

AQUA AMERICA INC
Form 10-Q
November 05, 2010

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON DC 20549
FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended September 30, 2010

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

For the transition period from _____ to _____

Commission File Number 1-6659

AQUA AMERICA, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania

23-1702594

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

762 W. Lancaster Avenue, Bryn Mawr, Pennsylvania

19010 -3489

(Address of principal executive offices)

(Zip Code)

(610) 527-8000

(Registrant's telephone number, including area code)

(Former Name, former address and former fiscal year, if changed since last report.)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer
(do not check if a smaller reporting company)

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of October 26, 2010: 137,540,249.

AQUA AMERICA, INC. AND SUBSIDIARIES
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Exhibit 32.1

Exhibit 32.2

EX-101 INSTANCE DOCUMENT

EX-101 SCHEMA DOCUMENT

EX-101 CALCULATION LINKBASE DOCUMENT

EX-101 LABELS LINKBASE DOCUMENT

EX-101 PRESENTATION LINKBASE DOCUMENT

EX-101 DEFINITION LINKBASE DOCUMENT

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Item 1. Financial StatementsAQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands of dollars, except per share amounts)
(UNAUDITED)

| | September 30, 2010 | December 31, 2009 |
|---|-----------------------|----------------------|
| Assets | | |
| Property, plant and equipment, at cost | \$ 4,389,159 | \$ 4,141,690 |
| Less: accumulated depreciation | 991,859 | 914,396 |
| Net property, plant and equipment | 3,397,300 | 3,227,294 |
| Current assets: | | |
| Cash and cash equivalents | 13,554 | 21,869 |
| Accounts receivable and unbilled revenues, net | 96,467 | 78,742 |
| Income tax receivable | 18,365 | 0 |
| Inventory, materials and supplies | 10,013 | 9,519 |
| Prepayments and other current assets | 10,766 | 11,441 |
| Total current assets | 149,165 | 121,571 |
| Regulatory assets | 219,396 | 226,351 |
| Deferred charges and other assets, net | 63,441 | 59,468 |
| Funds restricted for construction activity | 42,329 | 84,830 |
| Goodwill | 41,651 | 43,083 |
| | \$ 3,913,282 | \$ 3,762,597 |
| Liabilities and Equity | | |
| Aqua America stockholders' equity: | | |
| Common stock at \$.50 par value, authorized 300,000,000 shares, issued 138,191,194 and 137,148,749 in 2010 and 2009 | \$ 69,095 | \$ 68,574 |
| Capital in excess of par value | 658,563 | 642,786 |
| Retained earnings | 423,621 | 409,402 |
| Treasury stock, at cost, 678,572 and 662,410 shares in 2010 and 2009 | (12,403) | (12,138) |
| Accumulated other comprehensive income | 124 | 280 |
| Total Aqua America stockholders' equity | 1,139,000 | 1,108,904 |
| Noncontrolling interest | 565 | 560 |
| Total equity | 1,139,565 | 1,109,464 |

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| | | |
|--|--------------|--------------|
| Long-term debt, excluding current portion | 1,450,338 | 1,386,557 |
| Commitments and contingencies | | |
| Current liabilities: | | |
| Current portion of long-term debt | 12,805 | 59,577 |
| Loans payable | 69,472 | 27,487 |
| Accounts payable | 36,540 | 57,862 |
| Accrued interest | 19,161 | 16,265 |
| Accrued taxes | 17,504 | 18,813 |
| Dividends payable | 21,314 | 0 |
| Other accrued liabilities | 29,782 | 21,003 |
| Total current liabilities | 206,578 | 201,007 |
| Deferred credits and other liabilities: | | |
| Deferred income taxes and investment tax credits | 446,641 | 408,583 |
| Customers' advances for construction | 68,592 | 76,913 |
| Regulatory liabilities | 32,789 | 28,812 |
| Other | 113,557 | 114,490 |
| Total deferred credits and other liabilities | 661,579 | 628,798 |
| Contributions in aid of construction | 455,222 | 436,771 |
| | \$ 3,913,282 | \$ 3,762,597 |

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

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AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(In thousands, except per share amounts)
(UNAUDITED)

| | Nine Months Ended September 30, | |
|---|------------------------------------|------------|
| | 2010 | 2009 |
| Operating revenues | \$ 546,758 | \$ 502,646 |
| Operating expenses: | | |
| Operations and maintenance | 209,879 | 204,026 |
| Depreciation | 80,433 | 76,795 |
| Amortization | 10,115 | 8,848 |
| Taxes other than income taxes | 39,985 | 35,892 |
| | 340,412 | 325,561 |
| Operating income | 206,346 | 177,085 |
| Other expense (income): | | |
| Interest expense, net | 56,084 | 50,693 |
| Allowance for funds used during construction | (4,079) | (1,940) |
| Gain on sale of other assets | (2,330) | (375) |
| Income before income taxes | 156,671 | 128,707 |
| Provision for income taxes | 61,554 | 51,013 |
| Net income attributable to common shareholders | \$ 95,117 | \$ 77,694 |
| Net income attributable to common shareholders | \$ 95,117 | \$ 77,694 |
| Other comprehensive income, net of tax: | | |
| Unrealized holding gain on investments | 1,174 | 127 |
| Reclassification adjustment for (gains) losses reported in net income | (1,330) | 5 |
| Comprehensive income | \$ 94,961 | \$ 77,826 |
| Net income per common share: | | |
| Basic | \$ 0.70 | \$ 0.57 |
| Diluted | \$ 0.69 | \$ 0.57 |
| Average common shares outstanding during the period: | | |
| Basic | 136,798 | 135,673 |

| | | |
|--|---------|---------|
| Diluted | 137,112 | 136,006 |
| Cash dividends declared per common share | \$ 0.59 | \$ 0.55 |

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

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AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(In thousands, except per share amounts)
(UNAUDITED)

| | Three Months Ended September 30, | |
|--|-------------------------------------|------------|
| | 2010 | 2009 |
| Operating revenues | \$ 207,797 | \$ 180,826 |
| Operating expenses: | | |
| Operations and maintenance | 72,968 | 68,488 |
| Depreciation | 27,431 | 25,436 |
| Amortization | 3,629 | 3,029 |
| Taxes other than income taxes | 14,182 | 12,418 |
| | 118,210 | 109,371 |
| Operating income | 89,587 | 71,455 |
| Other expense (income): | | |
| Interest expense, net | 19,150 | 17,256 |
| Allowance for funds used during construction | (1,077) | (747) |
| Gain on sale of other assets | (291) | (162) |
| Income before income taxes | 71,805 | 55,108 |
| Provision for income taxes | 28,054 | 21,638 |
| Net income attributable to common shareholders | \$ 43,751 | \$ 33,470 |
| Net income attributable to common shareholders | \$ 43,751 | \$ 33,470 |
| Other comprehensive income, net of tax: | | |
| Unrealized holding gain (loss) on investments | 272 | (142) |
| Comprehensive income | \$ 44,023 | \$ 33,328 |
| Net income per common share: | | |
| Basic | \$ 0.32 | \$ 0.25 |
| Diluted | \$ 0.32 | \$ 0.25 |
| Average common shares outstanding during the period: | | |
| Basic | 137,095 | 135,975 |

| | | |
|--|---------|---------|
| Diluted | 137,394 | 136,260 |
| Cash dividends declared per common share | \$ 0.30 | \$ 0.28 |

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

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

| | September 30, 2010 | December 31, 2009 | |
|---|-----------------------|----------------------|---------------|
| Aqua America stockholders' equity: | | | |
| Common stock, \$.50 par value | \$ 69,095 | \$ 68,574 | |
| Capital in excess of par value | 658,563 | 642,786 | |
| Retained earnings | 423,621 | 409,402 | |
| Treasury stock, at cost | (12,403) | (12,138) | |
| Accumulated other comprehensive income | 124 | 280 | |
| Total Aqua America stockholders' equity | 1,139,000 | 1,108,904 | |
| Noncontrolling interest | 565 | 560 | |
| Total equity | 1,139,565 | 1,109,464 | |
| Long-term debt: | | | |
| Long-term debt of subsidiaries (substantially secured by utility plant): | | | |
| Interest Rate Range | Maturity Date Range | | |
| 0.00% to 0.99% | 2012 to 2034 | 6,420 | 6,868 |
| 1.00% to 1.99% | 2011 to 2035 | 21,057 | 21,917 |
| 2.00% to 2.99% | 2019 to 2029 | 13,626 | 12,935 |
| 3.00% to 3.99% | 2016 to 2025 | 26,568 | 28,455 |
| 4.00% to 4.99% | 2020 to 2041 | 269,967 | 271,346 |
| 5.00% to 5.99% | 2011 to 2043 | 384,794 | 384,694 |
| 6.00% to 6.99% | 2011 to 2036 | 121,587 | 121,876 |
| 7.00% to 7.99% | 2012 to 2025 | 30,432 | 31,236 |
| 8.00% to 8.99% | 2021 to 2025 | 34,332 | 34,543 |
| 9.00% to 9.99% | 2011 to 2026 | 45,228 | 69,983 |
| 10.40% | 2018 | 6,000 | 6,000 |
| | | 960,011 | 989,853 |
| Notes payable to bank under revolving credit agreement, variable rate, due May 2012 | | 68,000 | 64,149 |
| Unsecured notes payable: | | | |
| Notes ranging from 4.62% to 4.87%, due 2013 through 2024 | | 193,000 | 185,000 |
| Notes ranging from 5.01% to 5.95%, due 2014 through 2037 | | 242,132 | 207,132 |
| Current portion of long-term debt | | 1,463,143 | 1,446,134 |
| | | 12,805 | 59,577 |

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| | | |
|---|--------------|--------------|
| Long-term debt, excluding current portion | 1,450,338 | 1,386,557 |
| Total capitalization | \$ 2,589,903 | \$ 2,496,021 |

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

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AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF EQUITY
(In thousands of dollars)
(UNAUDITED)

| | Common Stock | Capital in Excess of Par Value | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Noncontrolling Interest | Total |
|--|-----------------|--------------------------------------|----------------------|-------------------|---|----------------------------|--------------|
| Balance at December 31, 2009 | \$ 68,574 | \$ 642,786 | \$ 409,402 | \$ (12,138) | \$ 280 | \$ 560 | \$ 1,109,464 |
| Net income | 0 | 0 | 95,117 | 0 | 0 | 5 | 95,122 |
| Unrealized holding gain on investments, net of income tax of \$632 | 0 | 0 | 0 | 0 | 1,174 | 0 | 1,174 |
| Reclassification adjustment for gain reported in net income, net of income tax of \$716 | 0 | 0 | 0 | 0 | (1,330) | 0 | (1,330) |
| Dividends paid | 0 | 0 | (59,584) | 0 | 0 | 0 | (59,584) |
| Dividends declared | 0 | 0 | (21,314) | 0 | 0 | 0 | (21,314) |
| Sale of stock (543,506 shares) | 259 | 8,550 | 0 | 479 | 0 | 0 | 9,288 |
| Repurchase of stock (41,255 shares) | 0 | 0 | 0 | (744) | 0 | 0 | (744) |
| Equity compensation plan (196,688 shares) | 98 | (98) | 0 | 0 | 0 | 0 | 0 |
| Exercise of stock options (327,344 shares) | 164 | 3,725 | 0 | 0 | 0 | 0 | 3,889 |
| Stock-based compensation | 0 | 3,095 | 0 | 0 | 0 | 0 | 3,095 |
| Employee stock plan tax benefits | 0 | 505 | 0 | 0 | 0 | 0 | 505 |
| Balance at September 30, 2010 | \$ 69,095 | \$ 658,563 | \$ 423,621 | \$ (12,403) | \$ 124 | \$ 565 | \$ 1,139,565 |

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

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AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOW
(In thousands of dollars)
(UNAUDITED)

| | Nine Months Ended September 30, | |
|--|------------------------------------|-----------|
| | 2010 | 2009 |
| Cash flows from operating activities: | | |
| Net income attributable to common shareholders | \$ 95,117 | \$ 77,694 |
| Adjustments to reconcile net income attributable to common shareholders to net cash flows from operating activities: | | |
| Depreciation and amortization | 90,548 | 85,643 |
| Deferred income taxes | 35,557 | 33,608 |
| Provision for doubtful accounts | 3,556 | 4,608 |
| Stock-based compensation | 3,095 | 2,714 |
| Gain on sale of utility system | 0 | (1,009) |
| Gain on sale of other assets | (2,330) | (375) |
| Net increase in receivables, inventory and prepayments | (19,867) | (6,091) |
| Net decrease in payables, accrued interest, accrued taxes and other accrued liabilities | (13,179) | (9,332) |
| Other | (3,119) | (6,555) |
| Net cash flows used in operating activities | 189,378 | 180,905 |
| Cash flows from investing activities: | | |
| Property, plant and equipment additions, including allowance for funds used during construction of \$4,079 and \$1,940 | (239,467) | (194,886) |
| Acquisitions of utility systems and other, net | (1,948) | (1,523) |
| Additions to funds restricted for construction activity | (1,051) | (59,722) |
| Release of funds previously restricted for construction activity | 43,552 | 74,016 |
| Net proceeds from the sale of utility system and other assets | 3,582 | 1,985 |
| Other | (4,438) | (3,504) |
| Net cash flows used in investing activities | (199,770) | (183,634) |
| Cash flows from financing activities: | | |
| Customers' advances and contributions in aid of construction | 5,682 | 3,852 |
| Repayments of customers' advances | (5,203) | (2,070) |
| Net proceeds (repayments) of short-term debt | 41,985 | (4,043) |
| Proceeds from long-term debt | 114,313 | 69,833 |
| Repayments of long-term debt | (97,678) | (6,505) |
| Change in cash overdraft position | (10,173) | (10,449) |
| Proceeds from issuing common stock | 9,288 | 8,776 |
| Proceeds from exercised stock options | 3,889 | 1,579 |
| Stock-based compensation windfall tax benefits | 302 | 98 |
| Repurchase of common stock | (744) | (302) |
| Dividends paid on common stock | (59,584) | (54,969) |
| Net cash flows from financing activities | 2,077 | 5,800 |

| | | |
|--|-----------|-----------|
| Net (decrease) increase in cash and cash equivalents | (8,315) | 3,071 |
| Cash and cash equivalents at beginning of period | 21,869 | 14,944 |
| Cash and cash equivalents at end of period | \$ 13,554 | \$ 18,015 |

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

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

Note 1 Basis of Presentation

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

Note 2 Goodwill

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

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

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

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

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

Note 3 Dispositions

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

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

Note 4 Long-term Debt and Loans Payable

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

Note 5 Fair Value of Financial Instruments

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

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

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

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

Note 6 Net Income per Common Share

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

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

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

Note 7 Stock-based Compensation

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

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

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

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

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

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

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

The following table summarizes stock option transactions for the nine months ended September 30, 2010:

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

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

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

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

Note 8 Pension Plans and Other Postretirement Benefits

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

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

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

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

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

Note 9 Water and Wastewater Rates

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

Note 10 Taxes Other than Income Taxes

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

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

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

Note 11 Segment Information

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

The following tables present the Company's segment information:

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

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

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

| | September 30, 2010 | December 31, 2009 |
|------------------------|-----------------------|----------------------|
| Total assets: | | |
| Regulated | \$ 3,833,263 | \$ 3,689,689 |
| Other and eliminations | 80,019 | 72,908 |
| Consolidated | \$ 3,913,282 | \$ 3,762,597 |

Note 12 Recent Accounting Pronouncements

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

Note 13 Commitments and Contingencies

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

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

(In thousands of dollars, except per share amounts)

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

Forward-looking Statements

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

General Information

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

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

(In thousands of dollars, except per share amounts)

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

Financial Condition

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

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

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

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

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

(In thousands of dollars, except per share amounts)

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

Results of Operations

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

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

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

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

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

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

(In thousands of dollars, except per share amounts)

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

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

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

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

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

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

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FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

(In thousands of dollars, except per share amounts)

Results of Operations

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

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

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

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

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

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

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

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

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(In thousands of dollars, except per share amounts)

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

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

Impact of Recent Accounting Pronouncements

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

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AQUA AMERICA, INC. AND SUBSIDIARIES

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

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

(b) Changes in Internal Control over Financial Reporting

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

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AQUA AMERICA, INC. AND SUBSIDIARIES

Part II. Other Information

Item 1. Legal Proceedings

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

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

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AQUA AMERICA, INC. AND SUBSIDIARIES

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

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

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

Item 1A. Risk Factors

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

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AQUA AMERICA, INC. AND SUBSIDIARIES

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

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

Issuer Purchases of Equity Securities

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

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

stock) upon exercise by delivering to us (and, thus, selling) shares of Aqua America common stock in accordance with the terms of our equity compensation plans that were previously approved by our shareholders and disclosed in our proxy statements. These features of our equity compensation plan are available to all employees who receive stock-based compensation under the plans. We purchased these shares at their fair market value, as determined by reference to the closing price of our common stock on the day of vesting of the restricted stock award or on the day prior to the option exercise.

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

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

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AQUA AMERICA, INC. AND SUBSIDIARIES

Item 6. Exhibits

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

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SIGNATURES

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

November 5, 2010

Aqua America, Inc.

Registrant

/s/ Nicholas DeBenedictis

Nicholas DeBenedictis
Chairman, President and
Chief Executive Officer

/s/ David P. Smeltzer

David P. Smeltzer
Chief Financial Officer

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EXHIBIT INDEX

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