

American Water Works Company, Inc.

Form 424B5

June 01, 2009

**Table of Contents**

**The information in this preliminary prospectus supplement is not complete and may be changed. This preliminary prospectus supplement and the accompanying prospectus are not an offer to sell these securities and are not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

Filed pursuant to Rule 424(b)(5)  
Registration No. 333-158949

*Preliminary Prospectus Supplement to Prospectus dated May 1, 2009*

*Subject to Completion, dated June 1, 2009*

**26,000,000 SHARES**

## **American Water Works Company, Inc.**

### **COMMON STOCK**

We are selling 14,500,000 shares and the selling stockholder is selling 11,500,000 shares of common stock in this offering. We will not receive any of the proceeds from the sale of shares by the selling stockholder.

Our common stock is traded on the New York Stock Exchange under the ticker symbol **AWK**. The last reported sale price of our common stock on May 29, 2009 was \$17.28 per share.

**Investing in our common stock involves risks. See Risk Factors beginning on page S-11 of this prospectus supplement and Item 1A, Risk Factors, of our most recent Annual Report on Form 10-K to read about factors you should consider before buying shares of our common stock.**

**Neither the Securities and Exchange Commission, any state securities commission nor any other regulatory body has approved or disapproved of these securities or passed on the accuracy or adequacy of this prospectus supplement or the accompanying prospectus. Any representation to the contrary is a criminal offense.**

	<b>Per Share</b>	<b>Total</b>
Public offering price	\$	\$
Underwriting discounts and commissions	\$	\$
Proceeds, before expenses, to the Company	\$	\$

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Proceeds, before expenses, to the selling stockholder \$ \$

The underwriters may also purchase up to an additional 3,900,000 shares of common stock from the selling stockholder at the public offering price, less the underwriting discount, within 30 days from the date of this prospectus supplement.

The underwriters have agreed to reimburse the Company and the selling stockholder for certain expenses in connection with this offering. See Underwriting beginning on page S-114 of this prospectus supplement.

The underwriters are offering the shares of our common stock as set forth under Underwriting beginning on page S-114 of this prospectus supplement. The underwriters expect to deliver the shares of common stock against payment therefor in New York, New York on or about , 2009.

**Merrill Lynch & Co.**

**Citi**

**Goldman, Sachs & Co.**

**Morgan Stanley**

**UBS Investment Bank**

**Janney Montgomery Scott**

**Brean Murray, Carret & Co.**

**Boenning & Scattergood, Inc.**

**Blaylock Robert Van, LLC**

**Societe Generale**

Prospectus supplement dated , 2009

**Table of Contents**

**TABLE OF CONTENTS**  
**PROSPECTUS SUPPLEMENT**

<u>ABOUT THIS PROSPECTUS SUPPLEMENT</u>	S-1
<u>WHERE YOU CAN FIND MORE INFORMATION</u>	S-2
<u>PROSPECTUS SUPPLEMENT SUMMARY</u>	S-4
<u>RISK FACTORS</u>	S-11
<u>FORWARD-LOOKING STATEMENTS</u>	S-15
<u>INDUSTRY AND MARKET DATA</u>	S-17
<u>USE OF PROCEEDS</u>	S-18
<u>PRICE RANGE OF COMMON STOCK</u>	S-19
<u>DIVIDEND POLICY</u>	S-20
<u>CAPITALIZATION</u>	S-21
<u>DILUTION</u>	S-22
<u>SELECTED HISTORICAL CONSOLIDATED FINANCIAL DATA</u>	S-23
<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	S-26
<u>BUSINESS</u>	S-80
<u>SELLING STOCKHOLDER</u>	S-108
<u>SHARES ELIGIBLE FOR FUTURE SALE</u>	S-109
<u>MATERIAL UNITED STATES FEDERAL TAX CONSEQUENCES FOR NON-U.S. STOCKHOLDERS</u>	S-111
<u>UNDERWRITING</u>	S-114
<u>VALIDITY OF THE COMMON STOCK</u>	S-119
<u>EXPERTS</u>	S-120
<u>GLOSSARY</u>	S-121

**PROSPECTUS**

<u>ABOUT THIS PROSPECTUS</u>	1
<u>AMERICAN WATER WORKS COMPANY, INC.</u>	1
<u>AMERICAN WATER CAPITAL CORP.</u>	2
<u>RISK FACTORS</u>	2
<u>SPECIAL NOTE ON FORWARD-LOOKING INFORMATION</u>	2
<u>SELLING SECURITY HOLDERS</u>	4
<u>USE OF PROCEEDS</u>	4
<u>RATIO OF EARNINGS TO FIXED CHARGES AND PREFERRED STOCK DIVIDENDS</u>	5
<u>DESCRIPTION OF CAPITAL STOCK</u>	6
<u>DESCRIPTION OF AWCC DEBT SECURITIES AND AMERICAN WATER SUPPORT AGREEMENT</u>	10
<u>DESCRIPTION OF DEPOSITARY SHARES</u>	24
<u>DESCRIPTION OF STOCK PURCHASE CONTRACTS AND STOCK PURCHASE UNITS</u>	27
<u>DESCRIPTION OF SUBSCRIPTION RIGHTS</u>	28
<u>DESCRIPTION OF WARRANTS</u>	30
<u>PLAN OF DISTRIBUTION</u>	31
<u>LEGAL MATTERS</u>	33
<u>EXPERTS</u>	33
<u>WHERE YOU CAN FIND MORE INFORMATION</u>	33

Our regulated subsidiaries are subject to economic regulation by state PUCs in Arizona, California, Hawaii, Illinois, Indiana, Iowa, Kentucky, Maryland, Missouri, New Jersey, New Mexico, New York, Ohio,

**Table of Contents**

Pennsylvania, Tennessee, Texas, Virginia and West Virginia. Some of these states have enacted laws that require regulatory approval for the acquisition of control of any regulated utility. In those states, obtaining control of the parent or any other company that controls a regulated utility also requires prior regulatory approval. The threshold for a change in control is a fact-specific inquiry that varies by state. For example, in some states, a presumption of control will arise when an acquiring party acquires more than 9.9% of the voting securities of the regulated utility or the controlling entity. In addition to ownership, other states may analyze the degree of influence or control an acquiror may exert over the company. Any person acquiring our common stock in this offering or in any other purchase of our common stock in a quantity sufficient to trigger a change in control under state law would need the prior approval of the applicable state PUC.

**Table of Contents**

**ABOUT THIS PROSPECTUS SUPPLEMENT**

All references in this prospectus supplement to American Water, we, our, us and the Company refer to American Water Works Company, Inc. and its consolidated subsidiaries unless the context otherwise requires.

This document is in two parts. The first part is this prospectus supplement, which describes the specific terms of this offering and certain other matters. The second part, the accompanying prospectus, gives more general information about us and our common stock. Generally, when we refer to this prospectus, we are referring to both parts of this document combined. To the extent information in this prospectus supplement conflicts with information in the accompanying prospectus, you should rely on the information in this prospectus supplement. You should rely only on the information contained in, or incorporated by reference in, this prospectus supplement and the accompanying prospectus. Neither we nor the selling stockholder have authorized anyone to provide you with different information.

Neither we nor the selling stockholder are making an offer or sale of these securities in any jurisdiction where the offer or sale is not permitted. The information which appears in this prospectus supplement, the accompanying prospectus and any document incorporated by reference is accurate as of their respective dates. Our business, financial condition, results of operations and prospects may have changed since the date of such information.

**The information contained on or accessible from our website does not constitute a part of this prospectus and is not incorporated by reference herein.**

American Water and its logos are our trademarks. Other service marks, trademarks and trade names referred to in this prospectus are the property of their respective owners.

**Table of Contents**

**WHERE YOU CAN FIND MORE INFORMATION**

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission, which we refer to as the SEC. These SEC filings are available to the public over the Internet at the SEC's website at <http://www.sec.gov> and our website at <http://www.amwater.com>. You may also read and copy any document we file with the SEC at the SEC's public reference room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room.

We have filed a registration statement on Form S-3 under the Securities Act of 1933, as amended, which we refer to as the Securities Act, with the SEC to register the shares of our common stock offered by this prospectus supplement. This prospectus does not contain all the information contained in the registration statement because certain parts of the registration statement are omitted in accordance with the rules and regulations of the SEC. The registration statement and the documents filed as exhibits to the registration statement are available for inspection and copying as described above.

We are incorporating by reference into this prospectus specific documents that we file with the SEC, which means that we can disclose important information to you by referring you to those documents that are considered part of this prospectus. Information that we file subsequently with the SEC will automatically update and supersede this information. We incorporate by reference the documents listed below, and any future documents that we file with the SEC under Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended, which we refer to as the Exchange Act, until the termination of the offerings of all of the securities covered by this prospectus has been completed. This prospectus is part of a registration statement filed with the SEC.

We are incorporating by reference into this prospectus the following documents filed with the SEC (excluding any portions of such documents that have been furnished but not filed for purposes of the Exchange Act):

<b>Filings</b>	<b>Period Covered or Date Filed</b>
Annual Report on Form 10-K, including the portions of our Proxy Statement on Schedule 14A filed on March 26, 2009 that are incorporated by reference therein	Year ended December 31, 2008
Quarterly Report on Form 10-Q	Quarter ended March 31, 2009
Current Reports on Form 8-K (other than the portions not deemed to be filed)	Filed on February 26, 2009 and on May 12, 2009

We will provide to each person, including any beneficial owner, to whom this prospectus supplement and the accompanying prospectus is delivered, upon written or oral request and without charge, a copy of the documents referred to above that we have incorporated in this prospectus by reference. You can request copies of such documents if you call or write us at the following address or telephone number: American Water Works Company, Inc., 1025 Laurel Oak Road, Voorhees, New Jersey 08043, Attention: General Counsel, (856) 346-8200.

This prospectus supplement and the accompanying prospectus contain summaries of certain agreements that we have filed as exhibits to various SEC filings, as well as certain agreements that we will enter into in connection with this offering. The descriptions of these agreements contained in this prospectus or information incorporated by reference herein do not purport to be complete and are subject to, or qualified in their entirety by reference to, the definitive agreements. Copies of the definitive agreements will be made available without charge to you by making a written or oral request to us.

**Table of Contents**

You should rely only upon the information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus or contained in any free writing prospectus prepared by or on behalf of us. We have not authorized anyone to provide you with different information. You should not assume that the information in this document is accurate as of any date other than that on the front cover of this prospectus.

Any statement contained herein or in a document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded for purposes of this prospectus to the extent that a statement contained herein, in any other subsequently filed document which also is or is deemed to be incorporated by reference herein, modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified and superseded, to constitute a part of this prospectus.

S-3

## **Table of Contents**

### **PROSPECTUS SUPPLEMENT SUMMARY**

*This summary highlights information contained elsewhere in this prospectus supplement and the accompanying prospectus. It may not contain all the information that is important to you. You should carefully read this prospectus supplement, the accompanying prospectus and the documents incorporated by reference therein in their entirety before making an investment decision. For the definition of certain terms used in this prospectus supplement and the accompanying prospectus, please refer to the definitions set forth in the section entitled "Glossary."*

#### **Our Company**

American Water Works Company, Inc., a Delaware corporation, is the most geographically diversified as well as the largest, as measured both by operating revenue and population served, investor-owned United States water and wastewater utility company. Our approximately 7,300 employees provide approximately 15 million people with drinking water, wastewater and other water-related services in 32 states and Ontario, Canada.

In 2008, we generated \$2,336.9 million in total operating revenue and \$186.9 million in operating loss, which includes \$750.0 million of impairment charges relating to continuing operations, and a net loss of \$562.4 million. In 2007, we generated \$2,214.2 million in total operating revenue, representing approximately four times the operating revenue of the next largest investor-owned company in the United States water and wastewater business, and \$15.1 million in operating income which includes \$509.3 million of impairment charges relating to continuing operations, and a net loss of \$342.8 million. For the three months ended March 31, 2009, we generated \$550.2 million in total operating revenue, \$335.4 million in operating loss, which includes \$450.0 million of impairment charges, and a net loss of \$413.1 million.

We have two operating segments which are also the Company's two reportable segments, which we refer to as the Regulated Businesses and Non-Regulated Businesses segments.

For 2008, our Regulated Businesses generated \$2,082.7 million in operating revenue, prior to inter-segment eliminations, representing 89.1% of total operating revenue. For the same period, our Non-Regulated Businesses generated \$272.2 million in operating revenue, prior to inter-segment eliminations, representing 11.6% of total consolidated operating revenue. For the three months ended March 31, 2009, our Regulated Businesses generated \$497.4 million in operating revenue, which accounted for 90.4% of total consolidated operating revenue. For the same period, our Non-Regulated Businesses generated \$57.5 million in operating revenue, which accounted for 10.5% of total consolidated operating revenue.

#### **Our Industry**

The United States water and wastewater industry has two main segments: (i) utility, which involves supplying water and wastewater services to customers, and (ii) general services, which involves providing water and wastewater-related services, including engineering, consulting and sales of water infrastructure and distribution products, such as pipes, to water and wastewater utilities and other consumers on a fee-for-service contract basis.

The utility segment includes municipal systems, which are owned and operated by local governments, and investor-owned systems. Government-owned systems make up the vast majority of the United States water and wastewater utility segment, accounting for approximately 84% of all United States community water systems and approximately 98% of all United States community wastewater systems.

The utility segment is characterized by high barriers to entry, including high capital spending requirements. Investor-owned water and wastewater utilities also face regulatory approval processes in order to do business, which may involve obtaining relevant operating approvals, including certificates of public convenience and



## **Table of Contents**

necessity (or similar authorizations), pursuant to which state PUCs grant investor-owned utilities the right to provide service within an authorized service area. The utility segment of the United States water and wastewater industry is highly fragmented, with approximately 52,000 community water systems and approximately 16,000 community wastewater facilities, according to the United States Environmental Protection Agency, or EPA, and therefore presents opportunities for consolidation. Larger utilities, such as ours, that have greater access to capital are generally more capable of making mandated and other necessary infrastructure upgrades to water and wastewater systems.

### **Our Strengths**

We believe that we are distinguished by the following key competitive strengths:

***Market leader with broad national footprint and strong local presence.*** We are the largest and most geographically diversified investor-owned water and wastewater utility company in the United States. Our scale provides us with a competitive advantage in procuring goods and services reliably and economically. Our geographic scope enables us to capitalize effectively on growth opportunities across our service areas, while helping to insulate us from adverse conditions relating to regulatory environments, weather and economic conditions in any one geographic area. Also, our active community involvement supports customer satisfaction.

***Regulated Businesses provide financial stability.*** Our Regulated Businesses provide a high degree of financial stability because (i) high barriers to entry insulate us from competitive pressures, (ii) economic regulation promotes predictability in financial planning and long-term performance through the rate-setting process and (iii) our largely residential customer base promotes consistent operating results.

***Experience in securing appropriate rates of return and promoting constructive regulatory frameworks.*** We seek appropriate rates of return on our investment and a return of our investment and recovery of prudently incurred operating expenses from state PUCs in the form of rate increases, which we refer to as rate relief. We have a strong track record of providing reliable service at cost-effective rates, which has generally allowed us to maintain positive relations with regulators. We have generally been granted rate relief in a timely manner after application.

***Significant growth opportunities with a low risk business profile.*** We believe we are well positioned to benefit from favorable industry dynamics in the water and wastewater sectors, which provide significant opportunities for future growth in both our Regulated Businesses and complementary Non-Regulated Businesses.

We intend to invest capital prudently to enable us to continue to provide essential services to our customers in the water and wastewater utility industry and to municipalities in meeting the capital challenges of making substantial required infrastructure upgrades.

Our Regulated Businesses provide a large platform on which to grow both organically and through consolidation from among the numerous water and wastewater systems in the United States.

Our national footprint increases our ability to make opportunistic investments in non-regulated businesses that are complementary to our Regulated Businesses.

***Experienced senior management team.*** Our four most senior executives, Donald L. Correll, President and Chief Executive Officer, Ellen C. Wolf, Senior Vice President and Chief Financial Officer, John S. Young, President, American Water Services, and Walter J. Lynch, President, Regulated Operations, have an average of over 20 years of experience in the utilities industry. Our 14 state presidents have an average of 25 years of experience in the utilities industry.

***Industry leader in water quality, testing and research.*** We are experts in water quality testing, compliance and treatment and have established and own industry-leading water testing facilities. Our technologically advanced quality control and testing laboratory in Belleville, Illinois is certified in 23 states and Puerto Rico.



## **Table of Contents**

### **Our Strategy**

Our goal is to consistently provide customers with safe, high quality drinking water and reliable water and wastewater services. Our business strategies include:

continuing to invest prudently in regulated water and wastewater infrastructure projects;

earning an appropriate rate of return on our investments from state PUCs;

growing our Regulated Businesses through acquisitions; and

continuing to pursue public/private partnerships, including O&M and military contracts and services, and other non-regulated businesses that are complementary to our Regulated Businesses.

### **The Selling Stockholder**

American Water is currently an indirect majority-owned subsidiary of RWE Aktiengesellschaft, which we refer to as RWE, a stock corporation incorporated in the Federal Republic of Germany whose shares are publicly listed on the Frankfurt and Düsseldorf stock exchanges and other German stock exchanges as well as on the Zurich stock exchange. RWE is one of Europe's leading electricity and gas companies and supplies 20 million customers with electricity and 10 million customers with gas in Germany, the United Kingdom and Central and Eastern Europe. On November 4, 2005, RWE announced its intention to exit its water activities in the United States and the United Kingdom in order to focus on its core European electricity and gas business and has since then completed the divestiture of its water business in the United Kingdom. As a part of this strategy, RWE sold approximately 63.2 million shares in the initial public offering of American Water's common stock in April 2008. Of the approximately 63.2 million shares sold, approximately 5.2 million were sold pursuant to the partial exercise of the underwriters' over-allotment option on May 27, 2008. RWE intends to fully divest its remaining ownership of American Water through the consummation of additional public offerings of common stock of American Water as soon as reasonably practicable, subject to market conditions, which, together with RWE's sale of shares in the initial public offering, we refer to as the RWE Divestiture. As of March 31, 2009, RWE owned approximately 60% of American Water's outstanding shares of common stock. Upon the consummation of this offering, RWE will own approximately 49% of our common stock (or approximately 47% if the underwriters' option to purchase additional shares is exercised in full).

### **Recent Developments**

On May 21, 2009, American Water Capital Corp., our wholly-owned financing subsidiary, which we refer to as AWCC, closed the remarketing of \$16.7 million in aggregate principal amount of 6.75% tax exempt bonds due 2031, \$18.0 million in aggregate principal amount of 6.1% tax exempt bonds due 2019, \$18.3 million in aggregate principal amount of tax exempt bonds due 2018 and \$31.9 million of variable rate demand bonds. The proceeds from the issuances were used to pay down short term debt.

On May 19, 2009, AWCC closed its private placement offering of \$25.5 million in aggregate principal amount of 8.27% Senior Unsecured Notes due 2039 and \$24.5 million in aggregate principal amount of 7.21% Senior Unsecured Notes due 2019. We used the proceeds principally to pay down short-term debt.

On May 13, 2009, New Jersey-American Water Company, our subsidiary, which we refer to as NJAWC, closed its private offering of \$75.0 million in aggregate principal amount of its 6.35% first mortgage bonds due 2039 and \$25.0 million in aggregate principal amount of its 5.48% first mortgage bonds due 2019. NJAWC used the proceeds principally to pay down short-term debt.

## **Table of Contents**

### **Organizational Structure**

American Water is currently a direct majority-owned subsidiary of RWE Aqua Holdings GmbH, which we refer to as the selling stockholder, a limited liability company organized under the laws of the Federal Republic of Germany and a direct wholly-owned subsidiary of RWE. The following chart sets forth our organizational structure after giving effect to the consummation of this offering (assumes no exercise of the underwriters' option to purchase additional shares):

### **Our Executive Offices**

We are a corporation incorporated under the laws of Delaware. Our principal executive offices are located at 1025 Laurel Oak Road, Voorhees, NJ 08043. Our telephone number is (856) 346-8200. Our internet address is [www.amwater.com](http://www.amwater.com). **The information contained on or accessible from our website does not constitute a part of this prospectus and is not incorporated by reference herein.**

American Water and its logos are our trademarks. Other service marks, trademarks and trade names referred to in this prospectus are the property of their respective owners.

**Table of Contents**

**THE OFFERING**

Common stock offered by us	14,500,000 shares
Common stock offered by the selling stockholder	11,500,000 shares
Common stock outstanding immediately after this offering	174,498,756 shares
Option to purchase additional shares	The underwriters have an option to purchase a maximum of additional shares from the selling stockholder.
Use of Proceeds	We estimate that the net proceeds from the offering of shares by us will be approximately \$ million (based on the public offering price of per share). We intend to use these net proceeds to redeem short-term debt, which includes borrowings under AWCC s \$840.0 million unsecured revolving credit facility and commercial paper. We will not receive any proceeds from the offering of shares of our common stock by the selling stockholder.
Dividend Policy	Subject to applicable law and the discretion of our board of directors, we will pay cash dividends at a rate of approximately \$0.20 per share per quarter in 2009 on our common stock to be paid approximately 60 days after the end of each fiscal quarter. The declaration, payment and amount of future dividends to holders of our common stock will be at the discretion of our board of directors and will depend on many factors, including our financial condition and results of operations, liquidity requirements, capital requirements of our subsidiaries, legal requirements, regulatory constraints and other factors our board of directors deems relevant.
Listing	Our common stock is listed on the NYSE under the symbol AWK.
Risk Factors	See Risk Factors beginning on page S-11 of this prospectus supplement, Item 1A, Risk Factors, in our most recent Annual Report on Form 10-K and other filings incorporated by reference herein for a discussion of factors that you should refer to and carefully consider before deciding to invest in shares of our common stock.
All information in this prospectus, unless otherwise indicated or the context otherwise requires:	

assumes an offering price of \$17.28 per share, which is the last reported sale price on the NYSE on May 29, 2009; and

assumes no exercise of the underwriters option to purchase additional shares.



**Table of Contents****SUMMARY HISTORICAL CONSOLIDATED FINANCIAL DATA**

The following table presents our summary historical consolidated financial data at the dates and for the periods indicated. The statement of operations data for the years ended December 31, 2006, 2007 and 2008 and the balance sheet data as of December 31, 2007 and 2008 have been derived from our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2008 and incorporated by reference in this prospectus supplement. The statement of operations data for the three months ended March 31, 2008 and 2009 and the balance sheet data as of March 31, 2009 have been derived from our unaudited historical consolidated financial statements, which have been prepared on a basis consistent with our annual consolidated financial statements, included in our Quarterly Report on Form 10-Q for the three months ended March 31, 2009 and are incorporated by reference in this prospectus supplement. In the opinion of management, such unaudited financial data reflects all adjustments, consisting only of normal and recurring adjustments, necessary for fair presentation of the results for those periods. The results of operations for the three months ended March 31, 2009 are not necessarily indicative of the results to be expected for the full year or any future period.

Our historical consolidated financial data is not necessarily indicative of our future performance or what our financial position and results of operations would have been if we had operated as a separate, stand-alone entity during the periods shown. This financial data should be read in conjunction with, and is qualified in its entirety by reference to, the information in Selected Historical Consolidated Financial Data, Use of Proceeds, Capitalization, Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008 and in our Quarterly Report on Form 10-Q for the three months ended March 31, 2009, which are incorporated by reference in this prospectus supplement.

	<b>For the Years Ended December 31,</b>			<b>For the Three Months</b>	
	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>Ended March 31</b>	<b>2009</b>
				<b>(unaudited)</b>	<b>(unaudited)</b>
	<b>(in thousands, except per share data)</b>				
<b>Statement of operations data(1):</b>					
Operating revenues	\$ 2,093,067	\$ 2,214,215	\$ 2,336,928	\$ 506,815	\$ 550,170
Operating expenses					
Operation and maintenance	1,174,544	1,246,479	1,303,798	311,261	314,402
Depreciation and amortization	259,181	267,335	271,261	63,916	68,843
General taxes	185,065	183,253	199,139	52,066	52,497
Loss (gain) on sale of assets(2)	79	(7,326)	(374)	(70)	(202)
Impairment charges	221,685	509,345	750,000	750,000	450,000
<b>Total operating expenses, net</b>	<b>1,840,554</b>	<b>2,199,086</b>	<b>2,523,824</b>	<b>1,177,173</b>	<b>885,540</b>
Operating income (loss)	252,513	15,129	(186,896)	(670,358)	(335,370)
<b>Other income (deductions)</b>					
Interest, net	(365,970)	(283,165)	(285,155)	(69,968)	(71,979)
Amortization of debt expense	(5,062)	(4,867)	(5,895)	(1,318)	(1,488)
Other, net(3)	9,581	17,384	27,352	1,149	1,114
<b>Total other income (deductions)</b>	<b>(361,451)</b>	<b>(270,648)</b>	<b>(263,698)</b>	<b>(66,228)</b>	<b>(67,138)</b>
Income (loss) from continuing operations before income taxes	(108,938)	(255,519)	(450,594)	(736,586)	(402,508)
Provision for income taxes	46,912	86,756	111,827	(4,102)	10,571
Income (loss) from continuing operations	\$ (155,850)	\$ (342,275)	\$ (562,421)	\$ (732,484)	\$ (413,079)
Income (loss) from continuing operations per basic common share(4)	\$ (0.97)	\$ (2.14)	\$ (3.52)	\$ (4.58)	\$ (2.58)
Income (loss) from continuing operations per diluted common share(4)	\$ (0.97)	\$ (2.14)	\$ (3.52)	\$ (4.58)	\$ (2.58)
Basic weighted average common shares(4)	160,000	160,000	159,967	160,000	160,011

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Diluted weighted average common shares(4)	160,000	160,000	159,967	160,000	160,011
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S-9



**Table of Contents**

	For the Years Ended December 31,			For the Three Months Ended March 31,	
	2006	2007	2008	2008 (unaudited)	2009 (unaudited)
	(in thousands)				
<b>Other data:</b>					
Operating activities	\$ 323,748	\$ 473,712	\$ 552,169	\$ 85,391	\$ 142,499
Investing activities	(691,438)	(746,578)	(1,033,667)	(187,705)	(202,281)
Financing activities	332,367	256,593	477,559	98,035	58,756
Construction expenditures	(682,863)	(750,810)	(1,008,806)	(188,437)	(196,178)
Dividends declared per common share			0.40		0.20

	As of December 31,			As of
	2006	2007	2008	March 31, 2009 (unaudited)
	(in thousands)			
<b>Balance sheet data:</b>				
Cash and cash equivalents	\$ 29,754	\$ 13,481	\$ 9,542	\$ 8,516
Utility plant and property, net of depreciation	8,605,341	9,199,909	9,991,783	10,102,399
Total assets	12,783,059	12,951,327	13,231,818	12,907,244
Other short-term and long-term debt	4,103,532	4,991,806	5,278,895	5,367,397
Redeemable preferred stock	1,774,475	24,296	24,150	24,153
Total debt and redeemable preferred stock	5,878,007	5,016,102	5,303,045	5,391,550
Common stockholders' equity	3,817,397	4,542,046	4,102,001	3,660,341
Preferred stock without mandatory redemption requirements	4,568	4,568	4,557	4,557
Total stockholders' equity	3,821,965	4,546,614	4,106,558	3,664,898

- (1) On September 28, 2007, Thames Water Aqua US Holdings, Inc., at the time an indirect wholly-owned subsidiary of RWE, which we refer to as Thames US Holdings, was merged with and into American Water, with American Water as the surviving entity. American Water was an indirect wholly-owned subsidiary of RWE until its initial public offering in April 2008. The historical consolidated financial statements of American Water represent the consolidated results of the Company, formerly issued under the name Thames Water Aqua US Holdings, Inc. and Subsidiary Companies.
- (2) Represents primarily losses (gains) on sales of publicly traded securities and dispositions of assets not needed in utility operations.
- (3) Includes allowance for other funds used during construction, allowance for borrowed funds used during construction and preferred dividends of subsidiaries.
- (4) For the three months ended March 31, 2009 and March 31, 2008, the number of shares used to compute loss from continuing operations per basic common share and loss from continuing operations per diluted common share is 160.0 million. For the year ended December 31, 2008, the number of shares used to compute loss from continuing operations per basic common share and loss from continuing operations per diluted common share is 160.0 million. The number of shares used to compute income (loss) from continuing operations per basic common share and income (loss) from continuing operations per diluted common share for the fiscal years ended December 31, 2007 and 2006 is 160.0 million after giving effect to the 160,000-for-1 stock split on November 7, 2007. For the three months ended March 31, 2009 and the year ended December 31, 2008 there are no dilutive incremental common shares included in diluted earnings per share as all potentially dilutive instruments would be antidilutive. For the three months ended March 31, 2008, the Company had no potentially dilutive shares.

**Table of Contents**

**RISK FACTORS**

*An investment in our common stock involves risks. This prospectus supplement does not describe all of these risks. You should carefully consider the risks described below and the risks described in Item 1A, Risk Factors, in our most recent Annual Report on Form 10-K, as updated or amended in subsequent filed reports with the SEC, as well as the other information included or incorporated by reference in this prospectus supplement and the accompanying prospectus, before making an investment decision. Our business, financial condition or results of operations could be materially adversely affected by any of these risks. The market or trading price of our common stock could decline due to any of these risks or other factors, and you may lose all or part of your investment.*

***The market price of our common stock may be volatile, which could cause the value of your investment to decline.***

The market price of our common stock may fluctuate widely. You may not be able to resell your shares at or above the offering price due to fluctuations in the market price of our common stock caused by changes in our operating performance or prospects and other factors, including broad market fluctuations. Some specific factors that may have a significant effect on the market price of our common stock include:

actual or anticipated fluctuations in our operating results or future prospects;

the public's reaction to our press releases, our other public announcements and our filings with the SEC;

strategic actions by us or our competitors, such as acquisitions or restructurings;

new laws or regulations or new interpretations of existing laws or regulations applicable to our business;

changes in accounting standards, policies, guidance, interpretations or principles;

adverse conditions in the financial markets or general economic conditions, including those resulting from war, incidents of terrorism and responses to such events;

sales of common stock by us, the selling stockholder or members of our management team; and

changes in stock market analyst recommendations or earnings estimates regarding our common stock, other comparable companies or the water services industry generally.

***Future sales of our shares, or the perception by the market that future sales of our shares may occur, could depress the market price of our common stock.***

Future sales, or the perception of the availability for sale in the public market, of substantial amounts of our common stock could adversely affect the prevailing market price of our common stock and could impair our ability to raise capital through future sales of equity securities at a time and price that we deem appropriate. As of May 4, 2009, there were 160,031,166 shares of our common stock outstanding.

The shares of common stock sold by RWE and by us in this offering will be freely transferable without restriction or further registration under the Securities Act. The 85,236,779 shares (or 81,336,779 shares if the underwriters' option to purchase additional shares is exercised in full) of common stock owned by RWE after the consummation of this offering will be restricted securities within the meaning of Rule 144 under the Securities Act but will be eligible for resale subject to applicable volume, manner of sale, holding period and other limitations of Rule 144 and the lock-up provisions described below. RWE has certain registration rights with respect to the common stock that they will retain following this offering and, subject to the lock-up provisions described in this prospectus, intends to fully divest its remaining ownership of American Water as

soon as reasonably practicable, subject to market conditions.

S-11

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**Table of Contents**

In connection with the initial public offering, we granted 269,254 restricted stock units, 89,921 restricted stock awards and 2,077,814 stock options under our 2007 Omnibus Equity Compensation Plan, and established an employee stock purchase plan, for which we have reserved 2.0 million shares of our common stock to be issued and sold thereunder.

We, our executive officers and directors and the selling stockholder have agreed to a lock-up, meaning that, subject to specified exceptions, neither we nor they will sell any shares or engage in any hedging transactions without the prior consent of the representatives of the underwriters for 90 days after the date of this prospectus. Following the expiration of this 90-day lock-up period, all of the million shares (or million shares if the underwriters' option to purchase additional shares is exercised in full) of our common stock held by our executive officers and directors and by the selling stockholder will be eligible for future sale, subject to the applicable volume, manner of sale, holding period and other limitations of Rule 144.

We expect to pursue issuances of our common stock in order to meet our capital expenditure needs. We may need to issue and sell shares of common stock as a result of additional goodwill impairments. We may also issue shares of our common stock, or other securities, from time to time as consideration for future acquisitions and investments. The number of shares of our common stock or the number or aggregate principal amount, as the case may be, of other securities that we may issue may in turn be significant. To the extent such shares or other securities are issued in private transactions, we may also grant registration rights covering those shares or other securities. In connection with any such acquisitions and investments, any additional capital raised through the sale of our equity securities may dilute your percentage ownership in us. See *Shares Eligible for Future Sale* for a discussion of the shares of common stock that may be sold into the public market in the future.

***You may never receive dividends on your investment in our common stock, which may limit your returns.***

Subject to applicable law and the discretion of our board of directors, we will pay regular quarterly cash dividends on our common stock. See *Dividend Policy*. However, you may not receive dividends in the amounts disclosed in this prospectus, or at all, as a result of the following factors:

we are not legally or contractually required to pay dividends;

we may modify or revoke our policy to pay a regular quarterly dividend at any time;

even if we do not modify or revoke our dividend policy, the actual amount of dividends distributed and the decision to make any distribution is entirely at the discretion of our board of directors, and any future dividends with respect to shares of our common stock will depend on, among other things, our financial condition and results of operations, liquidity requirements, capital requirements of our subsidiaries, legal requirements, regulatory constraints, management's assessment of our ability to fund capital expenditures through debt and equity offerings and other factors deemed relevant by our board of directors;

some of our debt agreements restrict our ability, subject to specified exceptions, to pay dividends, and our ability to pay dividends may be subject to restrictions imposed by agreements governing our future indebtedness;

our ability to pay dividends will depend on our ability to generate cash flow from operations in the future. This ability, to an extent, is subject to general economic, financial, competitive, regulatory and other factors that are beyond our control. In addition, we are a holding company with no substantial assets. Because substantially all of our operations are conducted through our subsidiaries, we will not be able to pay dividends unless we receive sufficient cash distributions from our operating subsidiaries. We cannot assure you that our operating subsidiaries will generate sufficient cash flow from operations, or have sufficient surplus or net profits to make cash contributions to us in an amount sufficient to enable us to pay dividends. Even if these amounts are sufficient, our operating subsidiaries are subject to regulation by applicable state PUCs which may limit their ability to pay distributions to us, and the amount of dividends our subsidiaries may distribute is restricted by the agreements governing their indebtedness; and

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## **Table of Contents**

the amount of dividends we may distribute is subject to Delaware law restrictions. If we do not have sufficient cash to fund dividend payments, we would either reduce or eliminate dividends or rely on cash provided by financing activities to fund dividend payments, and such financing may or may not be available.

Our dividend policy was in effect for the year ended December 31, 2008. Without making any pro forma adjustments other than the proposed payment of dividends, we were not able to fund our construction expenditures and fund our acquisitions without using excess cash, borrowings under our revolving credit facility or proceeds from additional financings.

***Our principal stockholder is in a position to affect our ongoing operations, corporate transactions and other matters, and its interests may conflict with or differ from your interests as a stockholder.***

Upon the consummation of this offering, RWE will own approximately 49% of our common stock (or approximately 47% if the underwriters option to purchase additional shares is exercised in full). As a result, RWE may be able to control the outcome on matters submitted to a vote of our stockholders, including the election of directors. So long as RWE continues to own a significant portion of the outstanding shares of our common stock, it will continue to be able to significantly influence the election of our directors, subject to compliance with applicable NYSE requirements, our decisions, policies, management and affairs and corporate actions requiring stockholder approval, including the approval of transactions involving a change in control. The interests of RWE and its affiliates may not coincide with the interests of our other stockholders.

***Provisions in our amended and restated certificate of incorporation, our bylaws, Delaware law and the laws of the states in which we operate may inhibit or discourage a takeover attempt and negatively affect the value of your shares.***

Provisions of our charter documents, the General Corporation Law of the State of Delaware, the state in which we are organized, and the laws of the states in which we operate, could discourage potential acquisition proposals or make it more difficult for a third party to acquire control of our company, even if doing so might be beneficial to our stockholders. See Description of Capital Stock in the accompanying prospectus for a summary description of American Water's Common Stock. Our amended and restated certificate of incorporation and bylaws provide for various procedural and other requirements that could make it more difficult for stockholders to effect certain corporate actions, or may deter, delay or prevent a third party from acquiring us. These provisions include:

limitations on who may call special meetings of stockholders;

the inability of stockholders to act by written consent;

advance notice requirements for nominations for election to the board of directors and for stockholder proposals; and

the authority of our board of directors to issue, without stockholder approval, shares of preferred stock with such terms as our board of directors may determine and to issue additional shares of our common stock.

In addition, some of the states in which we operate have enacted laws that require regulatory approval for the acquisition of control of regulated utilities. The threshold for a change in control is a fact-specific inquiry that varies by state. For instance, in some states, any person acquiring more than 9.9% of our common stock would need the prior approval of the applicable state PUC or a determination from such state PUC that control has not been acquired. In addition to ownership, other states may analyze the degree of influence or control an acquiror may exert over the company. Any person acquiring our common stock in this offering or in any other purchase of our common stock in a quantity sufficient to trigger a change in control under state law would need

**Table of Contents**

the prior approval of the applicable state PUC. For example, in Kentucky, KY. Rev. Stat. Ann. §278.020 requires that no person may acquire control of American Water without obtaining necessary regulatory approvals.

These provisions may discourage acquisition proposals and may make it more difficult or expensive for a third party to acquire a majority of our outstanding voting stock or may delay, prevent or deter a merger, acquisition, tender offer or proxy contest, which may negatively affect our common stock price.

S-14

**Table of Contents**

**FORWARD-LOOKING STATEMENTS**

We have made statements under Business, Risk Factors, Management's Discussion and Analysis of Financial Condition and Results of Operations and in other sections of this prospectus supplement or incorporated by reference herein that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and the Private Securities Litigation Reform Act of 1995. In some cases, these forward-looking statements can be identified by words with prospective meanings such as intend, plan, estimate, believe, anticipate, expect, predict, project, forecast, outlook, future, potential, continue, may, can, should and could and similar expressions. Forward-looking statements may relate to, among other things, our future financial performance, our growth strategies, our ability to repay debt, our ability to finance current operations and growth initiatives, trends in our industry, regulatory or legal developments or rate adjustments.

Forward-looking statements are predictions based on our current expectations and assumptions regarding future events. They are not guarantees of any outcomes, financial results or levels of performance, and you are cautioned not to place undue reliance upon them. These forward-looking statements are subject to a number of risks and uncertainties, and new risks and uncertainties of which we are not currently aware or which we do not currently perceive may arise in the future from time to time. Should any of these risks or uncertainties materialize, or should any of our expectations or assumptions prove incorrect, then our results may vary materially from those discussed in the forward-looking statements herein. Factors that could cause actual results to differ from those discussed in forward-looking statements include, but are not limited to, the factors discussed under Risk Factors in this prospectus supplement and Item 1A, Risk Factors, in our most recent Annual Report on Form 10-K, as updated or amended in subsequent filed reports with the SEC, and the following factors:

weather conditions, patterns or events, including drought or abnormally high rainfall;

changes in general economic, business and financial market conditions;

fluctuations in the value of benefit plan assets and liabilities that could increase our cost and funding requirements;

changes in laws, governmental regulations and policies, including environmental, health and water quality and public utility regulations and policies;

the decisions of governmental and regulatory bodies, including decisions to raise or lower rates;

the timeliness of regulatory commissions' actions concerning rates;

migration into or out of our service territories;

our ability to obtain permits for expansion projects;

changes in customer demand for, and patterns of use of, water, such as may result from conservation efforts;

the availability of adequate and cost-effective supplies of chemicals, electricity, fuel, water and other raw materials that are needed for our operations;

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our ability to successfully acquire and integrate water and wastewater systems that are complementary to our operations and the growth of our business;

our ability to manage the expansion of our business;

our ability to control operating expenses and to achieve efficiencies in our operations;

access to sufficient capital on satisfactory terms;

fluctuations in interest rates;

S-15



**Table of Contents**

restrictive covenants in or changes to the credit ratings on our current or future debt that could increase our financing costs or affect our ability to borrow, make payments on debt or pay dividends;

changes in our credit rating;

changes in capital requirements;

the incurrence of impairment charges;

difficulty in obtaining insurance at acceptable rates and on acceptable terms and conditions;

ability to retain and attract qualified employees;

cost overruns relating to improvements or the expansion of our operations; and

civil disturbance or terrorist threats or acts or public apprehension about future disturbances or terrorist threats or acts.

The risks and uncertainties referenced above are not intended to be exhaustive. See **Risk Factors** beginning on page S-11 of this prospectus supplement and our most recent Annual Report on Form 10-K, including the information in Item 1A, **Risk Factors**, therein, and other documents filed with the SEC for an expanded discussion of the risks and uncertainties described above and additional risks and uncertainties that could cause actual results to differ materially from the forward-looking statements. All forward-looking statements contained in or incorporated by reference in this prospectus are based upon information available to us on the date such statements are made. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events, changed circumstances or otherwise.

Any forward-looking statements we make speak only as of the date of such statement. Except as required by law, we do not have any obligation, and we specifically disclaim any undertaking or intention, to update any forward-looking statements, whether as a result of new information, future events or otherwise.

**Table of Contents**

**INDUSTRY AND MARKET DATA**

Unless otherwise indicated, information contained in this prospectus supplement concerning the water and wastewater industry, its segments and related markets and our general expectations concerning such industry and its segments and related markets are based on management estimates. Such estimates are derived from publicly available information released by third-party sources, as well as data from our internal research and on assumptions made by us based on such data and our knowledge of such industry and markets, which we believe to be reasonable. We have estimated the number of people served by our water and wastewater systems (i) by multiplying the number of residential water and wastewater connections by average people per household based on 2000 United States Census data by state (average people per household varies by state but is generally between 2.4 to 3.0 individuals per household); (ii) by adjusting for weather fluctuations, for some other customer classes, including commercial customers, and for bulk water sales and (iii) by reconciling drinking water and wastewater connections to avoid double counting population served where the same user has both drinking water and wastewater service. In some instances, population estimates for our Non-Regulated Businesses are based on either (i) specific population estimates from the client or (ii) population estimates based on the average volume of water processed by the applicable facilities. While we are not aware of any misstatements regarding the industry or similar data presented herein, such data involve risks and uncertainties and are subject to change based on various factors, including those discussed in Item 1A, Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2008 and incorporated by reference in this prospectus supplement.

**Table of Contents**

**USE OF PROCEEDS**

We estimate that we will receive net proceeds of approximately \$            million (based on the public offering price of \$            per share) from the sale of shares of our common stock by us in this offering after deducting underwriting discounts and commissions and estimated offering expenses.

We intend to use the net proceeds to us from this offering to redeem short-term debt, which includes borrowings under AWCC's \$840.0 million unsecured revolving credit facility and commercial paper with maturity of under one week. Affiliates of some of the underwriters are lenders under this credit facility. The credit facility is scheduled to terminate on September 15, 2012 for \$155.0 million of commitments and on September 15, 2013 for \$685.0 million of commitments. As of May 27, 2009, the average interest rate on our commercial paper was 1.08%, and the average interest rate on short term borrowings under the credit facility was 0.60%. AWCC had \$320.0 million of outstanding borrowings and \$46.9 million of outstanding letters of credit under this credit facility as of May 27, 2009. As of May 27, 2009, AWCC had \$165.0 million of commercial paper outstanding.

The selling stockholder will receive the remaining net proceeds from the sale of shares of our common stock in this offering. We will not receive any of the proceeds from the sale of shares of our common stock by the selling stockholder in this offering.

**Table of Contents****PRICE RANGE OF COMMON STOCK**

Prior to April 23, 2008, there was no established public trading market for our common stock. Since April 23, 2008, our common stock has traded on the NYSE under the symbol AWK. The following table sets forth the per-share range of the high and low closing sales prices of our common stock as reported on the NYSE for the periods indicated:

<b>Year Ended December 31, 2008</b>	<b>High</b>	<b>Low</b>
Second Quarter (from April 23, 2008)	\$ 23.37	\$ 20.60
Third Quarter	22.95	18.63
Fourth Quarter	22.16	17.16

  

<b>Year Ending December 31, 2009</b>	<b>High</b>	<b>Low</b>
First Quarter	\$ 21.48	\$ 16.53
Second Quarter (through May 29, 2009)	18.79	16.95

On May 29, 2009, there were approximately 37 holders of record of our common stock and the last reported sale price of our common stock on the NYSE was \$17.28 per share.

**Table of Contents**

**DIVIDEND POLICY**

Our board of directors has adopted a dividend policy to distribute to our stockholders a portion of our net cash provided by operating activities as regular quarterly dividends, rather than retaining that cash for other purposes. Subject to applicable law and the discretion of our board of directors, our policy is to distribute 50% to 70% of our net income annually.

Our cash dividend policy reflects our basic judgment that it is in the best interest of our stockholders to distribute to them a portion of the cash generated by our business. In order to fund construction expenditures, acquisitions (including tuck-in acquisitions) and principal and interest payments on our indebtedness, and pay dividends at the level currently anticipated under our dividend policy, we expect that we will need additional financing from external sources. In our judgment, our dividend policy, which is consistent with utility industry practice, will enable us to attract financing required to fund capital expenditures and acquisitions.

Subject to applicable law and the discretion of our board of directors, we will pay cash dividends at a rate of approximately \$0.20 per share per quarter in 2009 on our common stock, to be paid approximately 60 days after the end of each fiscal quarter. The quarterly and annual average aggregate dividend amounts for the next four quarters would be \$35.0 million and \$139.6 million, respectively. The aggregate dividend amounts are based upon the estimated average 174.5 million shares outstanding after this offering during the next four quarters.

We expect that dividends will be paid in March, June, September and December of each fiscal year to holders of record approximately 15 days prior to the distribution date. Since the dividends on our common stock will not be cumulative, only declared dividends will be paid.

We have paid quarterly dividends of \$0.20 per share since September 2, 2008. In March 2009, the Company made a cash dividend payment of \$0.20 per share to all shareholders of record as of February 18, 2009. On April 30, 2009 our board of directors declared a quarterly cash dividend payment of \$0.20 per share payable on June 1, 2009 to all shareholders of record as of May 18, 2009. From 2003 to 2007, inclusive, because we were not a public company, we did not pay dividends on our common stock. However, American Water, prior to its acquisition by RWE in 2003, paid dividends to common stockholders in each of the years since it became publicly traded in 1947.

For further information about our dividend policy and our ability to pay dividends, see **Risk Factors** **Risks Related to Our Industry and Business** Our Regulated Businesses require significant capital expenditures to maintain infrastructure and expand our rate base and may suffer if we fail to secure appropriate funding to make investments, or if we suffer delays in completing major capital expenditure projects under Item 1A of our most recent Annual Report on Form 10-K and **Risk Factors** You may never receive dividends on your investment in our common stock, which may limit your returns in this prospectus supplement.

**Table of Contents****CAPITALIZATION**

The following table sets forth our cash and cash equivalents and capitalization as of March 31, 2009 on an actual basis and on an as adjusted basis to give effect to the issuance and sale by us of shares of our common stock in this offering at an offering price of \$ \_\_\_\_\_ per share and the issuance of \$100.0 million of first mortgage bonds, \$50.0 million of senior unsecured notes and \$52.9 million of tax-exempt bonds since March 31, 2009 and the use of proceeds from each offering as if each had occurred on March 31, 2009.

You should read this table in conjunction with, and this table is qualified in its entirety by reference to, the sections in this prospectus entitled Summary Historical Consolidated Financial Data, Use of Proceeds, Selected Historical Consolidated Financial Data, Management's Discussion and Analysis of Financial Condition and Results of Operations, and our consolidated financial statements and the notes thereto incorporated by reference in this prospectus.

	As of March 31, 2009 (in thousands)	
	Historical (unaudited)	As Adjusted (unaudited)
Cash and cash equivalents	\$ 8,516	\$ 8,516
Short-term debt(1)(2)		
Short-term debt	645,092	
Total short-term debt	645,092	
Long-term debt of AWCC including current portion		
Senior notes(1)	3,006,000	3,108,900
Long-term debt of other subsidiaries including current portion		
Private activity bonds and government funded debt	935,800	935,800
Mortgage bonds(2)	675,200	775,200
Senior debt	40,518	40,518
Redeemable preferred stock at redemption value(3)	24,425	24,425
Notes payable and other	2,841	2,841
Unamortized debt discount, net	61,674	61,674
Total long-term debt	4,746,458	4,949,358
Total debt	5,391,550	
Equity		
Common stockholders' equity	3,660,341	
Preferred stock without mandatory redemption requirements	4,557	4,557
Total equity	3,664,898	
Total capitalization including short-term debt and current portion of long-term debt	\$ 9,056,448	

- (1) The as adjusted column reflects the issuance by AWCC of \$25.5 million in aggregate principal amount of 8.27% senior unsecured notes due 2039 and \$24.5 million in aggregate principal amount of 7.21% senior unsecured notes due 2019 on May 19, 2009, \$16.7 million in aggregate principal amount of 6.75% tax exempt bonds due 2031, \$18.0 million in aggregate principal amount of 6.1% tax exempt bonds due 2019 and \$18.3 million in aggregate principal amount of tax exempt bonds due 2018 on May 21, 2009. The proceeds from the issuances were used to pay down short term debt.

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- (2) The as adjusted column reflects the issuance by NJAWC of \$75.0 million in aggregate principal amount of its 6.35% first mortgage bonds due 2039 and \$25.0 million in aggregate principal amount of its 5.48% first mortgage bonds due 2019 on May 13, 2009. The proceeds from the issuance were used to pay down short term debt.
- (3) Includes current portion of redeemable preferred stock and the unamortized debt discount attributable to preferred stock of \$0.3 million.

S-21

**Table of Contents****DILUTION**

If you invest in our common stock, your interest will be diluted to the extent of the difference between the offering price per share of our common stock and the net tangible book value per share of our common stock after this offering.

Our net tangible book value as of March 31, 2009 was approximately \$2,459.1 million, or \$15.37 per share of common stock. Net tangible book value per share represents total tangible assets less total liabilities, divided by the number of shares of common stock outstanding as of March 31, 2009. Total tangible assets represent total assets, excluding goodwill of \$1,249.8 million and other intangible assets and deferred financing costs of \$68.9 million. After giving effect to the issuance and sale by us of 14,500,000 shares of our common stock in this offering at an assumed offering price of \$17.28 per share (the last reported sale price of our common stock on May 29, 2009, on the NYSE), and after deducting the underwriting discounts and estimated offering expenses that we will pay, our net tangible book value as of March 31, 2009 would have been approximately \$2,701.1 million, or \$15.48 per share of common stock. This represents an immediate increase in net tangible book value of \$0.11 per share to existing stockholders and an immediate dilution of \$1.80 per share to new investors purchasing shares of common stock in this offering.

The following table illustrates this per share dilution:

	<b>Per Share</b>
Assumed offering price per share	\$ 17.28
Net tangible book value per share as of March 31, 2009	\$ 15.37
Increase per share attributable to this offering	\$ 0.11
Net tangible book value per share after this offering	\$ 15.48
Decrease per share to new investors due to dilution	\$ 1.80

These calculations assume no issuance of shares of our common stock through the exercise of stock options as of March 31, 2009. To the extent all of these options had been exercised as of March 31, 2009, our net tangible book value per share of common stock would have further decreased and the dilution per share of common stock to new investors in this offering would have further increased. Sales of shares by the selling stockholder in this offering do not affect our net tangible book value.



**Table of Contents**

**SELECTED HISTORICAL CONSOLIDATED FINANCIAL DATA**

The following table presents our selected historical consolidated financial data at the dates and for the periods indicated. The statement of operations data for the years ended December 31, 2006, 2007 and 2008 and the balance sheet data as of December 31, 2007 and 2008 have been derived from our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2008 and incorporated by reference in this prospectus supplement. The statement of operations data for the years ended December 31, 2004 and 2005, and the balance sheet data as of December 31, 2004, 2005 and 2006 have been derived from our historical financial statements, in each case, which are not included in our Annual Report on Form 10-K for the year ended December 31, 2008 and are not incorporated by reference in this prospectus supplement. The statement of operations data for the three months ended March 31, 2008 and 2009 and the balance sheet data as of March 31, 2009 have been derived from our unaudited historical consolidated financial statements, which have been prepared on a basis consistent with our annual consolidated financial statements are included in our Quarterly Report on Form 10-Q for the three months ended March 31, 2009 and are incorporated by reference in this prospectus supplement. In the opinion of management, such unaudited financial data reflects all adjustments, consisting only of normal and recurring adjustments, necessary for fair presentation of the results for those periods. The results of operations for the three months ended March 31, 2009 are not necessarily indicative of the results to be expected for the full year or any future period.

**Table of Contents**

Our historical consolidated financial data are not necessarily indicative of our future performance or what our financial position and results of operations would have been if we had operated as a separate, stand-alone entity during the periods shown. This financial data should be read in conjunction with, and is qualified in its entirety by reference to, the information in Summary Historical Consolidated Financial Data, Use of Proceeds, Capitalization, Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008 and our Quarterly Report on Form 10-Q for the three months ended March 31, 2009, which are incorporated by reference in this prospectus supplement.

	For the Years Ended December 31,					For the Three Months Ended March 31,	
	2004	2005	2006	2007	2008	2008	2009
	(in thousands, except per share data)						
<b>Statement of operations data(1):</b>							
Operating revenues	\$ 2,017,871	\$ 2,136,746	\$ 2,093,067	\$ 2,214,215	\$ 2,336,928	\$ 506,815	\$ 550,170
Operating expenses							
Operation and maintenance	1,121,970	1,201,566	1,174,544	1,246,479	1,303,798	311,261	314,402
Depreciation and amortization	225,260	261,364	259,181	267,335	271,261	63,916	68,843
General taxes	170,165	183,324	185,065	183,253	199,139	52,066	52,497
Loss (gain) on sale of assets(2)	(8,611)	(6,517)	79	(7,326)	(374)	(70)	(202)
Impairment charges	78,688	385,434	221,685	509,345	750,000	750,000	450,000
Total operating expenses, net	1,587,472	2,025,171	1,840,554	2,199,086	2,523,824	1,177,173	885,540
Operating income (loss)	430,399	111,575	252,513	15,129	(186,896)	(670,358)	(335,370)
Other income (deductions)							
Interest, net	(315,944)	(345,257)	(365,970)	(283,165)	(285,155)	(69,968)	(71,979)
Amortization of debt expense	(3,377)	(4,367)	(5,062)	(4,867)	(5,895)	(1,318)	(1,488)
Other, net(3)	14,350	13,898	9,581	17,384	27,352	1,149	1,114
Total other income (deductions)	(304,971)	(335,726)	(361,451)	(270,648)	(263,698)	(66,228)	(67,138)
Income (loss) from continuing operations before income taxes	125,428	(224,151)	(108,938)	(255,519)	(450,594)	(736,586)	(402,508)
Provision for income taxes	66,328	50,979	46,912	86,756	111,827	(4,102)	10,571
Income (loss) from continuing operations	\$ 59,100	\$ (275,130)	\$ (155,850)	\$ (342,275)	\$ (562,421)	\$ (732,484)	\$ (413,079)
Income (loss) from continuing operations per basic common share(4)	\$ 0.37	\$ (1.72)	\$ (0.97)	\$ (2.14)	\$ (3.52)	\$ (4.58)	\$ (2.58)
Income (loss) from continuing operations per diluted common share(4)	\$ 0.37	\$ (1.72)	\$ (0.97)	\$ (2.14)	\$ (3.52)	\$ (4.58)	\$ (2.58)
Basic weighted average common shares(4)	160,000	160,000	160,000	160,000	159,967	160,000	160,011
Diluted weighted average common shares(4)	160,000	160,000	160,000	160,000	159,967	160,000	160,011



**Table of Contents**

	For the Years Ended December 31,					For the Three Months Ended March 31,	
	2004	2005	2006	2007	2008	2008 (unaudited)	2009 (unaudited)
	(in thousands)						
<b>Other data:</b>							
Cash flows provided by (used in):							
Operating activities	\$ 458,408	\$ 525,435	\$ 323,748	\$ 473,712	\$ 552,169	\$ 85,391	\$ 142,499
Investing activities	(545,903)	(530,165)	(691,438)	(746,578)	(1,033,667)	(187,705)	(202,281)
Financing activities	95,254	(9,049)	332,367	256,593	477,559	98,035	58,756
Construction expenditures	(540,765)	(552,636)	(682,863)	(750,810)	(1,008,806)	(188,437)	(196,178)
Dividends declared per common share					0.40		0.20

	As of December 31,					As of
	2004	2005	2006	2007	2008	March 31, 2009 (unaudited)
	(in thousands)					
<b>Balance sheet data:</b>						
Cash and cash equivalents	\$ 78,856	\$ 65,077	\$ 29,754	\$ 13,481	\$ 9,542	\$ 8,516
Utility plant and property, net of depreciation	7,754,434	8,101,769	8,605,341	9,199,909	9,991,783	10,102,399
Total assets	12,728,410	12,542,029	12,783,059	12,951,327	13,231,818	12,907,244
Other short-term and long-term debt	5,101,891	5,030,078	4,103,532	4,991,806	5,278,895	5,367,397
Redeemable preferred stock	1,775,224	1,774,691	1,774,475	24,296	24,150	24,153
Total debt and redeemable preferred stock	6,877,115	6,804,769	5,878,007	5,016,102	5,303,045	5,391,550
Common stockholders equity	3,129,555	2,804,716	3,817,397	4,542,046	4,102,001	3,660,341
Preferred stock without mandatory redemption requirements	4,651	4,571	4,568	4,568	4,557	4,557
Total stockholders equity	3,134,206	2,809,287	3,821,965	4,546,614	4,106,558	3,664,898

- (1) On September 28, 2007, Thames US Holdings, at the time an indirect wholly-owned subsidiary of RWE, was merged with and into American Water, with American Water as the surviving entity. American Water was an indirect wholly-owned subsidiary of RWE until its initial public offering in April 2008. The historical consolidated financial statements of American Water represent the consolidated results of the Company, formerly issued under the name Thames Water Aqua US Holdings, Inc. and Subsidiary Companies.
- (2) Represents primarily losses (gains) on sales of publicly traded securities and dispositions of assets not needed in utility operations.
- (3) Includes allowance for other funds used during construction, allowance for borrowed funds used during construction and preferred dividends of subsidiaries.
- (4) For the three months ended March 31, 2009 and March 31, 2008, the number of shares used to compute loss from continuing operations per basic common share and loss from continuing operations per diluted common share is 160.0 million. For the year ended December 31, 2008, the number of shares used to compute loss from continuing operations per basic common share and loss from continuing operations per diluted common share is 160.0 million. The number of shares used to compute income (loss) from continuing operations per basic common share and income (loss) from continuing operations per diluted common share for the fiscal years ended December 31, 2007 and 2006 is 160.0 million after giving effect to the 160,000-for-1 stock split on November 7, 2007. For the three months ended March 31, 2009 and the year ended December 31, 2008 there are no dilutive incremental common shares included in diluted earnings per share as all potentially

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dilutive instruments would be antidilutive. For the three months ended March 31, 2008, the Company had no potentially dilutive shares.

S-25

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**Table of Contents**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion and analysis of our financial condition and results of operations covers periods prior to the consummation of our initial public offering and related transactions. Accordingly, the discussion and analysis of historical periods before our initial public offering and related transactions do not reflect the significant impact that these transactions have had or will have on us. You should read the following discussion together with the financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008 and our Quarterly Report on Form 10-Q for three months ended March 31, 2009, which are incorporated by reference in this prospectus supplement. This discussion contains forward-looking statements that are based on management's current expectations, estimates and projections about our business and operations. The cautionary statements made, or incorporated by reference, in this prospectus supplement should be read as applying to all related forward-looking statements whenever they appear, or are incorporated by reference, in this prospectus supplement. Our actual results may differ materially from those currently anticipated and expressed in such forward-looking statements as a result of a number of factors, including those we discuss herein under "Risk Factors" and in Item 1A, "Risk Factors," in our Annual Report on Form 10-K for the year ended December 31, 2008, as updated or amended in subsequent filed reports with the SEC, and those appearing elsewhere in this prospectus supplement or otherwise incorporated herein by reference. You should read "Risk Factors" and "Forward-Looking Statements." Certain 2007 and 2006 amounts have been reclassified within operations and maintenance expense to conform to the 2008 presentation.*

**Overview**

Founded in 1886, American Water is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our approximately 7,300 employees provide drinking water, wastewater and other water-related services to more than 15 million people in 32 states and Ontario, Canada. In 2008, we generated \$2,336.9 million in total operating revenue, representing approximately four times the operating revenue of the next largest investor-owned company in the United States water and wastewater business, and \$186.9 million in operating loss, which includes \$750.0 million of impairment charges relating to continuing operations, and a net loss of \$562.4 million. For the three months ended March 31, 2009, we generated \$550.2 million in total operating revenue, \$335.4 million in operating loss, which includes \$450.0 million of impairment charges, and a net loss of \$413.1 million.

Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers. Our Regulated Businesses that provide these services are generally subject to economic regulation by state PUCs in the states in which they operate. The federal government and the states also regulate environmental, health and safety and water quality matters. Our Regulated Businesses currently provide services in 20 states and in 2008 served approximately 3.3 million customers, or connections to our water and wastewater networks. We report the results of this business in our Regulated Businesses segment. For the year ended December 31, 2008 and for the three months ended March 31, 2009, our Regulated Businesses generated \$2,082.7 million and \$497.4 million, respectively, in operating revenue, prior to inter-segment eliminations, representing 89.1% and 90.4%, respectively, of our consolidated operating revenue.

We also provide services that are not subject to economic regulation by state PUCs. Our Non-Regulated Businesses include our:

Contract Operations Group, which enters into public/private partnerships, including O&M and DBO contracts for the provision of services to water and wastewater facilities for municipalities, the United States military and other customers;

Applied Water Management Group, which works with customers to design, build and operate small water and wastewater treatment plants; and

## **Table of Contents**

Homeowner Services Group, which provides services to domestic homeowners to protect against the cost of repairing broken or leaking pipes inside and outside their homes.

We report these results in our Non-Regulated Businesses segment. For the year ended December 31, 2008 and for the three months ended March 31, 2009, our Non-Regulated Businesses generated \$272.2 million and \$57.5 million, respectively, in operating revenue, prior to inter-segment eliminations.

### *History*

Prior to being acquired by RWE in 2003, we were the largest publicly traded water utility company as measured by both operating revenue and population served in the United States. In 2003, we were acquired by RWE and became a private company. On September 28, 2007, Thames US Holdings was merged with and into American Water with American Water being the surviving entity, which we refer to as the Merger. Prior to the Merger, Thames US Holdings, formerly an indirect wholly-owned subsidiary of RWE, was the holding company for us and our regulated and unregulated subsidiaries throughout the United States and Ontario, Canada. The RWE acquisition resulted in certain changes in our business. For example, our operations and management were managed through Thames Water.

Our consolidated statements of operations for the year ended December 31, 2006 reflects expense allocations for some central corporate functions historically provided to us by Thames Water, including information systems, human resources, accounting and treasury activities and legal services. These allocations reflect expenses specifically identifiable as relating to our business as well as our share of expenses allocated to us based on capital employed, capital expenditures, headcount, revenues, production volumes, fixed costs, environmental accruals or other methods management considers to be reasonable. During our transition to a separate, stand-alone company, we have developed or obtained additional in-house capabilities related to these functions, and therefore there were no such expense allocations in 2008 or in 2007 from RWE or its affiliates. We and RWE consider these allocations to be a reasonable reflection of our utilization of the services provided by Thames Water. However, our expenses as a separate, stand-alone company may be higher or lower than the amounts reflected in our 2006 consolidated statements of operations. Also, we agreed not to file rate cases with some state PUCs for specified periods of time as a condition of the acquisition. As of December 31, 2007, all rate stay-out provisions associated with the RWE acquisition had expired.

In 2005, RWE decided to divest American Water. In March 2006, RWE decided to divest American Water through the sale of shares in one or more public offerings. In order to become a public company once again, we have had to incur substantial initial costs, including costs associated with ensuring adequate internal control over financial reporting in order to achieve compliance with the Sarbanes-Oxley Act. These substantial initial costs will not be recovered in rates charged to our customers. See [Our Internal Control and Remediation Initiatives](#).

Upon the completion of our initial public offering in April 2008, we again became listed on the NYSE. RWE Aqua Holdings GmbH, the selling stockholder, sold approximately 63.2 million shares of the Company's common stock. RWE currently owns approximately 60% of the Company's shares of common stock.

We performed valuations of our goodwill in 2008, 2007 and 2006. As a result of the valuation analyses, we recorded pre-tax charges of \$750.0 million, \$509.3 million and \$227.8 million, including impairment charges from discontinued operations, for the years ended December 31, 2008, 2007 and 2006, respectively. We also recognized \$450.0 million as a goodwill impairment charge for the three months ended March 31, 2009. See [Goodwill Impairment](#).

### *Our Internal Control and Remediation Initiatives*

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance

**Table of Contents**

regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. However, from 2003 to April 28, 2008, we were an indirect wholly-owned subsidiary of RWE and, as a privately owned company, were not required to comply with the requirements of the SEC and the Sarbanes-Oxley Act or to prepare our own consolidated financial statements. As a public reporting company, we are required, among other things, to maintain a system of effective internal control over financial reporting suitable to prepare our publicly reported financial statements in a timely and accurate manner, and also to evaluate and report on such system of internal control. In particular, we are required to certify our compliance with Section 404 of the Sarbanes-Oxley Act for the year ended December 31, 2009, which will require us to perform system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting.

In connection with the preparation of our consolidated financial statements as of December 31, 2006, we and our independent registered public accountants identified the following material weaknesses in our internal control over financial reporting:

Inadequate internal staffing and skills;

Inadequate controls over financial reporting processes;

Inadequate controls over month-end closing processes, including account reconciliations;

Inadequate controls over maintenance of contracts and agreements;

Inadequate controls over segregation of duties and restriction of access to key accounting applications; and

Inadequate controls over tax accounting and accruals.

Management has assigned a high priority to the evaluation and remediation of our internal controls, and have taken numerous steps to enhance these internal controls to a level that would prevent or detect a material misstatement in the consolidated financial statements and to implement an ongoing process to evaluate and strengthen our overall internal controls over financial reporting. Some of the actions taken to remediate these material weaknesses and to evaluate and strengthen our other internal controls over financial reporting include:

Increasing our internal financial staff numbers and skill levels, and using external resources to supplement our internal staff when necessary;

Implementing detailed processes and procedures related to our period-end financial closing processes, key accounting applications and our financial reporting processes;

Implementing or enhancing systems used in the financial reporting processes and month-end close processes;

Conducting extensive training on existing and newly developed processes and procedures as well as explaining to employees Sarbanes-Oxley Act requirements and the value of internal controls;



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Enhancing our internal audit staff;

Hiring a director of internal control and a director of taxes during 2007;

Implementing a tracking mechanism and new policy and procedure for approval of all contracts and agreements; and

Retaining a nationally recognized accounting and auditing firm to assist management in developing policies and procedures surrounding internal controls over financial reporting, to evaluate and test these internal controls and to assist in the remediation of internal control deficiencies.

With respect to the material weaknesses described above, we believe that we have addressed the areas of material weakness, and have tested the effectiveness of controls designed to address these material weaknesses.

S-28

## **Table of Contents**

Based on these actions and the length of time these controls have been operating at a level that would prevent or detect a material misstatement in the consolidated financial statements, we no longer consider these control deficiencies to be material weaknesses as of March 31, 2009, except for the control deficiencies relating to the maintenance of contracts and agreements, which in our opinion should remain as a material weakness until we have sufficient experience with the sustainability of the levels at which the associated controls have been operating.

As of March 31, 2009, the Company had incurred \$58.4 million to remediate these material weaknesses and to document and test key financial reporting controls. At this time, the Company cannot indicate with certainty what additional costs may need to be incurred in the future. As a condition to state PUC approval of the RWE Divestiture, we agreed that costs incurred in connection with our initial internal control and remediation initiatives would not be recoverable in rates charged to our customers.

Elements of our remediation activities can only be accomplished over time, and our initiatives provide no assurances that they will result in an effective internal control environment. Our board of directors, in coordination with our audit committee, will continually assess the progress and sufficiency of these initiatives and make adjustments, as necessary.

The Company believes the additional control procedures as designed, when implemented, will fully remediate the material weaknesses described above.

## **Factors Affecting Our Results of Operations**

As the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served, our financial condition and results of operations are influenced by a variety of industry-wide factors, including the following:

economic utility regulation;

the need for infrastructure investment;

compliance with environmental, health and safety standards;

production costs;

customer growth;

an overall trend of declining water usage per customer;

weather and seasonality; and

economic environment.

Since our acquisition by RWE in 2003, our results of operations have also been significantly influenced by goodwill impairments. See [Goodwill Impairment](#).

Factors that may affect the results of operations of our Regulated Businesses' operating performance are mitigated by state PUCs granting us appropriate rate relief that is designed to allow us to recover prudently incurred expenses and to earn an appropriate rate of return on our investment.

*Economic Utility Regulation*

Our subsidiaries in the states in which we operate our Regulated Businesses are generally subject to extensive economic regulation by their respective state PUCs. Although specific authority might differ from state to state, in most states, these state PUCs must approve rates, accounting treatments, long-term financing programs, significant capital expenditures and plant additions, transactions between the regulated subsidiary and

S-29

## **Table of Contents**

affiliated entities, reorganizations and mergers and acquisitions, in many instances prior to their completion. Regulatory policies not only vary from state to state, they may change over time. These policies will affect the timing as well as the extent of recovery of expenses and the realized return on invested capital.

Our operating revenue is typically determined by reference to the volume of water supplied to a customer multiplied by a price-per-gallon set by a tariff approved by the relevant state PUC. The process to obtain approval for a change in rates, or rate case, involves filing a petition with the state PUC on a periodic basis as determined by our capital expenditures needs and our operating costs. Rate cases and other rate-related proceedings can take several months to a year or more to complete. Therefore, there is frequently a delay, or regulatory lag, between the time one of our regulated subsidiaries makes a capital investment or incurs an operating expense increase and when those costs are reflected in rates. The management team at each of our regulated subsidiaries works to minimize regulatory lag.

Our results of operations are significantly affected by rates authorized by the state PUCs in the states in which we operate, and we are subject to risks and uncertainties associated with rate stay-outs and delayed or inadequate rate recovery. In addition to general rate case filings, we generate revenues through other cost recovery procedures. For example, some states in which we operate allow utility subsidiaries to recover system infrastructure replacement costs without the necessity of filing a full rate proceeding. Since infrastructure replacement is a significant element of capital expenditures made by our subsidiaries, such programs can reduce regulatory lag.

Currently, Pennsylvania, Illinois, Missouri, Indiana, New York, California and Ohio have allowed the use of these infrastructure surcharges. These surcharges adjust periodically based on qualified capital expenditures being completed or anticipated in a future period. These surcharges are typically reset to zero when new base rates are effective and incorporate the costs of these infrastructure expenditures. As of May 29, 2009, we have been granted an additional \$12.6 million in revenues, assuming constant sales volumes from such surcharges in several of our states. Furthermore, we were granted a \$0.2 million increase for an arsenic surcharge in our Arizona subsidiary, allowing recovery for costs associated with the construction and operation of arsenic treatment facilities.

Also, some of the states in which we operate permit pass-through provisions that allow for an increase in certain operating costs, such as purchased power and property taxes, to be passed on to and recovered from the customers outside of a general rate proceeding.

Some states have permitted use of some form of forecast or forward-looking test year instead of historical data to set rates. Examples of these states include Hawaii, Illinois, Kentucky, Ohio, Pennsylvania, New York, Tennessee and California. In addition, a number of states in which we operate have allowed the utility to update historical data for some changes that occur for some limited period of time subsequent to the historical test year. This allows the utility to take account of some more current costs or capital investments in the rate-setting process. Examples of these states include New Mexico, Texas, Missouri, Iowa, Virginia, Maryland, West Virginia, New Jersey and Arizona.

Another regulatory mechanism to address issues of regulatory lag includes the ability, in some circumstances, to recover in rates a return on utility plant before it is actually in service, instead of capitalizing an allowance for funds used during construction. Examples of states that have allowed such recovery include Texas, Pennsylvania, Ohio, Kentucky, Virginia and California.

The infrastructure surcharge, pass-through provisions, the forward-looking test year and the allowance of a return on utility plant before it is actually in service are examples of mechanisms that present an opportunity to limit the risks associated with regulatory lag. We employ each of these mechanisms as part of our rate case management program to ensure efficient recovery of our costs and investment and to ensure positive short-term liquidity and long-term profitability.

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**Table of Contents**

In addition, some states have permitted us to seek pre-approval of certain capital projects and associated costs. In this pre-approval process, the PUCs assess the prudence of such projects.

As a condition to our acquisition by RWE in 2003, we agreed not to file rate cases in some of the states where our Regulated Businesses operate. In the first three months of 2009 we received authorizations for additional annualized revenues from general rate cases of \$5.2 million. As of March 31, 2009, we were awaiting a final order for Hawaii's general case that was filed in 2007, requesting \$1.3 million in total additional annual revenues. In October 2008, The Hawaii Public Utility Commission approved, on an interim basis, an increase in additional annualized revenues of \$0.7 million. The interim rates were effective for the fourth quarter of 2008. Also, at March 31, 2009, we were awaiting final orders in five states for general rate cases filed in 2008 and in one state for a general rate case filed in 2009, requesting additional annualized revenues of \$120.6 million. During May 2009, the New Mexico rate case, which was filed in 2008, was finalized. The final order authorized additional annualized revenues of \$1.4 million. Also in May 2009, our Applied Wastewater Management, Inc. rate case was finalized and additional annualized revenues of \$1.6 million was authorized. The residual amount of \$118.4 million for the remaining four cases filed in 2008 and the case filed in the first quarter of 2009 is under consideration by the state PUCs. Also, during April and May 2009, we filed general rate cases in six states amounting to additional annualized revenue of \$182.6 million, including the recovery of higher pension and postretirement benefit costs. In regards to the pension and postretirement benefit cost, we have begun discussions with our regulators about the appropriate treatment for these incremental costs in order to minimize regulatory lag between incurring of the expense and any recovery of the expense. To date, we have authorization to recover or defer \$5.8 million of this annual increase and have requested permission to recover or defer as a deferred asset until the next rate case is concluded an additional \$7.3 million of this increase in 2009. Until we receive permission from the regulators to defer costs, we will continue to expense them. We are also discussing with regulators other ways in which to defer the costs until future rate cases are filed. There is no assurance that the filed amount, or any portion thereof, of any requested increases will be granted. In April 2009, additional annualized revenues of \$2.4 million and \$3.8 million resulting from infrastructure charges for our Pennsylvania and Indiana subsidiaries became effective. There is no assurance that the filed amount, or any portion thereof, of any requested increases will be granted.

*Infrastructure Investment*

The water and wastewater utility industry is highly capital intensive. We invested approximately \$1 billion and \$750 million in net Company-funded capital improvements in 2008 and 2007, respectively. From 2009 to 2013, we estimate that Company-funded capital investment will total between \$4.0 billion and \$4.5 billion. We anticipate spending between \$790 million and \$1.0 billion yearly on Company-funded capital investment for the foreseeable future, depending upon the timing of major capital projects. Our capital investment includes both infrastructure renewal programs, where we replace existing infrastructure, as needed, and construction of new facilities to meet customer growth. From 2009 to 2013, we estimate we will invest approximately \$1.3 billion to \$1.4 billion to replace aging infrastructure including mains, meters, and supply and treatment facilities. We estimate that we will invest approximately \$1.2 billion to \$1.3 billion in new facilities to serve customer growth over this same period. In addition, we estimate that complying with water quality standards and other regulatory requirements will require approximately \$300 million to \$400 million of investment. Projects to enhance system reliability, quality of service and risk reduction are estimated to require an investment of approximately \$800 million while efficiency related projects are estimated to require an investment of approximately \$400 million to \$600 million over this same period.

These capital investments are needed on an ongoing basis to comply with existing and new regulations, renew aging treatment and network assets, provide capacity for new growth and enhance system reliability, security and quality of service. The need for continuous investment presents a challenge due to the potential for regulatory lag, or the delay in recovering our operating expenses and earning an appropriate rate of return on our invested capital and a return of our invested capital. Because the decisions of state PUCs and the timing of those decisions can have a significant impact on the operations and earnings of our Regulated Businesses, we maintain a rate case management program guided by the goals of obtaining efficient recovery of costs of capital and utility operation and maintenance costs, including costs incurred for compliance with environmental, health and safety

## **Table of Contents**

and water quality regulation. As discussed above under Economic Utility Regulation, we pursue methods to minimize the adverse impact of regulatory lag and have worked with state PUCs and legislatures to implement a number of approaches to achieve this result, including promoting the implementation of forms of forward-looking test years and infrastructure surcharges.

### *Compliance with Environmental, Health and Safety Standards*

Our water and wastewater operations are subject to extensive United States federal, state and local and, in the case of our Canadian operations, Canadian laws and regulations, governing the protection of the environment, health and safety, the quality of the water we deliver to our customers, water allocation rights, and the manner in which we collect, treat, discharge and dispose of wastewater. These requirements include the Safe Drinking Water Act, the Clean Water Act and similar state and Canadian laws and regulations. We are also required to obtain various environmental permits from regulatory agencies for our operations. State PUCs also set conditions and standards for the water and wastewater services we deliver. We incur substantial costs associated with compliance with environmental, health and safety and water quality regulation to which our Regulated Businesses are subject.

Environmental, health and safety and water quality regulations are complex and change frequently, and the overall trend has been that they have become more stringent over time. We face the risk that as newer or stricter standards are introduced, they could increase our operating expenses. In the past, we have generally been able to recover expenses associated with compliance for environmental, health and safety standards, but this recovery is affected by regulatory lag and the corresponding uncertainties surrounding rate recovery.

### *Production Costs*

Our water and wastewater services require significant production inputs and result in significant production costs. These costs include fuel and power, which is used to operate pumps and other equipment, purchased water and chemicals used to treat water and wastewater. We also incur production costs for waste disposal. For 2008, production costs accounted for approximately 11.4% of our total operating costs. Price increases associated with these inputs impact our results of operations until rate relief is granted.

### *Customer Growth*

Customer growth in our Regulated Businesses is driven by (i) organic population growth within our authorized service areas and (ii) by adding new customers to our regulated customer base by acquiring water and wastewater utility systems through acquisitions. Generally, we add customers through tuck-ins of small water and/or wastewater systems, typically serving fewer than 10,000 customers, in close geographic proximity to where we currently operate our Regulated Businesses. During 2008, 2007 and 2006, we had cash outflows of \$12.5 million, \$15.9 million and \$12.5 million, respectively, for tuck-in acquisitions of water and wastewater systems which allowed us to expand our regulated customer base. We also seek larger acquisitions that allow us to acquire multiple water and wastewater utility systems in our existing markets and markets where we currently do not operate our Regulated Businesses. Our experienced development team evaluates potential acquisition targets across the country, particularly in higher-growth areas. Before entering new markets, we will evaluate the regulatory environment to ensure that we will have the opportunity to achieve an appropriate return on our investment while maintaining our high standards for quality, reliability and compliance with environmental, health and safety and water quality standards. These acquisitions may include large acquisitions of companies that have operations in multiple markets. For further information, see Business Growth.

### *Declining Water Usage Per Customer*

Increased water conservation, including through the use of more efficient household fixtures and appliances among residential consumers, combined with declining household sizes in the United States, has contributed to a trend of declining water usage per residential customer. Additionally, in the current economic environment, both industrial and commercial usage continues to decline.

## **Table of Contents**

The average annual decrease in residential water usage per customer from January 1999 through December 2008 (as a percentage of January 1999 usage) in the larger states served by our Regulated Businesses ranged from a decline 0.56% per year in New Jersey at the low end to as high as 1.62% per year in West Virginia. The decline in industrial and commercial usage from 2007 to 2008 was 3.7%.

Because the characteristics of residential water use are driven by many factors, including socio-economic and other demographic characteristics of our service areas, climate, seasonal weather patterns and water rates, these declining trends vary by state and service area and change over time. The trend of declining residential water usage per customer is higher in the predominantly rural states served by our Regulated Businesses. We do not believe that the trend in any particular state or region will have a disproportionate impact on our results of operations.

Our Regulated Businesses are heavily dependent upon operating revenue generated from rates we charge to our customers for the volume of water they use. Declining usage due to conservation or economic environment will have a negative impact on our long-term operating revenues if we are unable to secure appropriate regulatory treatment to offset the usage decline.

### *Water Supply*

Our ability to meet the existing and future water demands of our customers depends on an adequate supply of water. Drought, governmental restrictions, overuse of sources of water, the protection of threatened species or habitats or other factors may limit the availability of ground and surface water. Also, customer usage of water is affected by weather conditions, in particular during the summer. Our water systems experience higher demand in the summer due to the warmer temperatures and increased usage by customers for lawn irrigation and other outdoor uses. Summer weather that is cooler and wetter than average generally serves to suppress customer water demand, and can have a downward effect on our operating revenue and operating income. Conversely, when weather conditions are extremely dry and even if our water supplies are sufficient to serve our customers, our systems may be affected by drought-related warnings and/or water usage restrictions imposed by governmental agencies, purchase supply allocation and mandatory conservation measures. All of the above conditions serve to reduce customer demand and operating revenues. These restrictions may be imposed at a regional or state level and may affect our service areas regardless of our readiness to meet unrestricted customer demands. We employ a variety of measures to ensure that we have adequate sources of water supply, both in the short-term and over the long-term. For additional detail concerning these measures, see [Business Our Regulated Businesses Overview of Networks, Facilities and Water Supply](#).

The geographic diversity of our service areas tends to mitigate some of the effect of weather extremes. In any given summer, some areas are likely to experience drier than average weather while other areas will experience wetter than average weather.

### *Goodwill Impairment*

At March 31, 2009, the Company's goodwill totaled \$1,249.8 million. The Company's annual impairment reviews are performed as of November 30 of each year, in conjunction with the timing of the completion of the Company's annual strategic business plan. The Company also undertakes interim reviews when the Company determines that a triggering event that would more likely than not reduce the fair value of a reporting unit below its carrying value has occurred.

The Company's calculated market capitalization at March 31, 2009 was \$1,186.0 million below its aggregated carrying value of its reporting units. During the first quarter of 2009, despite no apparent significant adverse changes in its underlying business, the Company's market price experienced a high degree of volatility and, as of March 31, 2009, had a sustained period for which it was below historical averages and 10% below the market price employed in the Company's 2008 annual goodwill impairment test. Having considered both

## **Table of Contents**

qualitative and quantitative factors, management concluded that this sustained decline in market value below the market value which existed at the 2008 annual impairment test, was an interim triggering event and performed an interim impairment test.

Management concluded the fair value of certain of the Company's reporting units were below their carrying values as of March 31, 2009. Upon completing the impairment calculation, the Company recognized \$450.0 million as a goodwill impairment charge for the three months ended March 31, 2009.

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

The Company uses a two-step impairment test to identify potential goodwill impairment and measure the amount of a goodwill impairment loss to be recognized (if any) in accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, which we refer to as SFAS 142. The step 1 calculation used to identify potential impairment compares the calculated fair value for each of the Company's reporting units to their respective net carrying values (book values), including goodwill, on the measurement date. If the fair value of any reporting unit is less than such reporting unit's carrying value, then step 2 is performed to measure the amount of the impairment loss (if any) for such reporting unit.

The step 2 calculation of the impairment test compares, by reporting unit, the implied fair value of the goodwill to the carrying value of goodwill. The implied fair value of goodwill is equal to the excess of the fair value of each reporting unit above the fair value of such reporting unit's identified assets and liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill for any reporting unit, an impairment loss is recognized in an amount equal to the excess (not to exceed the carrying value of goodwill) for that reporting unit.

The determination of the fair value of each reporting unit and the fair value of each reporting unit's assets and liabilities is performed as of the measurement date using observable market data before and after the measurement date (if that subsequent information is relevant to the fair value on the measurement date).

The estimated fair value of the regulated reporting unit for step 1 is based on a combination of the following valuation techniques:

- observable trading prices of comparable equity securities of publicly-traded water utilities considered by us to be the Company's peers; and

- discounted cash flow models developed from the Company's internal forecasts.

The estimated fair values of the non-regulated reporting units are determined entirely on the basis of discounted cash flow models.

The first valuation technique applies average peer multiples to the Regulated reporting unit's historic and forecasted cash flows. The peer multiples are calculated using the average trading prices of comparable equity securities of publicly-traded water utilities, their published cash flows and forecasts of market price and cash flows for those peers.



## **Table of Contents**

The second valuation technique forecasts each reporting unit's five-year cash flows using an estimated long-term growth rate and discounts these cash flows at their respective estimated weighted average cost of capital.

In conjunction with step 1, the Company also reconciles the difference between the calculated market capitalization and the aggregate carrying value of the reporting units to ensure that any excess is supportable by relevant market information. The Company makes certain assumptions, which it believes to be appropriate, that support this reconciliation. The Company considers, in addition to the listed trading price of the Company's shares, the effect on that price due to RWE's majority ownership, the effect of RWE's expected disposition of its owned Company shares on the market for those shares, the applicability of a control premium to the Company's shares and certain other factors the Company deems appropriate. As a result, the Company may conclude that the Company's fair value exceeds what the Company might otherwise have concluded had it relied on market price alone.

In addition, given recent market conditions, management determined that it is appropriate for the Company to consider the average of the Company's closing market price over a thirty day period rather than using a particular date to calculate its market capitalization.

If step 2 of the impairment test is required, the Company determines the fair value of the applicable reporting unit's assets and liabilities. The fair values of the applicable debt are highly dependent upon market conditions surrounding the measurement date. For the step 2 calculations of the fair value of debt, the Company uses observable prices of instruments and indices that have risks similar to those instruments being valued, adjusted to compensate for differences in credit profile, collateral, tax treatment and call features, to calculate the fair value of each reporting unit's debt.

For the years ended December 31, 2008, 2007 and 2006, the Company recorded impairment charges for goodwill, including discontinued operations, in the amount of \$750.0 million, \$509.3 million and \$227.8 million, respectively.

As of March 31, 2008, in light of the initial public offering price and trading levels in our common stock subsequent to the date of the initial public offering, the Company performed an interim impairment test and, on May 9, 2008, management concluded that the carrying value of the Company's goodwill was impaired. The Company believed that the initial public offering price was indicative of the value of the Company at March 31, 2008, and accordingly, based on those factors recorded an impairment charge to the goodwill of its Regulated reporting unit in the amount of \$750.0 million as of March 31, 2008. The impairment charge was primarily attributed to the market price of the Company's common stock (both the initial public offering price and the price during subsequent trading) being less than that implied by the trading value of peer companies used during the 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company's debt (due to increased market interest rates). As a result of the impairment charge, RWE Aqua Holdings GmbH (a wholly-owned subsidiary of RWE) transferred \$245.0 million to the Company on May 13, 2008. This cash was used to reduce short-term debt. RWE is not obligated to make any additional capital contributions.

During the third quarter of 2007, as a result of the Company's debt being placed on review for a possible downgrade and the proposed sale of a portion of the Company in the initial public offering, management determined at that time it was appropriate to update its valuation analysis before the next scheduled annual test. Based on this assessment, the Company performed an interim impairment test and recorded an impairment charge to goodwill related to its Regulated reporting unit in the amount of \$243.3 million as of September 30, 2007. The decline was primarily due to a slightly lower long-term earnings forecast caused by updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery.

The Company completed its scheduled annual impairment test in the fourth quarter of 2007 and determined that an impairment had occurred based upon information regarding the Company's market value in connection with the initial public offering. Management determined that the indicative fair value of the Company based on

**Table of Contents**

estimates of the initial public offering price range was the best evidence of the Company's market value and incorporated this indicated market value into the Company's valuation methodology, which also considered other items, such as peer multiples, discounted cash flows and a control premium. Based on the results of the impairment test, an impairment of \$266.0 million to the Company's carrying value was recognized as of December 31, 2007.

The 2006 impairment charge of \$227.8 million was attributable to higher interest rates in the Regulated reporting unit and a change in the potential net realizable value of a non-regulated reporting unit.

*Economic Environment*

Continued market disruption could cause a broad economic downturn. This downturn could lead to increased incidence of customers' failure to pay for services delivered as well as a decreased usage by our industrial and commercial customers.

**Table of Contents****Results of Operations**

The following table sets forth our consolidated statement of operations data for the years ended December 31, 2008, 2007 and 2006 and for the three months ended March 31, 2009 and 2008:

	For the Years Ended December 31,			For the three months ended March 31,	
	2006	2007	2008	2008	2009
	(in thousands, except per share data)			(unaudited)	(unaudited)
Operating revenues	\$ 2,093,067	\$ 2,214,215	\$ 2,336,928	\$ 506,815	\$ 550,170
Operating expenses:					
Operation and maintenance	1,174,544	1,246,479	1,303,798	311,261	314,402
Depreciation and amortization	259,181	267,335	271,261	63,916	68,843
General taxes	185,065	183,253	199,139	52,066	52,497
Loss (gain) on sale of assets	79	(7,326)	(374)	(70)	(202)
Impairment charges	221,685	509,345	750,000	750,000	450,000
Total operating expenses, net	1,840,554	2,199,086	2,523,824	1,177,173	885,540
Operating income (loss)	252,513	15,129	(186,896)	(670,358)	(335,370)
Other income (deductions):					
Interest, net	(365,970)	(283,165)	(285,155)	(69,968)	(71,979)
Allowance for other funds used during construction	5,980	7,759	14,497	2,541	3,343
Allowance for borrowed funds used during construction	2,652	3,449	8,171	1,368	1,872
Amortization of debt expense	(5,062)	(4,867)	(5,895)	(1,318)	(1,488)
Preferred dividends of subsidiaries	(215)	(225)	(225)		
Other, net	1,164	6,401	4,909	1,149	1,114
Total other income (deductions)	(361,451)	(270,648)	(263,698)	(66,228)	(67,138)
Loss from continuing operations before income taxes	(108,938)	(255,519)	(450,594)	(736,586)	(402,508)
Provision for income taxes	46,912	86,756	111,827	(4,102)	10,571
Loss from continuing operations	(155,850)	(342,275)	(562,421)	(732,484)	(413,079)
Loss from discontinued operations, net of tax	(6,393)	(551)			
Net loss	\$ (162,243)	\$ (342,826)	\$ (562,421)	(732,484)	(413,079)
Loss per common share:					
Basic					
Loss from continuing operations	\$ (0.97)	\$ (2.14)	\$ (3.52)	\$ (4.58)	\$ (2.58)
Loss from discontinued operations, net of tax	\$ (0.04)	\$ (0.00)	\$		
Net loss	\$ (1.01)	\$ (2.14)	\$ (3.52)	\$ (4.58)	\$ (2.58)
Diluted					
Loss from continuing operations	\$ (0.97)	\$ (2.14)	\$ (3.52)	\$ (4.58)	\$ (2.58)
Loss discontinued operations, net of tax	\$ (0.04)	\$ (0.00)	\$		
Net loss	\$ (1.01)	\$ (2.14)	\$ (3.52)	\$ (4.58)	\$ (2.58)
Average common shares outstanding during the period:					
Basic	160,000	160,000	159,967	160,000	160,011
Diluted	160,000	160,000	159,967	160,000	160,011
Dividends per common share	\$	\$	\$ 0.40	\$	\$ 0.20



**Table of Contents**

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

	For the Years Ended December 31,						For the Three Months Ended March 31,			
	2006		2007		2008		2008		2009	
	Regulated Businesses	Non- Regulated Businesses	Regulated Businesses	Non- Regulated Businesses	Regulated Businesses	Non- Regulated Businesses	Regulated Businesses (unaudited)	Non- Regulated Businesses (unaudited)	Regulated Businesses (unaudited)	Non- Regulated Businesses (unaudited)
Operating revenues	\$ 1,854,618	\$ 248,451	\$ 1,987,565	\$ 242,678	\$ 2,082,740	\$ 272,186	\$ 449,534	\$ 61,172	\$ 497,370	\$ 57,532
Adjusted EBIT(1)	\$ 468,701	\$ (4,725)	\$ 500,088	\$ 23,579	\$ 531,774	\$ 26,307	\$ 71,900	\$ 4,582	\$ 107,726	\$ 4,715

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

Our primary business involves the ownership of water and wastewater utilities that provide services to residential, commercial and industrial customers. As such, our results of operations are significantly impacted by rates authorized by the state regulatory commissions in the states in which we operate. The table below details the annualized revenues, including step increases resulting from rate authorizations and infrastructure charges, which were granted in 2008, 2007 and 2006 and the three months ended March 31, 2009.

State	Annualized Rate Increases Granted During the Years Ended December 31, Three Months Ended March 31,			
	2006	2007	2008	2009
	(in millions)			
New Jersey	\$	\$ 56.2	\$ 72.1	\$
Pennsylvania	8.0	40.6	12.2	6.0
Missouri	6.8	24.0	37.2	
Illinois	0.9	1.7	22.7	
Indiana	1.8	14.0	3.9	
California	15.1	0.5	13.0	
West Virginia			14.5	5.2
New York			6.6	0.4
Arizona	7.9	3.7	9.2	0.2
Other	0.8	18.2	14.9	
Total	\$ 41.3	\$ 158.9	\$ 206.3	\$ 11.8

The effective dates for the larger rate increases granted in 2008 were December 8, 2008, November 28, 2008 and August 8, 2008 in New Jersey, Missouri and Illinois, respectively. The effective dates for the larger rate increases granted in 2007 were March 30, 2007, November 30, 2007 and October 22, 2007 in New Jersey, Pennsylvania and Missouri, respectively. The change in annualized rate increases granted between 2006 and 2007 can be attributed to the removal of the stay-out provisions and increased investment in our regulated infrastructure programs.

**Comparison of Results of Operations for the Three Months Ended March 31, 2009 and 2008**

**Operating revenues.** Operating revenues increased by \$43.4 million, or 8.6% for the three months ended March 31, 2009 compared to the three months ended March 31, 2008. Regulated Businesses revenues increased by \$47.8 million, or 10.6% for the three months ended March 31, 2009 compared to the same period in the prior year. The Non-Regulated Businesses revenues for the three months ended March 31, 2009 decreased by \$3.6 million, or 6.0% compared to the three months ended March 31, 2008.



**Table of Contents**

The increase in revenues from the Regulated Businesses for the three months ended March 31, 2009 compared to the three months ended March 31, 2008 was primarily due to rate increases obtained through rate authorizations for many of our operating companies (most of which were granted and became effective during periods throughout 2008) of which the first quarter 2009 impact was approximately \$43.5 million. In addition, surcharge and balancing account revenues increased by \$3.7 million for the three months ended March 31, 2009 compared to the same period in 2008. These increases were offset by decreased revenues of approximately \$2.0 million attributable to lower demand in the first quarter of 2009 compared to the first quarter of 2008.

The net decrease in revenues from the Non-Regulated Businesses was primarily attributable to lower revenues of \$3.2 million in our Contract Operations Group, which was mainly attributable to lower revenues associated with design and build contracts, offset by increased military project revenues.

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

Customer Class	2009		For the three months ended March 31, 2008		2009		2008	
	Operating Revenues		Operating Revenues		Water Sales Volume		Water Sales Volume	
	(Dollars in thousands, gallons in millions)		(Dollars in thousands, gallons in millions)		(Dollars in thousands, gallons in millions)		(Dollars in thousands, gallons in millions)	
Water service:								
Residential	\$ 286,620	57.6%	\$ 257,223	57.2%	44,555	53.0%	45,245	52.0%
Commercial	91,133	18.3%	82,853	18.4%	18,229	21.7%	18,916	21.7%
Industrial	23,081	4.7%	23,837	5.3%	8,629	10.3%	9,908	11.4%
Public and other	62,808	12.6%	57,820	12.9%	12,614	15.0%	12,959	14.9%
Other water revenues	12,063	2.4%	9,046	2.0%				
Total water revenues	475,705	95.6%	430,779	95.8%	84,027	100.0%	87,028	100.0%
Wastewater service	21,665	4.4%	18,755	4.2%				
	\$ 497,370	100.0%	\$ 449,534	100.0%				

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

*Water Services* Water service operating revenues from residential customers for the three months ended March 31, 2009 totaled \$286.6 million, a \$29.4 million increase, or 11.4%, over the same period in 2008, mainly due to rate increases partially offset by a decrease in sales volume. The volume of water sold to residential customers decreased by 1.3% for the three months ended March 31, 2009 to 44.6 billion gallons, from 45.2 billion gallons for the same period in 2008.

Water service operating revenues from commercial water customers for the three months ended March 31, 2009 increased by \$8.2 million, or 9.9%, to \$91.1 million mainly due to rate increases offset by decreases in sales volume compared to the same period in 2008. The volume of water sold to commercial customers decreased by 3.7% for the three months ended March 31, 2009, to 18.2 billion gallons, from 18.9 billion gallons for the three months ended March 31, 2008.

Water service operating revenues from industrial customers totaled \$23.1 million for the three months ended March 31, 2009, a decrease of \$0.7 million, or 2.9%, from those recorded for the same period in 2008 mainly due to decreased sales volume offset by rate increases. The volume of water sold to industrial customers totaled 8.6 billion gallons for the three months ended March 31, 2009, a decrease of 13.1% from the 9.9 billion gallons for

**Table of Contents**

the three months ended March 31, 2008. We attribute this decrease to the current economic environment as customers reduce demand due to a slow-down in their production process or the shut-down of production all together in the case of some bankruptcies.

Water service operating revenues from public and other customers increased \$5.0 million, or 8.7%, for the three months ended March 31, 2009 to \$62.8 million from \$57.8 million for the three months ended March 31, 2008 mainly due to rate increases. Revenues from municipal governments for fire protection services and customers requiring special private fire service facilities totaled \$27.2 million for the three months ended March 31, 2009, an increase of \$1.6 million over the same period of 2008. Revenues generated by sales to governmental entities and resale customers for the three months ended March 31, 2009 totaled \$35.6 million, an increase of \$3.4 million from the three months ended March 31, 2008.

*Wastewater services* Our subsidiaries provide wastewater services in 12 states. Revenues from these services increased by \$2.9 million, or 15.4%, to \$21.7 million for the three months ended March 31, 2009, from \$18.8 million for the same period in 2008. The increase was attributable to increases in rates charged to customers in a number of our operating companies as well as higher revenues as a result of acquisitions of wastewater systems in Pennsylvania and West Virginia in the last six months of 2008.

*Operation and maintenance.* Operation and maintenance expense increased \$3.1 million, or 1.0%, for the three months ended March 31, 2009 compared to the same period in the prior year.

Operation and maintenance expenses for the three months ended March 31, 2009 and 2008, by major expense category, were as follows:

	For the three months ended March 31,			
	2009	2008	Increase (Decrease)	Percentage
	(In thousands)			
Production costs	\$ 69,027	\$ 64,228	\$ 4,799	7.5%
Employee-related costs	132,611	126,833	5,778	4.6%
Operating supplies and services	56,830	69,495	(12,665)	(18.2)%
Maintenance materials and services	32,242	34,947	(2,705)	(7.7)%
Customer billing and accounting	10,803	7,410	3,393	45.8%
Other	12,889	8,348	4,541	54.4%
<b>Total</b>	<b>\$ 314,402</b>	<b>\$ 311,261</b>	<b>\$ 3,141</b>	<b>1.0%</b>

Production costs, including fuel and power, purchased water, chemicals and waste disposal increased by \$4.8 million, or 7.5%, for the three months ended March 31, 2009 compared to the same period in the prior year. Production costs, by major expense type were as follows:

	For the three months ended March 31,			
	2009	2008	Increase (Decrease)	Percentage
	(In thousands)			
Fuel and power	\$ 25,906	\$ 25,218	\$ 688	2.7%
Purchased water	20,351	19,350	1,001	5.2%
Chemicals	14,827	11,267	3,560	31.6%
Waste disposal	7,943	8,393	(450)	(5.4)%
<b>Total</b>	<b>\$ 69,027</b>	<b>\$ 64,228</b>	<b>\$ 4,799</b>	<b>7.5%</b>

The increase in purchased water is primarily due to rate increases by our suppliers resulting from higher costs incurred. Chemical costs increased due to rising prices for those commodities.





**Table of Contents**

Employee-related costs including wage and salary, group insurance, and pension expense increased \$5.8 million or 4.6%, for the three months ended March 31, 2009, compared to the same period in the prior year. These employee related costs represented 42.2% and 40.7% of operation and maintenance expenses for the three months ended March 31, 2009 and 2008, respectively.

	For the three months ended March 31,			
	2009	2008	Increase (Decrease)	Percentage
	(In thousands)			
Salaries and wages	\$ 92,706	\$ 92,673	\$ 33	0.0%
Pensions	14,649	11,260	3,389	30.1%
Group insurance	20,264	17,810	2,454	13.8%
Other benefits	4,992	5,090	(98)	(1.9)%
<b>Total</b>	<b>\$ 132,611</b>	<b>\$ 126,833</b>	<b>\$ 5,778</b>	<b>4.6%</b>

Salaries and wages remained relatively unchanged with increased headcount offset by less overtime worked in addition to the lower incentive payouts. Pension expense increased for the three months ended March 31, 2009 due to an increase in the amortization of actuarial losses attributable to lower than expected returns on plan assets in 2008 as a result of the decline in the economic environment. These market conditions are also the primary reason for the rise of other post employment benefits which are included in the group insurance figures above.

Operating supplies and services include the day-to-day expenses of office operation, legal and other professional services, as well as information systems and other office equipment rental charges. For the three months ended March 31, 2009, these costs decreased by \$12.7 million or 18.2%, compared to the same period in 2008.

	For the three months ended March 31,			
	2009	2008	Increase (Decrease)	Percentage
	(In thousands)			
Contracted services	\$ 18,564	\$ 27,019	\$ (8,455)	(31.3)%
Office supplies and services	14,842	14,805	37	0.2%
Transportation	7,281	8,453	(1,172)	(13.9)%
Rents	5,366	5,717	(351)	(6.1)%
Other	10,777	13,501	(2,724)	(20.2)%
<b>Total</b>	<b>\$ 56,830</b>	<b>\$ 69,495</b>	<b>\$ (12,665)</b>	<b>(18.2)%</b>

Contracted services decreased for the three months ended March 31, 2009 compared to the same period in 2008. This decrease is due to the consulting fees associated with our remediation efforts to comply with the Sarbanes-Oxley Act of 2002. These costs amounted to \$6.0 million for the period ended March 31, 2008. Additionally, contracted services decreased in our Contract Operations group by \$3.0 million primarily related to a decreased level of activity for the Design, Build and Operate project in Fillmore, California. The decrease in transportation costs was due to lower gasoline prices during the three months ended March 31, 2009 compared to the same period in 2008. Other operating supplies and services decreased due to lower divestiture related costs. These costs totaled \$3.3 million in 2008 compared to \$0.4 million in 2009.

**Table of Contents**

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, decreased \$2.7 million or by 7.7%, for the three months ended March 31, 2009 compared to the same period in the prior year.

	For the three months ended March 31,			
	2009	2008	Increase (Decrease)	Percentage
	(In thousands)			
Maintenance services and supplies	\$ 22,233	\$ 24,394	\$ (2,161)	(8.9)%
Removal costs, net	10,009	10,553	(544)	(5.2)%
<b>Total</b>	<b>\$ 32,242</b>	<b>\$ 34,947</b>	<b>\$ (2,705)</b>	<b>(7.7)%</b>

The Regulated Businesses' maintenance materials and service costs decreased by \$3.0 million for the three months ended March 31, 2009. In addition to lower removal costs, the expenses for the quarter ended March 31, 2008 included \$1.8 million in costs associated with a program in Illinois to maintain valves. Additionally, tank painting expenses were lower by \$1.1 million primarily in New Jersey.

Customer billing and accounting expenses increased by \$3.4 million, or 45.8%, for the three months ended March 31, 2009 compared to the same period in the prior year.

	For the three months ended March 31,			
	2009	2008	Increase (Decrease)	Percentage
	(In thousands)			
Uncollectible accounts expense	\$ 4,735	\$ 1,407	\$ 3,328	236.5%
Postage	2,966	2,797	169	6.0%
Other	3,102	3,206	(104)	(3.2)%
<b>Total</b>	<b>\$ 10,803</b>	<b>\$ 7,410</b>	<b>\$ 3,393</b>	<b>45.8%</b>

The increase was the result of higher uncollectible accounts expense in our Regulated Businesses of \$3.9 million due to an usually low balance in 2008 due to a concerted collection effort of previously written off accounts in the first quarter of 2008 as well as increases in our overall write-off percentages and specific provisions for certain receivables due to the uncertainty of collectability in the first quarter of 2009. Our Non-Regulated Businesses' uncollectible expense decreased by \$0.5 million, primarily due to collection of previous write-offs.

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs increased by \$4.5 million, or 54.4%, in 2009.

	For the three months ended March 31,			
	2009	2008	Increase (Decrease)	Percentage
	(In thousands)			
Insurance	\$ 10,344	\$ 6,478	\$ 3,866	59.7%
Regulatory expenses	2,545	1,870	675	36.1%
<b>Total</b>	<b>\$ 12,889</b>	<b>\$ 8,348</b>	<b>\$ 4,541</b>	<b>54.4%</b>

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



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**Table of Contents**

**Depreciation and amortization.** Depreciation and amortization expense increased by \$4.9 million, or 7.7%, for the three months ended March 31, 2009 compared to the same period in the prior year as a result of additional utility plant placed in service.

**General taxes.** General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, relatively remained unchanged, increasing by only \$0.4 million, or 0.8%, in the three months ended March 31, 2009 compared to the three months ended March 31, 2008.

**Gain on sale of assets.** Gain on sale of assets was \$0.2 million for the three months ended March 31, 2009 compared to a gain of \$0.1 million for the three months ended March 31, 2008 due to non-recurring sales of assets no longer used in our operations.

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

**Other income (deductions).** Interest expense, net of interest income, which is the primary component of our other income (deductions), increased by \$2.0 million, or 2.9%, for the three months ended March 31, 2009 compared to the same period in the prior year. The increase is primarily due to the increased borrowings associated with capital expenditures. Partially offsetting the change in interest expense was an increase in AFUDC of \$1.3 million for the three months ended March 31, 2009 compared to the same period in 2008 as a result of increased construction work in progress.

**Provision for income taxes.** Our consolidated provision for income taxes increased \$14.7 million, or 358.5%, to \$10.6 million for the three months ended March 31, 2009. The effective tax rates for the three months ended March 31, 2009 and 2008 of (2.6%) and 0.6% respectively, reflect the tax effects of goodwill impairments as discrete items as the Company considers these charges as infrequently occurring or unusual.

**Net income (loss).** Net loss decreased \$319.4 million, to \$413.1 million for the three months ended March 31, 2009 compared to a net loss of \$732.5 million for the three months ended March 31, 2008. The decrease is the result of the aforementioned changes.

***Comparison of Results of Operations for the Years Ended December 31, 2008 and 2007***

**Operating revenues.** Our operating revenues increased by \$122.7 million, or 5.5%, to \$2,336.9 million for 2008 from \$2,214.2 million for 2007. Regulated Businesses' revenues increased by \$95.2 million, or 4.8%, for 2008 compared to 2007. The Non-Regulated Businesses' revenues for 2008 increased by \$29.5 million, or 12.2%, from 2007.

The increase in the Regulated Businesses' revenues was primarily due to rate increases obtained through general rate cases totaling approximately \$132.8 million as well as higher revenues resulting from surcharges of \$4.5 million and from customer growth and acquisitions of approximately \$3.3 million. This increase was offset by a \$52.3 million decrease in revenues related to lower customer consumption, mainly in our states in the Midwestern region of the United States primarily due to the extremely wet weather conditions in those areas during 2008, as well as decreased usage in 2008 compared to 2007 in New Jersey and Pennsylvania mainly due to drier weather conditions in 2007.

## Table of Contents

Our Non-Regulated Businesses' operating revenues increased by \$29.5 million, or 12.2%, to \$272.2 million in 2008 from \$242.7 million for 2007. The net increase was primarily attributable to higher revenues in our Contract Operations Group and our Homeowner Services Group, partially offset by decreased revenues in our Applied Water Management Group and Canadian Fixed Residuals. The increase in Contract Operations Group revenues was primarily attributable to incremental revenues associated with design and build contracts, as well as increased military construction and O&M project revenues. The increase from our Homeowner Service Group represented increased product penetration within its existing customer base. Applied Water Management Group revenues were lower than the prior year as a result of the decline in design and build activity resulting from the downturn in new home construction.

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

Customer Class	2008		For the Years Ended December 31, 2007		2008		2007	
	Operating Revenues (dollars in thousands)				Water Sales Volume (gallons in millions)			
Water service:								
Residential	\$ 1,197,723	57.5%	\$ 1,146,133	57.7%	214,045	52.9%	223,386	52.8%
Commercial	403,596	19.4%	385,272	19.4%	89,920	22.2%	93,010	22.0%
Industrial	101,769	4.9%	94,734	4.8%	42,032	10.4%	44,609	10.5%
Public and other	255,637	12.3%	247,578	12.4%	58,838	14.5%	62,299	14.7%
Other water revenues	44,157	2.1%	38,277	1.9%				
Total water revenues	2,002,882	96.2%	1,911,994	96.2%	404,835	100.0%	423,304	100.0%
Wastewater service	79,858	3.8%	75,571	3.8%				
	\$ 2,082,740	100.0%	\$ 1,987,565	100.0%				

*Water services* Water service operating revenues from residential customers for 2008 increased \$51.6 million, or 4.5%, from 2007, primarily due to rate increases offset by a decrease in sales volume. The volume of water sold to residential customers decreased by 9.3 billion gallons, or 4.2%, from 2007, largely as a result of wetter weather conditions in California and the Midwestern region of the United States in 2008 and drier weather conditions in New Jersey and Pennsylvania in 2007.

Water service operating revenues from commercial water customers for 2008 increased by \$18.3 million, or 4.8%, mainly due to rate increases offset by decreases in sales volume compared to 2007. The volume of water sold to commercial customers decreased by 3.1 billion gallons, or 3.3%, from 2007.

Water service operating revenues from industrial customers for 2008 increased \$7.0 million, or 7.4%, from 2007 mainly due to rate increases, offset by decreased sales volume that we believe were caused by the downturn in the economy. The volume of water sold to industrial customers decreased 2.6 billion gallons, or 5.8%, from 2007.

Water service operating revenues from public and other customers increased \$8.1 million, or 3.3%, from 2007 mainly due to rate increases. Revenues from municipal governments for fire protection services and customers requiring special private fire service facilities totaled \$104.3 million for 2008, an increase of \$5.0 million from 2007. Revenues generated by sales to governmental entities and resale customers for 2008 totaled \$151.3 million, an increase of \$3.1 million from 2007.

*Wastewater services* Our subsidiaries provide wastewater services in 12 states. Revenues from these services for 2008 increased by \$4.3 million, or 5.7%, from 2007. The increase was attributable to increases in rates charged to customers principally in Arizona, New Jersey and Pennsylvania.

**Table of Contents**

**Operation and maintenance.** Operation and maintenance expense increased \$57.3 million, or 4.6%, for 2008 compared to 2007.

Operation and maintenance expense for the 2008 and 2007, by major expense category, were as follows:

	For the Years Ended December 31,			Percentage
	2008	2007	Increase (Decrease) (in thousands)	
Production costs	\$ 288,571	\$ 278,065	\$ 10,506	3.8%
Employee-related costs	505,550	463,362	42,188	9.1%
Operating supplies and services	283,230	293,475	(10,245)	(3.5)%
Maintenance materials and services	136,305	128,016	8,289	6.5%
Customer billing and accounting	44,012	38,256	5,756	15.0%
Other	46,130	45,305	825	1.8%
<b>Total</b>	<b>\$ 1,303,798</b>	<b>\$ 1,246,479</b>	<b>\$ 57,319</b>	<b>4.6%</b>

Production costs increased by \$10.5 million, or 3.8%, for 2008 compared to 2007. Production costs by major expense type were as follows:

	For the Years Ended December 31,			Percentage
	2008	2007	Increase (Decrease) (in thousands)	
Fuel and power	\$ 110,641	\$ 106,937	\$ 3,704	3.5%
Purchased water	95,253	94,011	1,242	1.3%
Chemicals	50,823	45,159	5,664	12.5%
Waste disposal	31,854	31,958	(104)	(0.3)%
<b>Total</b>	<b>\$ 288,571</b>	<b>\$ 278,065</b>	<b>\$ 10,506</b>	<b>3.8%</b>

The increase in fuel and power costs was primarily due to higher electricity prices. Purchased water costs were higher as a result of rate increases resulting from higher costs incurred by our suppliers. The increase in chemical costs were attributable to rising prices as well as additional usage requirements related to fluctuating raw water quality caused by weather conditions in some of the states in which we operate.

Employee-related costs including wage and salary, group insurance, and pension expense increased \$42.2 million, or 9.1%, for 2008 compared to 2007. These employee-related costs represented 38.8% and 37.2% of operation and maintenance expenses for 2008 and 2007, respectively.

	For the Years Ended December 31,			Percentage
	2008	2007	Increase (Decrease) (in thousands)	
Salaries and wages	\$ 379,509	\$ 352,177	\$ 27,332	7.8%
Pensions	39,315	29,984	9,331	31.1%
Group insurance	67,330	64,832	2,498	3.9%
Other benefits	19,396	16,369	3,027	18.5%
<b>Total</b>	<b>\$ 505,550</b>	<b>\$ 463,362</b>	<b>\$ 42,188</b>	<b>9.1%</b>

Salaries and wages increased \$23.7 million and \$5.1 million in our Regulated and Non-Regulated Businesses, respectively. These increases primarily resulted from stock-based compensation expense of





**Table of Contents**

\$3.7 million mainly attributable to the issuance of awards granted in connection with the initial public offering, \$4.3 million of wages related to job reclassification of certain hourly employees for services performed and from an increase in the number of employees primarily as a result of enhancing customer service and inflationary wage rate increases. The increase in pension expense was primarily due to an increase in our Regulated Businesses' pension expense of \$9.1 million, or 25.1%, for 2008 over 2007. Pension expense in excess of the amount contributed to the pension plans is deferred by certain of our regulated subsidiaries pending future recovery in rates as contributions are made to the plans. Although our pension expense calculated in accordance with SFAS 87 remained relatively unchanged, pension expense increased for 2008 due to increased contributions by certain of our regulated operating companies whose costs are recovered based on the Company's funding policy, which is to fund at least the minimum amount required by the Employee Retirement Income Security Act of 1974 which we refer to as ERISA, rather than the SFAS 87 expense. The increase in the contributions is attributable to a change in the discount rate and lower than expected returns on plan assets. Medical benefit expenses for employees increased due to an increase in the number of employees and the rising cost of health care. Other benefits increased primarily as a result of increased salaries and wages which in turn resulted in increased Company contribution to the 401(k) and defined contribution plans. Also other benefit expenses increased due to the benefit expense related to the new employee stock purchase plan.

Operating supplies and services include the day-to-day expenses of office operation, legal and other professional services, as well as information systems and other office equipment rental charges. For 2008, these costs decreased by \$10.2 million, or 3.5%, compared to 2007.

	For the Years Ended December 31,			
	2008	2007	Increase (Decrease)	Percentage
	(in thousands)			
Contracted services	\$ 111,847	\$ 110,083	\$ 1,764	1.6%
Office supplies and services	63,422	62,464	958	1.5%
Transportation	36,337	35,051	1,286	3.7%
Rents	22,543	21,985	558	2.5%
Other	49,081	63,892	(14,811)	(23.2)%
Total	\$ 283,230	\$ 293,475	\$ (10,245)	(3.5)%

Contracted services increased in 2008 compared to the same period in 2007. This increase was primarily due to higher contracted services in our Contract Operations group in 2008 as compared to 2007, associated with several operating contracts (including a DBO project in Fillmore, California). Offsetting this increase were lower consulting fees associated with our remediation efforts to comply with Sarbanes-Oxley Act of 2002. These costs decreased by \$22.6 million to \$9.4 million in 2008 from \$32.0 million in 2007. Other operating supplies and services were lower in 2008 as 2007 costs were higher due to a write-off of certain deferred costs totaling \$1.1 million by our New Jersey subsidiary as they were no longer deemed recoverable. Additionally, our Non-Regulated Businesses recorded loss contingencies of \$3.6 million in 2007. Other decreases are associated with the cost of materials primarily related to our Contract Operations Group, due to changes in project work performed.

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, increased \$8.3 million, or by 6.5%, for 2008 compared to 2007.

	For the Years Ended December 31,			
	2008	2007	Increase (Decrease)	Percentage
	(in thousands)			
Maintenance services and supplies	\$ 94,790	\$ 92,041	\$ 2,749	3.0%
Removal costs, net	41,515	35,975	5,540	15.4%
Total	\$ 136,305	\$ 128,016	\$ 8,289	6.5%

**Table of Contents**

Our Regulated Businesses' maintenance materials and service costs increased by \$6.8 million in 2008 mainly due to increased costs of \$1.7 million associated with a program in Illinois to maintain valves and fire hydrants, and higher cost of removal expenses of \$5.5 million in certain of our operating companies, partially offset by lower paving costs of \$1.4 million in our New Jersey and Missouri operating companies. The Non-Regulated Businesses' maintenance and services expenses increased by \$1.7 million as a result of higher frequency of claims, primarily resulting from the increase in the number of customer contracts, with the service line protection program in our Homeowner Services Group, as well as from increased costs associated with the Contract Operations Group mainly due to costs associated with new military operations and maintenance projects.

Customer billing and accounting expenses increased by \$5.8 million, or 15.0%, for 2008 compared to 2007.

	For the Years Ended December 31,			
	2008	2007	Increase (Decrease) (in thousands)	Percentage
Uncollectible accounts expense	\$ 19,233	\$ 15,818	\$ 3,415	21.6%
Postage	11,829	10,932	897	8.2%
Other	12,950	11,506	1,444	12.6%
Total	\$ 44,012	\$ 38,256	\$ 5,756	15.0%

The increase was primarily the result of higher uncollectible accounts expense in our Regulated Businesses of \$0.6 million and in our Non-Regulated Businesses of \$2.9 million primarily due to increased uncollectible expense in the Applied Water Management Group of \$1.8 million primarily due to the collection of \$1.2 million in 2007 for an amount that was previously written-off as well as higher uncollectible expense in our Contract Operation Group. In addition, postage expense increased in our Regulated subsidiaries \$0.9 million compared to 2007.

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs increased by \$0.8 million, or 1.8%, for 2008 compared to 2007.

	For the Years Ended December 31,			
	2008	2007	Increase (Decrease) (in thousands)	Percentage
Insurance	\$ 33,173	\$ 37,276	\$ (4,103)	(11.0)%
Regulatory expenses	12,957	8,029	4,928	61.4%
Total	\$ 46,130	\$ 45,305	\$ 825	1.8%

Insurance expense decreased due to more favorable claims experience in 2008 compared to 2007. Regulatory expenses increased primarily due to write-offs of deferred rate case expenses, primarily in Tennessee, Illinois, California, and Ohio as well as increased rate case amortization costs associated with rate cases settled in 2007.

**Depreciation and amortization.** Depreciation and amortization expense increased by \$3.9 million, or 1.5%, for 2008 compared to 2007. This increase was primarily due to additional assets placed in service, mainly in our Regulated Businesses, over the last year.

**General taxes.** General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, increased by \$15.9 million, or 8.7%, in 2008 compared to 2007. This increase is primarily due to increased gross receipts taxes of \$7.9 million primarily in New Jersey and Missouri and higher property tax expense of \$4.2 million primarily in Ohio and Missouri. Additionally, payroll taxes increased by \$2.7 million, due to increased salaries and wages and higher payroll tax limits.

## **Table of Contents**

**Gain on sale of assets.** The gain on sale of assets was \$0.4 million for 2008 compared to a gain of \$7.3 million for 2007. The gains in 2008 and 2007 are primarily attributable to non-recurring sales of assets no longer used in our operations.

**Impairment charge.** The impairment charge was \$750.0 million for 2008 compared to \$509.3 million for 2007. The 2008 impairment charge was primarily due to the market price of the Company's common stock (both the initial public offering price and the price during subsequent trading) being less than what was anticipated during our 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company's debt (due to increased interest rates). The 2007 impairment charge to goodwill to our Regulated Businesses was primarily due to slightly lower long-term earnings forecast caused by our updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery. See Factors Affecting Our Results of Operations Goodwill Impairment.

**Other income (deductions).** Interest expense, net of interest income, the primary component of our other income (deductions), increased by \$2.0 million, or 0.7%, for 2008 compared to 2007. The increase is primarily due to increased borrowings associated with capital expenditures. Offsetting the change in interest expense is an increase in AFUDC of \$11.5 million for 2008 compared to 2007 as a result of increased construction activity in 2008 over 2007. Amortization of debt expense increased \$1.0 million for 2008 compared to 2007 as a result of debt restructuring. Other items contributing to the change include lower miscellaneous income for 2008 compared to 2007 primarily as a result of our Indiana subsidiary now accounting for certain income in operating revenues in accordance with a 2007 rate order.

**Provision for income taxes.** Our consolidated provision for income taxes increased \$25.0 million, or 28.8%, to \$111.8 million for 2008 from \$86.8 million for 2007.

**Net income (loss).** The net loss for 2008 was \$562.4 million compared to a net loss of \$342.8 million for 2007. The variation between the periods is the result of the aforementioned changes.

### ***Comparison of Results of Operations for the Years Ended December 31, 2007 and 2006***

**Operating revenues.** Our consolidated operating revenues increased \$121.1 million, or 5.8%, to \$2,214.2 million for 2007 from \$2,093.1 million for 2006. An increase in operating revenues for our Regulated Businesses of \$132.9 million in 2007 was somewhat offset by a decrease in operating revenues for our Non-Regulated Businesses of \$5.8 million. The increase in the Regulated Businesses' operating revenues was primarily due to rate increases of approximately \$61.9 million obtained through general rate cases in New Jersey, Ohio, Arizona, California and other states. In addition, rate increases obtained through infrastructure-related provisions in Pennsylvania, Missouri, Illinois and Indiana totaled approximately \$15.5 million. Water service operating revenues also increased due to growth of 0.7% in our Regulated Businesses' customer base through small acquisitions in our service areas and through growth in existing service areas. Water sales volume associated with existing customers increased by 1.5% in 2007 compared to the prior year due to dry weather mainly in New Jersey and Pennsylvania.

**Table of Contents**

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

Customer Class	2007		For the Years Ended December 31, 2006		2007		2006	
	Operating Revenues (dollars in thousands)		Operating Revenues (dollars in thousands)		Water Sales Volume (gallons in millions)		Water Sales Volume (gallons in millions)	
Water service:								
Residential	\$ 1,146,133	57.7%	\$ 1,067,865	57.6%	223,386	52.8%	217,172	52.1%
Commercial	385,272	19.4%	362,754	19.5%	93,010	22.0%	91,589	22.0%
Industrial	94,734	4.8%	92,024	5.0%	44,609	10.5%	44,408	10.6%
Public and other	247,578	12.4%	230,177	12.4%	62,299	14.7%	63,814	15.3%
Other water revenues	38,277	1.9%	29,621	1.6%				
Total water revenues	1,911,994	96.2%	1,782,441	96.1%	423,304	100.0%	416,983	100.0%
Wastewater service	75,571	3.8%	72,177	3.9%				
	\$ 1,987,565	100.0%	\$ 1,854,618	100.0%				

*Water Services* Water service operating revenues from residential customers for 2007 amounted to \$1,146.1 million, a 7.3% increase over 2006, primarily due to rate increases and changes in sales volume. The volume of water sold to residential customers increased by 2.9% in 2007 to 223.4 billion gallons, from 217.2 billion gallons in 2006, largely as a result of favorable weather conditions in the Mid-Atlantic states and a 0.7% increase in the residential customer base due to growth, primarily through acquisitions.

Water service operating revenues from commercial water customers for 2007 amounted to \$385.3 million, a 6.2% increase over 2006, primarily due to rate increases and changes in sales volume. The volume of water sold to commercial customers increased by 1.6% in 2007 to 93.0 billion gallons, from 91.6 billion gallons in 2006, driven by favorable weather conditions and partially offset by a decline in the number of commercial customers.

Water service operating revenues from industrial customers amounted to \$94.7 million in 2007, a 2.9% increase over 2006, primarily due to rate increases and changes in sales volume. The volume of water sold to industrial customers increased by 0.5% in 2007 to 44.6 billion gallons, from 44.4 billion gallons in 2006.

Water service operating revenues from public and other customers increased \$17.4 million for 2007 to \$247.6 million from \$230.2 million for 2006, mainly due to rate increases and changes in sales volume. Revenues from municipal governments for fire protection services and customers requiring special private fire service facilities totaled \$99.3 million for 2007, an increase of \$0.8 million over the same period of 2006. Revenues generated by sales to governmental entities and resale customers for 2007 totaled \$148.3 million, an increase of \$16.6 million from 2006.

*Wastewater Services* Our subsidiaries provide wastewater services in 12 states. Operating revenues from these services increased by 4.7% to \$75.6 million for 2007. The increase reflects a growth of 0.4% in the number of wastewater customers served but is primarily due to increases in rates charged to customers in states where we have wastewater operations (principally Arizona, Hawaii, and New Jersey).

Our Non-Regulated revenues decreased by \$5.8 million, or 2.3%, to \$242.7 million in 2007 from \$248.5 million for 2006. The net decline in revenues is primarily attributable to a \$15.8 million decrease in revenues of our Contract Operations Group, partially offset by a \$7.4 million increase in revenues of our Homeowner Services Group, and an increase of \$3.5 million from our other Non-Regulated Businesses. The decline in revenues of our Contract Operations Group includes the effects of having substantially completed the

**Table of Contents**

construction of the Lake Pleasant Water Treatment plant, a large water treatment plant in Phoenix, Arizona, during 2006 (\$49.5 million of construction revenue recognized in 2006 compared to \$5.2 million in 2007). Pursuant to our DBO contract with the city of Phoenix, we served as the lead contractor in connection with the construction of the Lake Pleasant facility, which includes an 80 million gallons-per-day surface water treatment plant and granular activated carbon reactivation system. The Lake Pleasant facility is significantly larger in size and function compared to other projects with which we have been engaged. However, we do not expect the completion of this project to have a material impact on our results of operations. Revenues from that project were partially replaced by new contracts, including a DBO project in Fillmore, California generating \$12.3 million of incremental revenues and new military projects generating approximately \$10.0 million of revenues. The increase from our Homeowner Services Group represents expansion into new geographic markets (Virginia and Trenton, New Jersey). The increase in our other Non-Regulated Businesses' revenues is due to revenues attributable to special projects in 2007.

**Operation and maintenance.** Our consolidated operation and maintenance expense increased by \$71.9 million, or 6.1%, to \$1,246.5 million for 2007 from \$1,174.5 million for 2006.

Operation and maintenance expense by major category was as follows:

	For the Years Ended December 31,			
	2007	2006	Increase (Decrease) (in thousands)	Percentage
Production costs	\$ 278,065	\$ 257,727	\$ 20,338	7.9%
Employee-related costs	463,362	418,807	44,555	10.6%
Operating supplies and services	293,475	291,352	2,123	0.7%
Maintenance materials and services	128,016	109,797	18,219	16.6%
Customer billing and accounting	38,256	54,624	(16,368)	(30.0)%
Other	45,305	42,237	3,068	7.3%
<b>Total</b>	<b>\$ 1,246,479</b>	<b>\$ 1,174,544</b>	<b>\$ 71,935</b>	<b>6.1%</b>

Production costs, including fuel and power, purchased water, chemicals and waste disposal, increased by \$20.3 million, or 7.9%, for 2007 compared to 2006.

	For the Years Ended December 31,			
	2007	2006	Increase (Decrease) (in thousands)	Percentage
Fuel and power	\$ 106,937	\$ 97,896	\$ 9,041	9.2%
Purchased water	94,011	85,701	8,310	9.7%
Chemicals	45,159	41,758	3,401	8.1%
Waste disposal	31,958	32,372	(414)	(1.3)%
<b>Total</b>	<b>\$ 278,065</b>	<b>\$ 257,727</b>	<b>\$ 20,338</b>	<b>7.9%</b>

The increases were primarily attributable to increased demand and higher electricity prices, as rate freezes resulting from electricity deregulation expired in some states in which we operate.

**Table of Contents**

Employee-related costs including wage and salary, group insurance, and pension expense increased by \$44.6 million, or 10.6%, for 2007 compared to 2006. These costs represented 37.2% and 35.7% of operation and maintenance expense for 2007 and 2006, respectively.

	For the Years Ended December 31,			
	2007	2006	Increase (Decrease)	Percentage
	(in thousands)			
Salaries and wages	\$ 352,177	\$ 311,439	\$ 40,738	13.1%
Pensions	29,984	31,940	(1,956)	(6.2)%
Group insurance	64,832	59,546	5,286	8.9%
Other benefits	16,369	15,882	487	3.1%
<b>Total</b>	<b>\$ 463,362</b>	<b>\$ 418,807</b>	<b>\$ 44,555</b>	<b>10.6%</b>

The increase in 2007 was due to higher wage, salary and group insurance expenses in our Regulated Businesses, primarily resulting from an increase in the number of employees to enable service enhancements in our Regulated Businesses as well as wage rate increases. This increase was offset by a reduction in pension expense. Pension expense in excess of the amount contributed to the pension plans is deferred by some of our regulated subsidiaries pending future recovery in rates as contributions are made to the plans. The decrease is primarily attributable to lower pension expense in 2007. In addition, pension expense for 2006 included additional pension expense due to curtailment charges and a special transaction benefit charge.

Operating supplies and services include the day-to-day expenses of office operation, legal and other professional services, as well as information systems and other office equipment, facilities rental charges and other miscellaneous expenses. For 2007, these costs increased by \$2.1 million or 0.7% compared to 2006.

	For the Years Ended December 31,			
	2007	2006	Increase (Decrease)	Percentage
	(in thousands)			
Contracted services	\$ 110,083	\$ 116,775	\$ (6,692)	(5.7)%
Office supplies and services	62,464	55,882	6,582	11.8%
Transportation	35,051	31,050	4,001	12.9%
Rents	21,985	18,599	3,386	18.2%
Other	63,892	69,046	(5,154)	(7.5)%
<b>Total</b>	<b>\$ 293,475</b>	<b>\$ 291,352</b>	<b>\$ 2,123</b>	<b>0.7%</b>

The decrease in contracted services is primarily associated with the design and build of the Lake Pleasant Water Treatment Plant in Phoenix, Arizona. In 2006, these costs were approximately \$38.7 million, compared to \$4.3 million in 2007. Additionally, the decrease reflects operating contracts of our Non-Regulated Businesses that ended during 2006, and a decline in design and build activity by the Applied Water Management Group of \$3.4 million due to a downturn in new home construction. Offsetting these decreases were additional expenses associated with several other contracts in our Non-Regulated Businesses, including a DBO project in Fillmore, totaling \$7.6 million in 2007 compared to \$0.4 million in 2006, as well as increased military contract expenses of \$6.1 million. Also offsetting the decrease were consulting fees associated with our remediation efforts in connection with the Sarbanes-Oxley Act of 2002. These costs increased \$15.1 million over 2006. Office supplies and services increased as a result of increased travel as well as inflation. Transportation costs increased primarily within our Regulated Businesses due to increased leasing costs and higher gasoline prices, amounting to approximately \$3.2 million. Other operating supplies and services decreased primarily as a result of the aforementioned Non-Regulated contracts, with Lake Pleasant costs of \$0.8 million in 2007 compared to \$10.1 million in 2006 and Fillmore DBO costs of \$4.8 million in 2007 compared to \$0.2 million in 2006. Offsetting these decreases was a 2006 restatement by our Indiana subsidiary of \$2.4 million previously disallowed in the

**Table of Contents**

regulatory process. Additional expenses related to the RWE Divesture were \$0.8 million higher for 2007 than 2006 due to higher divesture support costs.

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, increased by \$18.2 million, or 16.6%, for 2007 compared to 2006.

	For the Years Ended December 31,			
	2007	2006	Increase (Decrease)	Percentage
	(in thousands)			
Maintenance services and supplies	\$ 92,041	\$ 75,170	\$ 16,871	22.4%
Removal costs, net	35,975	34,627	1,348	3.9%
<b>Total</b>	<b>\$ 128,016</b>	<b>\$ 109,797</b>	<b>\$ 18,219</b>	<b>16.6%</b>

These increases were primarily the result of a larger number of main breaks in 2007 compared to 2006 experienced by several of our operating subsidiaries due to winter weather conditions, increased paving costs for our New Jersey, Missouri, Illinois and Pennsylvania subsidiaries, as well as higher expenses in our Non-Regulated Businesses, primarily the Homeowner Services Group.

Customer billing and accounting expenses decreased by \$16.4 million, or 30.0%, for 2007 compared to 2006.

	For the Years Ended December 31,			
	2007	2006	Increase (Decrease)	Percentage
	(in thousands)			
Uncollectible accounts expense	\$ 15,818	\$ 33,079	\$ (17,261)	(52.2)%
Postage	10,932	10,114	818	8.1%
Other	11,506	11,431	75	0.7%
<b>Total</b>	<b>\$ 38,256</b>	<b>\$ 54,624</b>	<b>\$ (16,368)</b>	<b>(30.0)%</b>

The decrease was primarily due to lower bad debt expense of \$9.2 million in our Regulated Business and \$5.8 million in our Non-Regulated Businesses as a result of an increased focus on collection of past due accounts.

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs increased by \$3.1 million, or 7.3%, for 2007 compared to 2006.

	For the Years Ended December 31,			
	2007	2006	Increase (Decrease)	Percentage
	(in thousands)			
Insurance	\$ 37,276	\$ 31,438	\$ 5,838	18.6%
Regulatory expenses	8,029	10,799	(2,770)	(25.7)%
<b>Total</b>	<b>\$ 45,305</b>	<b>\$ 42,237</b>	<b>\$ 3,068</b>	<b>7.3%</b>

Insurance related expenses increased due to less favorable claims experience compared to 2006. This unfavorable variance was offset by a reduction in regulatory expenses due to the write-off of certain deferred rate case expenses in 2006 associated with our California subsidiary.

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***Depreciation and amortization.*** Our consolidated depreciation and amortization expense increased \$8.1 million, or 3.1%, to \$267.3 million for 2007 from \$259.2 million for 2006. The increase was primarily due to property placed in service, net of retirements, of \$798.8 million as a result of an increased focus on infrastructure spending mainly in our Regulated Businesses.

S-52



## **Table of Contents**

**General taxes.** Our consolidated general taxes expense, which includes taxes for property, payroll, gross receipts and other miscellaneous items, decreased \$1.8 million, or 1.0%, to \$183.3 million for 2007 from \$185.1 million for 2006. The decrease was primarily due to lower taxes for expatriates because employees seconded by Thames Water to American Water were no longer employed by American Water in 2007.

**Loss (gain) on sale of assets.** Our consolidated gain on sale of assets was \$7.3 million for 2007 compared to a loss of \$0.1 million for 2006 due to non-recurring sales of assets not needed in our utility operations in 2007.

**Impairment charges.** Our consolidated impairment charges were \$509.3 million for 2007 and \$221.7 million, excluding discontinued operations, for 2006. The 2007 impairment charges were primarily due to slightly lower long-term earnings caused by updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery as well as new information regarding our market value. The 2006 impairment charge was primarily attributable to higher interest rates in our Regulated Businesses and a change in the potential net realizable value of our Non-Regulated Businesses.

**Other income (deductions).** Interest expense, the primary component of our consolidated other income (deductions), decreased \$82.8 million, or 22.6%, to \$283.2 million for 2007 from \$366.0 million for 2006. The decline was primarily due to the repayment of outstanding debt with new equity contributions from RWE in order to establish a capital structure that is consistent with other regulated utilities and also to meet the capital structure expectations of various state regulatory commissions. This decrease was offset slightly by higher interest expense of our Regulated Businesses of \$9.8 million mainly due to increased borrowings to fund capital programs.

**Provision for income taxes.** Our consolidated provision for income taxes increased \$39.9 million, or 85.1%, to \$86.8 million for 2007 from \$46.9 million for 2006. The increase is due to higher taxable income in 2007 as compared to 2006.

**Net income (loss).** Our consolidated net loss including results from discontinued operations increased \$180.6 million, or 111.3%, to \$342.8 million for 2007 from \$162.2 million for 2006. The increase is the result of the changes discussed above.

## **Liquidity and Capital Resources**

Our business is capital intensive and requires considerable capital resources. A portion of these capital resources are provided by internally generated cash flows from operations. When necessary, we obtain funds from external sources in the capital markets and through bank borrowings. Our access to external financing on reasonable terms depends on our credit ratings and current business conditions, including that of the water utility industry in general as well as conditions in the debt or equity capital markets. If these business and market conditions deteriorate to the extent that we no longer have access to the capital markets at reasonable terms, we have access to revolving credit facilities with aggregate bank commitments of \$850.0 million, of which \$483.1 million was available as of May 27, 2009, that we use to fulfill our short-term liquidity needs, to issue letters of credit and back our \$165.0 million outstanding commercial paper. As of May 27, 2009, the Company can issue additional commercial paper of \$317.8 million which is backed by the credit facilities. See [Credit Facilities and Short-Term Debt](#) below for further discussion.

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

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## **Table of Contents**

We use our capital resources, including cash, to (i) fund capital requirements, including construction expenditures, (ii) pay off maturing debt, (iii) pay dividends, (iv) fund pension and postretirement welfare obligations and (v) invest in new and existing ventures. We spend a significant amount of cash on construction projects that have a long-term return on investment. Additionally, we operate in rate-regulated environments in which the amount of new investment recovery may be limited, and where such recovery takes place over an extended period of time, as our recovery is subject to regulatory lag. As a result of these factors, our working capital, defined as current assets less current liabilities, was in a net deficit position of \$748.6 million as of March 31, 2009.

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

We rely on our revolving credit facility and the capital markets to satisfy our liquidity needs. Disruptions in the credit markets may discourage lenders from meeting their existing lending commitments, extending the terms of such commitments or agreeing to new commitments. Market disruptions may also limit our ability to issue debt securities in the capital markets. In order to meet our short-term liquidity needs we are borrowing under AWCC's existing \$850.0 million revolving credit facilities. AWCC had \$320.0 million of outstanding borrowings under its lines of credit, \$46.9 million of outstanding letters of credit under this credit facility and \$165.0 million of outstanding overnight commercial paper as of May 27, 2009. We can provide no assurances that our lenders will meet their existing commitments or that we will be able to access the commercial paper or loan markets in the future on terms acceptable to us or at all.

As of December 31, 2008, the Company had issued, through its subsidiaries, \$120.3 million of variable rate demand bonds, which are periodically remarketed. During the first quarter of 2009, the Company used its commercial paper and revolver, to redeem, through its subsidiaries, these variable rate demand bonds because no buyer was willing to purchase the bonds at market rates. As of March 31, 2009, all variable rate demand bonds had been repurchased and were held in the Company's treasury. On May 21, 2009, AWCC successfully remarketed \$31.9 million of these variable rate demand bonds. On May 21, 2009, AWCC closed its remarketing on \$52.9 million fixed rate Tax Exempt Water Facility Revenue Bonds, which were part of the \$120.3 million variable rate demand bonds. As of May 28, 2009 \$35.4 million of these variable rate demand bonds are held in the Company's treasury. We can provide no assurance that the bonds will be remarketed successfully or at reasonable rates.

On May 19, 2009, AWCC closed its private placement offering of \$25.5 million in aggregate principal amount of 8.27 % Senior Unsecured Notes due 2039 and \$24.5 million in aggregate principal amount of 7.21 % Senior Unsecured Notes due 2019. On May 13, 2009, NJAWC closed its private offering of \$75 million in aggregate principal amount of its 6.35% first mortgage bonds due 2039 and \$25 million in aggregate principal amount of its 5.48% first mortgage bonds due 2019.

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

### ***Cash Flows from Operating Activities***

Cash flows from operating activities primarily result from the sale of water and wastewater services and, due to the seasonality of operations, are weighted toward the third quarter of each fiscal year. Our future cash flows from operating activities will be affected by economic utility regulation; infrastructure investment; inflation; compliance with environmental, health and safety standards; production costs; customer growth; declining per customer usage of water; and weather and seasonality. See Factors Affecting our Results of Operations.

**Table of Contents**

Cash flows from operating activities have been a reliable, steady source of cash flow, sufficient to meet operating requirements and a portion of our capital expenditures requirements. We will seek access to debt and equity capital markets to meet the balance of our capital expenditure requirements. There can be no assurance that we will be able to successfully access such markets on favorable terms or at all. Operating cash flows can be negatively affected by changes in our rate regulatory environments or changes in our customer economic outlook and ability to pay for service in a timely manner. We can provide no assurance that our customers' historical payment pattern will continue in the future. Cash flows from operating activities for the three months ended March 31, 2009 were \$142.5 million compared to \$85.4 million for the three months ended March 31, 2008.

During 2008, the Company's unfunded status of its pension plan increased significantly primarily due to lower than expected 2008 asset returns, which are expected to result in increased benefit costs and required funding contributions in future years. Such an increase is likely to be material to results in 2009 and subsequent years. Based on current plan assets and expected future asset returns, the Company currently estimates the increase to pension and postretirement expense (net of capitalized amounts) in 2009 to be approximately \$32 million, pre-tax. We have begun discussions with our regulators about the appropriate treatment for these incremental costs in order to minimize the regulatory lag between the incurrence of the expense and any recovery of the expense. To date, we have authorization to recover or defer \$5.8 million of this annual increase and have requested permission to recover or defer as a deferred asset until the next rate case is concluded an additional \$7.3 million of this increase in 2009. Until we receive permission from the regulators to defer costs, we will continue to expense them. We are also discussing with regulators other ways in which to defer the costs until future rate cases are filed. The Company currently expects to make pension and postretirement benefit contributions to the plan trusts of \$125.9 million, \$132.5 million, \$124.7 million, \$161.9 million and \$123.2 million in 2009, 2010, 2011, 2012 and 2013 respectively. Through March 2009, we have made contributions to fund pension and other postretirement benefits of \$17.1 million and \$10.4 million, respectively. Actual amounts contributed could change significantly from these estimates.

The following table provides a summary of the major items affecting our cash flows from operating activities for the periods indicated:

	For the Years Ended December 31,			For the Three Months	
	2006	2007	2008	2008	2009
	(in thousands)				
Net income (loss)	\$ (162,243)	\$ (342,826)	\$ (562,421)	\$ (732,484)	\$ (412,079)
Add (subtract):					
Non-cash operating activities(1)	664,060	881,013	1,214,120	826,569	585,065
Changes in working capital(2)	(96,578)	16,770	5,523	21,144	(1,978)
Pension and postretirement healthcare contributions	(81,491)	(81,245)	(105,523)	(29,838)	(27,509)
Net cash flows provided by operations	\$ 323,748	\$ 473,712	\$ 552,169	\$ 85,391	\$ 142,499

(1) Includes (gain) loss on sale of businesses, depreciation and amortization, impairment charges, removal costs net of salvage, provision for deferred income taxes, amortization of deferred investment tax credits, provision for losses on utility accounts receivable, allowance for other funds used during construction, (gain) loss on sale of assets, deferred regulatory costs, amortization of deferred charges and other non-cash items, net, less pension and postretirement healthcare contributions.

(2) Changes in working capital include changes to accounts receivable and unbilled utility revenue, taxes receivable (including federal income), other current assets, accounts payable, taxes accrued (including federal income), interest accrued and other current liabilities. The increase in cash flows from operations during 2008 compared to 2007 was primarily due to increased revenues partially offset by higher contributions to our pension and postretirement healthcare trusts.

**Table of Contents**

The increase in cash flows from operations during 2007 compared to 2006 was primarily due to improvements in working capital mainly driven by changes in taxes accrued and other current liabilities, slightly offset by changes in accounts receivable and unbilled utility revenues.

***Cash Flows from Investing Activities***

Cash flows used in investing activities were as follows for the periods indicated:

	For the Years Ended December 31,			For the Three Months Ended March 31,	
	2006	2007	2008	2008	2009
	(in thousands)				
Construction expenditures	\$ (682,863)	\$ (750,810)	\$ (1,008,806)	\$ (188,437)	\$ (196,178)
Other investing activities, net(1)	(8,575)	4,232	(24,861)	732	(6,103)
Net cash flows used in investing activities	\$ (691,438)	\$ (746,578)	\$ (1,033,667)	\$ (187,705)	\$ (202,281)

- (1) Includes allowances for other funds used during construction, acquisitions, proceeds from the sale of assets and securities, proceeds from the sale of discontinued operations, removal costs from property, plant and equipment retirements, receivables from affiliates, restricted funds and investment in equity investee.

Cash flows used in investing activities for the three months ended March 31, 2009 and 2008 were \$202.3 million and \$187.7 million, respectively. Construction expenditures increased \$7.8 million to \$196.2 million for the three months ended March 31, 2009 from \$188.4 million for the three months ended March 31, 2008 as a result of increased investment in regulated utility plant projects. We anticipate investing approximately \$800.0 million on construction and other capital projects in 2009.

Cash flows used in investing activities increased in 2008 compared to 2007 and in 2007 compared to 2006, as we continued to increase our investment in regulated infrastructure projects. From 2009 to 2013, we estimate that Company-funded capital investment will total between \$4.0 billion and \$4.5 billion. We anticipate spending between \$790 million and \$1.0 billion yearly on Company-funded capital investment for the foreseeable future, depending upon the timing of major capital projects. We expect construction expenditures to be approximately \$800 million during 2009. We intend to invest capital prudently to provide essential services to our regulated customer base, while working with regulators in the various states in which we operate to have the opportunity to earn an appropriate rate of return on our investment and a return of our investment. As part of our strategy to improve operational efficiencies, we are evaluating our processes, along with the information systems associated with those processes, to optimize workflow throughout our field operations as well as streamlining our back-office operations, as we believe are necessary and appropriate. When we make adjustments to our operations, we will incur incremental expenses, including costs to upgrade or replace outdated information systems, prior to realizing the benefit of a more efficient workforce and operating structure. We believe that increasing our operating efficiency and controlling the costs associated with the operation of our business are important to providing the quality service to our customers and communities we serve as well as to our long-term competitiveness. We are currently developing a timeline for the implementation of this strategic initiative but expect that it will span a period of three to five years. The details, including scope, cost and implementation of these solutions will not be fully known until the data gathering phase has been completed, which is targeted for December 2009. Expenditures associated with this project are included in the \$4.0 billion to \$4.5 billion capital investment spending outlined above.

Our construction program consists of both infrastructure renewal programs, where we replace infrastructure as needed, and construction of new water and wastewater treatment and delivery facilities to meet new customer growth. An integral aspect of our strategy is to seek growth through tuck-ins and other acquisitions which are complementary to our existing business and support the continued geographical diversification and growth of our

**Table of Contents**

operations. Our projected capital expenditures and other investments are subject to periodic review and revision to reflect changes in economic conditions and other factors. Generally, acquisitions are funded initially with short-term debt and later refinanced with the proceeds from long-term debt or equity offerings.

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

The following table provides a summary of our historical construction expenditures:

	For the Years Ended December 31,			For the Three Months Ended March 31,	
	2006	2007	2008	2008	2009
	(in thousands)				
Transmission and distribution	\$ 314,282	\$ 325,222	\$ 449,249	\$ 79,638	\$ 82,804
Treatment and pumping	127,094	178,073	211,930	34,605	39,489
Services, meter and fire hydrants	132,610	179,933	224,089	39,915	28,838
General structures and equipment	72,892	32,336	71,146	17,070	28,348
Sources of supply	35,985	35,135	53,292	17,208	16,699
Total construction expenditures	\$ 682,863	\$ 750,810	\$ 1,008,806	\$ 188,437	\$ 196,178

Construction expenditures for the periods noted above were partially offset by customer advances and contributions for construction (net of refunds) of \$3.1 million, \$35.8 million, and \$47.4 million for the years ended December 31, 2008, 2007 and 2006, respectively. Customer advances and contributions are reflected in net cash flows from financing activities. Capital expenditures during the periods noted above were related to the renewal of supply and treatment assets, new water mains and customer service lines, as well as rehabilitation of existing water mains and hydrants.

Construction expenditures for 2008 increased by \$258.0 million, or 34.4%, over 2007. Expenditures related to transmission and distribution increased by \$123.9 million in 2008 over 2007 and meter and fire hydrant replacements increased by \$44.2 million in 2008 compared to 2007. These increases occurred due to an increase in the rate of infrastructure replacement. Treatment and pumping expenditures increased by \$33.9 million in 2008 compared to 2007 as a result of significant treatment improvements in a number of states in which we operate including Kentucky, Illinois and Arizona.

Construction expenditures for 2007 increased by \$67.9 million, or 10.0%, over 2006. The increase consisted mainly of infrastructure replacements and upgrades to treatment facilities at several plants including Joplin, Missouri, Maricopa County, Arizona, Franklin Township, New Jersey and Champaign, Illinois.

We also conduct ongoing reviews of our existing investments. As a result of these reviews, we sold the operations of various non-regulated water-related businesses during 2006 and 2007.

The following provides a summary of the major acquisitions and dispositions affecting our cash flows from investing activities in the years indicated:

2008:

We paid approximately \$12.5 million for the acquisition of water and waste water systems.

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We received approximately \$12.6 million from the sale of other assets, which included \$10.6 million in cash from the sale of the Felton water system. In September 2008, our California subsidiary completed

S-57

**Table of Contents**

its sale of the Felton water system to San Lorenzo Valley Water District ( SLVWD ). Under the terms of the agreement, SLVWD paid \$13.4 million for the operating assets of the water system, which serves approximately 1,330 customers in Felton. The payment included a \$10.6 million cash payment to California American Water and the assumption by SLVWD of \$2.8 million in debt. The sale of the Felton system resulted in a loss on sale of \$0.4 million.

2007:

We paid approximately \$15.9 million for the acquisition of a number of water and wastewater systems, the largest of which was S.J. Services Inc., the parent company of Pennsgrove Water Supply Company, Inc. and South Jersey Water Supply Company, Inc. The purchase price, including acquisition costs, for S.J. Services Inc. was \$13.5 million in cash.

We received approximately \$9.7 million in cash proceeds from the sale of a group of assets of the Residuals business.

We received \$16.3 million in cash proceeds from the sale of other assets, including \$13.0 million of proceeds on a property in Mansfield, New Jersey owned by a Non-Regulated subsidiary.

2006:

We paid approximately \$12.5 million for the acquisition of water and wastewater systems.

We received approximately \$30.2 million in cash proceeds from the sale of discontinued operations, including a group of assets of the Residuals business and the Underground business.

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

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

On February 25, 2009, a small group of Trenton residents filed a petition with the City Clerk seeking to force the sale to a referendum. On April 3, 2009, the BPU issued its order approving the Stipulation. The effective date of the Stipulation has been automatically stayed pending the resolution of court proceedings initiated in New Jersey Superior Court by a small number of Trenton residents seeking to submit the sale to a referendum. The trial court ruled in March 2009 that a referendum is not required. In May 2009, the court granted the residents motion for reconsideration of that ruling and the matter will now proceed to a hearing before the trial court judge. The Company can provide no assurance as to the outcome of the court proceedings.

Included in the Stipulation, and dependent upon the consummation of the sale, the Company intends to purchase finished water from the City for the next twenty years under a water supply agreement. The acquisition is expected to add approximately forty thousand customers to the Company's customer base.

***Cash Flows from Financing Activities***

Our financing activities whose primary purpose is to fund construction expenditures, include the issuance of long-term and short-term debt, primarily through our wholly-owned financing subsidiary, AWCC. We intend to





## Table of Contents

access the capital markets on a regular basis, subject to market conditions. In addition, we intend to issue equity in the future to maintain an appropriate capital structure, subject to any restrictions in the registration rights agreement between us and RWE. In order to finance new infrastructure, we received customer advances and contributions for construction (net of refunds) of \$2.6 million and (\$13.7) million for the three months ended March 31, 2009 and 2008, respectively, and \$3.1 million, \$35.8 million, and \$47.4 million for the years ended December 31, 2008, 2007, 2006, respectively.

On May 21, 2009, AWCC successfully remarketed \$31.9 million of variable rate demand notes previously held in the Company's treasury. The net proceeds from this offering were used to repay commercial paper. Also, on May 21, 2009, AWCC remarketed \$52.9 million of these variable rate demand notes as fixed rate Tax Exempt Water Facility Revenue bonds with interest rates ranging from 6.00% to 6.75%. The net proceeds from this offering were used to repay short-term debt. On May 19, 2009, AWCC closed its private placement offering of \$25.5 million in aggregate principal amount of 8.27 % Senior Unsecured Notes due 2039 and \$24.5 million in aggregate principal amount of 7.21 % Senior Unsecured Notes due 2019. We will use the net proceeds to pay down short-term debt. We used the proceeds principally to pay down short-term debt. On May 13, 2009, NJAWC closed its private offering of \$75 million in aggregate principal amount of its 6.35% first mortgage bonds due 2039 and \$25 million in aggregate principal amount of its 5.48% first mortgage bonds due 2019. NJAWC used the proceeds principally to pay down short-term debt.

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

In February 2009, AWCC completed its public offering of \$75.0 million of 8.25% senior notes with a maturity date of 2038. The net proceeds of the offering were used to repay short-term debt incurred to fund capital expenditures and general working capital purposes.

In May 2008, AWCC issued senior notes through private placement offerings totaling \$200.0 million. Interest rates ranged from 6.25% to 6.55%, and maturities ranged from 2018 to 2023. On May 13, 2008, we received a cash equity contribution from RWE of \$245.0 million. In November 2008, AWCC issued \$75.0 million of 10% senior notes with a maturity date of 2038 through a public offering. Proceeds from the \$275.0 million in debt offerings and the \$245.0 million in cash equity contribution were used to repay short-term debt incurred to fund capital expenditures and general working capital purposes.

AWCC issued senior notes through private placement offerings totaling \$2,117.0 million during 2007. Interest rates ranged from 5.39% to 6.59% and maturities ranged from seven years to 30 years. RWE made equity contributions to the Company amounting to \$1,067.1 million and \$1,194.5 million during 2007 and 2006, respectively. The Company used the equity contributions and proceeds from the senior notes to offset loans payable to RWE, to repay outstanding commercial paper and for other corporate purposes.

Additionally, during September 2007, AWCC issued \$1,750.0 million of RWE redemption notes to RWE. The RWE redemption notes bear interest monthly at the one-month London Interbank Offered Rate, which we refer to as LIBOR, plus 22.5 basis points and mature on the earliest of the following to occur (a) March 20, 2009, (b) the date on which the Company and RWE mutually agree to terminate the notes with all accrued and unpaid interest and principal becoming immediately due and payable in full, or (c) the date on which RWE no longer owns more than 80% of the voting rights of the Company. The Company used the proceeds from the RWE redemption notes to redeem \$1,750.0 million of its 5.9% mandatory redeemable preferred stock held by RWE.

During October 2007, AWCC issued \$750.0 million in senior notes with a term of 10 years and a fixed interest rate of 6.085% and \$750.0 million in senior notes with a term of 30 years and a fixed interest rate of

**Table of Contents**

6.593%, which we refer to as the new senior notes. AWCC used the proceeds to fund the redemption of \$1,286.0 million aggregate principal amount of RWE redemption notes and \$206.0 million (including after tax gains of \$2.2 million, net of \$1.4 million of tax) aggregate principal amount of RWE notes. In the second quarter of 2008, the Company completed an offer to exchange fully registered 6.085% Senior Notes due 2017 and fully registered 6.593% Senior Notes due 2037 for all of its outstanding unregistered notes of the same series. The Company did not receive any proceeds from the exchange offer, nor did the Company's debt level change as a result of the exchange offer. The terms of the registered notes and the unregistered notes are substantially identical in all material respects. In December 2007, we used the net proceeds from the issuance of approximately \$415.0 million of commercial paper and \$49.0 million of excess cash to fund the repayment of approximately \$464.0 million of RWE redemption notes.

Our board of directors has adopted a dividend policy to distribute to our stockholders a portion of our net cash provided by operating activities as regular quarterly dividends, rather than retaining that cash for other purposes. Our policy is to distribute 50% to 70% of our net income annually. We expect that dividends will be paid every March, June, September and December of each fiscal year to holders of record approximately 15 days prior to the distribution date. Since the dividends on our common stock will not be cumulative, only declared dividends will be paid. For 2008, we paid a dividend of \$0.20 per share on September 2, 2008 and December 1, 2008. There were no dividend payments made for 2007. Subject to applicable law and the discretion of our board of directors, we will pay cash dividends of approximately \$0.20 per share per quarter in 2009, to be paid approximately 60 days after the end of each fiscal quarter. The quarterly and annual average aggregate dividend amounts for the four quarters would be \$34.3 million, and \$137.1 million annually. The aggregate dividend amounts are based upon the estimated average 171.3 million shares outstanding during the next four quarters. Under Delaware law, our board of directors may declare dividends only to the extent of our surplus (which is defined as total assets at fair market value *minus* total liabilities, *minus* statutory capital) or, if there is no surplus, out of our net profits for the then current and/or immediately preceding fiscal year. Although we believe we will have sufficient net profits or surplus to pay dividends at the anticipated levels during the next four quarters, our board of directors will seek periodically to assure itself of this before actually declaring any dividends. In future periods, our board of directors may seek opinions from outside valuation firms to the effect that our solvency or assets are sufficient to allow payment of dividends, and such opinions may not be forthcoming. If we sought and were not able to obtain such an opinion, we likely would not be able to pay dividends.

On February 6, 2009, our board of directors declared a quarterly cash dividend payment of \$0.20 per share payable on March 2, 2009 to all shareholders of record as of February 18, 2009. On April 30, 2009 our board of directors declared a quarterly cash dividend payment of \$0.20 per share payable on June 1, 2009 to all shareholders of record as of May 18, 2009.

On May 1, 2009 we and AWCC filed a universal shelf registration statement, of which this prospectus supplement forms a part, that enables us to offer and sell from time to time various types of securities, including common stock, preferred stock and debt securities, subject to market demand and ratings status.

In addition, on May 1, 2009, we asked the SEC to withdraw the registration statement on Form S-1 that we originally filed on December 18, 2008 for the proposed offering of our common stock. No securities have been sold pursuant to such registration statement.

The following long-term debt was issued in the first three months of 2009:

Company	Type	Interest	Maturity	Amount (in thousands)
American Water Capital Corp.	Senior notes	8.25%	2038	\$ 75,000
Total issuances				\$ 75,000

**Table of Contents**

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

<b>Company</b>	<b>Type</b>	<b>Interest</b>	<b>Maturity</b>	<b>Amount (in thousands)</b>
<i>Long-term debt:</i>				
American Water Capital Corp.	Floating rate	1.55%-2.20%	2018-2032	\$ 86,860
American Water Capital Corp.	Senior notes-fixed rate	6.87%	2011	28,000
Other subsidiaries	Floating rate	1.50%-10.00%	2015-2032	33,420
Other subsidiaries	Fixed rate	5.00%-9.10%	2009-2030	565
Other subsidiaries	State financing authority loans and other	0.00%-5.00%	2009-2034	