | 53%                     |

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Long-term debt and redeemable preferred stock at redemption value

|   |      |      |
|---|------|------|
| Short-term debt and current portion of long-term debt | 5%   | 5%   |
|   | 100% | 100% |

### ***Debt Covenants***

Our debt agreements contain financial and non-financial covenants. To the extent that we are not in compliance, we or our subsidiaries may be restricted in our ability to pay dividends, issue new debt or access our revolving credit facility. We were in compliance with our covenants as of June 30, 2012. Our failure to comply with restrictive covenants under our credit facility could accelerate repayment obligations. Our long-term debt indentures contain a number of covenants that, among other things, limit the Company from issuing debt secured by the Company's assets, subject to certain exceptions.

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Certain long-term notes and the revolving credit facility require us to maintain a ratio of consolidated debt to consolidated capitalization of not more than 0.70 to 1.00. As of June 30, 2012, our ratio was 0.57 and therefore we were in compliance with the covenant.

**Security Ratings**

Our access to the capital markets, including the commercial paper market, and respective financing costs in those markets, is directly affected by securities ratings of the entity that is accessing the capital markets. We primarily access the capital markets, including the commercial paper market, through AWCC. However, we also issue debt through our regulated subsidiaries, primarily in the form of tax exempt securities, to lower our overall cost of debt.

On January 30, 2012, Standard & Poor's Ratings Service, which we refer to as S&P, reaffirmed its BBB+ corporate credit rating on AWCC and American Water and AWCC's A2 short-term rating. On June 18, 2012, S&P revised its rating outlook for American Water and AWCC to positive from stable. Moody's rating outlook for both American Water and AWCC continues to be stable. The following table shows the Company's securities ratings as of June 30, 2012:

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

A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating agency, and each rating should be evaluated independently of any other rating. Security ratings are highly dependent upon our ability to generate cash flows in an amount sufficient enough to service our debt and meet our investment plans. We can provide no assurances that our ability to generate cash flows is sufficient to maintain our existing ratings. None of our borrowings are subject to default or prepayment as a result of the downgrading of these security ratings, although such a downgrading could increase fees and interest charges under our credit facilities.

As part of the normal course of business, we routinely enter into contracts for the purchase and sale of water, energy, fuels and other services. These contracts either contain express provisions or otherwise permit us and our counterparties to demand adequate assurance of future performance when there are reasonable grounds for doing so. In accordance with the contracts and applicable contract law, if we are downgraded by a credit rating agency, especially if such downgrade is to a level below investment grade, it is possible that a counterparty would attempt to rely on such a downgrade as a basis for making a demand for adequate assurance of future performance, which could include a demand that we provide collateral to secure our obligations. We do not expect that our posting of collateral would have a material adverse impact on our results of operations, financial position or cash flows.

**Dividends**

Our board of directors has adopted a dividend policy to distribute to our shareholders a portion of our net cash provided by operating activities as regular quarterly dividends, rather than retaining that cash for other purposes. Since the dividends on our common stock will not be cumulative, only declared dividends will be paid.

In March and June 2012, the Company made cash dividend payments of \$0.23 per share to all shareholders of record as February 3, 2012 and April 20, 2012, respectively. In March 2011 and June 2011, the Company made cash dividend payments of \$0.22 per share to all shareholders of record as of February 18, 2011 and May 18, 2011, respectively.

On May 11, 2012, our board of directors declared a quarterly cash dividend payment of \$0.25 per share payable on September 3, 2012 to all shareholders of record as of July 6, 2012. As of June 30, 2012, these dividends totaling \$44.1 million had been accrued in other current liabilities on the accompanying Consolidated Balance Sheets.

**Market Risk**

There have been no significant changes to our market risk since December 31, 2011. For a discussion of our exposure to market risk, refer to Part II, Item 7A. Quantitative and Qualitative Disclosures about Market Risk, contained in our Annual Report on Form 10-K for the year ended December 31, 2011.

*Application of Critical Accounting Policies and Estimates*

Our financial condition, results of operations and cash flows are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. See Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates, in our Form 10-K for the year ended December 31, 2011 filed with the SEC for a discussion of our critical accounting policies.

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

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

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are subject to market risks in the normal course of business, including changes in interest rates and equity prices. For further discussion of market risks see Market Risk in Part I, Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations.

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

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

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

Our management, including the Chief Executive Officer and the Chief Financial Officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) of the Exchange Act) as of June 30, 2012 pursuant to 15d-15(e) under the Exchange Act.

Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of June 30, 2012, our disclosure controls and procedures were effective at a reasonable level of assurance. Our disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

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

There have been no changes in our internal control over financial reporting that occurred during the three months ended June 30, 2012, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

As noted under *Business Transformation Project* in Part I, Item 2- Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-Q, we have undertaken a project with the goals of increasing our operating efficiency and effectiveness and controlling the costs associated with the operation of our business, all of which are important to providing quality service to our customers and communities we serve. The focus of the project is the implementation of Enterprise Resource Planning systems, which encompass applications that will handle human resources, finance and supply chain/procurement management; an Enterprise Asset Management system, which will handle the management of asset lifecycles; and a Customer Information system. The project is reasonably likely to materially affect our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

The following information updates and amends the information provided in the Company's annual report on Form 10-K for the year ended December 31, 2011 (the Form 10-K) in Part I, Item 3, Legal Proceedings, and in the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2012 (the Form 10-Q) in Part II, Item 1, ( Legal Proceedings ).

#### ***Alternative Water Supply in Lieu of Carmel River Diversions***

As described in the Form 10-K, the California State Water Resources Control Board (the State Water Board) adopted a Cease and Desist Order applicable to California-American Water Company (CAWC) on October 20, 2009 (the 2009 Order), and CAWC appealed the 2009 Order

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to the Superior Court of California, challenging the findings and requirements of the 2009 Order. In July 2012, CAWC, the State Water Board, and other parties to CAWC's action and a related action entered into a Stipulation For Dismissal, Without Prejudice, Agreement to Toll Statute of Limitations and Proposed Order (the Stipulation). Under the Stipulation, the actions against the State Water Board generally would be dismissed without prejudice and, subject to limited exceptions, CAWC and the other parties could not initiate a civil action for judicial review of the 2009 Order prior to August 1, 2013. In addition, the statute of limitations related to any future judicial review of the 2009 Order as to claims alleged in the CAWC's appeal of the 2009 Order and in a related action would be tolled. From CAWC's perspective, the Stipulation would enable it to focus its efforts on providing a viable alternative water supply in lieu of diversions from the Carmel River, while retaining its right to seek judicial review of the 2009 Order in the future, if necessary. Although not required, the Stipulation has been submitted to the Superior Court for its approval. If the Superior Court does not approve the Stipulation, CAWC will reassess its position with respect to the Stipulation.

As also described in the Form 10-K, CAWC filed a petition (the Petition) with the California Public Utilities Commission (CPUC) seeking clarification that it may go forward with constructing four pipelines and two pump stations (the Ancillary Facilities), regardless of the status of the Regional Desalination Project (the Project) that was to be implemented through a Water Purchase Agreement (WPA) and ancillary agreements (the Agreements) among the Marina Coast Water District (MCWD), the Monterey County Water Resources Agency (MCWRA) and CAWC. In addition, as described in the Form 10-Q, CAWC filed an application with the CPUC for approval of the Monterey Peninsula Water Supply Project (the New Project). The New Project involves construction of a desalination plant and related facilities, all to be owned by CAWC. In addition, the New Project may encompass CAWC's purchase of water from the proposed Monterey Peninsula Groundwater Replenishment Project, a joint project between the Monterey Regional Water Pollution Control Agency and the Monterey Peninsula Water Management District (MPWMD). The New Project also would involve aquifer storage and recovery through an already established aquifer storage and recovery program between CAWC and the MPWMD.

On April 23, 2012, CAWC filed a withdrawal of the Petition, stating that the application for the New Project renders the Petition moot. The CPUC treated the withdrawal as a motion to withdraw and, on July 12, 2012, granted the motion and closed the proceedings relating to the Project. In its decision, the CPUC stated that there may be costs that have been incurred with respect to the Project that may be recoverable in rates, but that it would examine the recoverability of such costs in other proceedings.

As noted in the Form 10-Q, CAWC's ability to move forward on the New Project will be subject to extensive administrative review. In addition, a large number of federal, state and local approvals must be obtained, and other possible impediments, including a Monterey County (County) ordinance limiting sponsorship of a desalination project to government-owned enterprises, must be addressed.

On June 21, 2012, counsel for CAWC sent a letter to the County Counsel of Monterey County stating that, because CAWC is a CPUC-regulated water utility and a public water system regulated by the California Department of Public Health, the ordinance is not enforceable against CAWC. In the letter, CAWC counsel requested that the County Board of Supervisors (Board of Supervisors) decide, at its meeting on June 26, 2012, that the ordinance does not apply to and may not be enforced against the desalination facility proposed by CAWC as part of the New Project. Counsel for CAWC added that if the Board of Supervisors decided otherwise or declined to make a decision, CAWC would file suit against the County to resolve the issue. In response, on June 26, 2012, the County filed a complaint for declaratory relief against CAWC and others, in the California Superior Court in and for the County of San Francisco. In its complaint, the County asserts, among other things, that the ordinance applies to CAWC. The County seeks a declaration of the parties' rights and duties with regard to the application of the ordinance to CAWC and CAWC's right to lawfully operate a desalination facility in the County without a permit from the County's Director of Environmental Health. The matter is pending.

We cannot assure you that CAWC's application for the New Project will be approved or that the New Project will be completed.

### ***San Clemente Dam***

As noted in the Form 10-K, CAWC challenged the Proposed Decision, as revised (the PD), of the administrative law judge assigned to CAWC's application for approval of the Carmel River Reroute and San Clemente Dam Removal Project (the Dam Project). As also noted in the Form 10-Q, a CPUC Commissioner subsequently issued an Alternate Proposed Decision (the Alternate PD) that includes significant changes from the PD.

On June 21, 2012, the PUC issued a Decision approving the Dam Project that is substantially similar to the Alternate PD. Specifically, the decision provides for rate recovery by CAWC of the \$49 million in prospective costs over a 20 year period: CAWC may file an application with the CPUC to increase the amount of costs subject to rate recovery if project costs exceed \$49 million. In addition, the Decision permits CAWC to earn its full rate of equity return on this investment by allowing CAWC to draw interest at its authorized cost of capital, which includes both the debt and equity rates set by the CPUC. While the \$49 million to be recovered by CAWC would be offset by tax benefits derived by CAWC's donation of certain land, the offset will not apply to a parcel being used for utility purposes and which is not part of the Dam Project. In addition, the Decision permits CAWC's rate recovery of approximately \$27 million in historical costs. The Decision places all authorized and estimated costs in a regulatory asset/balancing account and provides for recovery of the regulatory asset/balancing account over a twenty-year period beginning July 1, 2012. The decision also finds that CAWC did not make a misrepresentation regarding descriptions of the use of the dam as a point of water diversion.



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On July 27, 2012, the Division of Ratepayer Advocates of the CPUC (the DRA ) filed an application for rehearing of the Decision. While supporting the Dam Project, the DRA challenged the portion of the Decision authorizing CAWC to earn a full rate of return on expenses of the Dam Project. The CPUC has not yet ruled on the DRA s application.

### ***Other Matters***

On June 29, 2012, a pipe bridge that supported three pipes carrying raw and treated water to and from the New Jersey American Water ( NJAW ) Monmouth County Swimming River Treatment plant collapsed, substantially reducing the plant s capacity. This plant provides approximately 50% of the total capacity needed to meet maximum day demands for NJAW s Coastal North system, which serves 95,000 customers: other sources provide the remaining capacity. An estimated 200 to 300 customers at the highest elevations of the service area were left without water service for a six hour period on June 30, and the drop in water pressure resulted in the declaration of a state of emergency by Monmouth County and a precautionary boil water advisory for all customers served by the system. NJAW distributed 51,000 cases of bottled water to its customers in the system. Emergency, temporary piping across a road bridge was constructed and substantial capacities were restored by July 1, at which time the boil water advisory was lifted. Full plant capacity completed on July 4, and the state of emergency was lifted on July 9.

NJAW has retained a forensic engineer to conduct an assessment as to the cause of the bridge collapse. The New Jersey Board of Public Utilities (the BPU ) has directed NJAW to preserve documents and damaged portions of the bridge and piping pending an investigation that the BPU will be undertaking. The BPU also has advised NJAW that it will be directing NJAW to retain a special reliability master to conduct that investigation and present findings to the BPU. We are unable to predict the outcome of the assessment and investigations at this early stage. NJAW is cooperating fully with the BPU.

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**ITEM 1A. RISK FACTORS**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in the "Risk Factors" in the Company's Form 10-K for the year ended December 31, 2011, and our other public filings, which could materially affect our business, financial condition or future results. There have been no material changes from risk factors previously disclosed in "Risk Factors" in the Company's Form 10-K for the year ended December 31, 2011.

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

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4. MINE SAFETY DISCLOSURES**

None

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

**Exhibit**

| <b>Number</b> | <b>Exhibit Description</b>  |
|---------------|---|
| *10.1         | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2012 Form of Stock Unit Grant Agreement for Non-Employee Directors   |
| *31.1         | Certification of Jeffrey Sterba, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act   |
| *31.2         | Certification of Ellen C. Wolf, Senior Vice President and Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act  |
| *32.1         | Certification of Jeffrey Sterba, President and Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act   |
| *32.2         | Certification of Ellen C. Wolf, Senior Vice President and Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act  |
| 101           | The following financial statements from American Water Works Company, Inc.'s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2012, filed with the Securities and Exchange Commission on August 2, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations and Comprehensive Income; (iii) the Consolidated Statements of Cash Flows; (iv) the Consolidated Statements of Changes in Stockholders' Equity; and (v) the Notes to Consolidated Financial Statements. |

\* filed herewith.

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**Signatures**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 2nd day of August, 2012.

American Water Works Company, Inc.

(Registrant)

/s/ Jeffry Sterba

Jeffry Sterba

President and Chief Executive Officer

(Principal Executive Officer)

/s/ Ellen C. Wolf

Ellen C. Wolf

Senior Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)

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| * filed herewith. |  |