

AQUA AMERICA INC
Form 10-Q
November 07, 2007

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

(Mark One)

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

For the quarterly period ended September 30, 2007

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

For the transition period from ____ to ____

Commission File Number 1-6659

AQUA AMERICA, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania

23-1702594

(State or other jurisdiction of incorporation or organization)

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

762 W. Lancaster Avenue, Bryn Mawr, Pennsylvania

19010-3489

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code:

(610)527-8000

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of October 23, 2007.

133,249,378

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

| | September 30, 2007 | December 31, 2006 |
|---------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------|
| Assets | | |
| Property, plant and equipment, at cost | \$ 3,477,005 | \$ 3,185,111 |
| Less: accumulated depreciation | 771,398 | 679,116 |
| Net property, plant and equipment | 2,705,607 | 2,505,995 |
| Current assets: | | |
| Cash and cash equivalents | 15,582 | 44,039 |
| Accounts receivable and unbilled revenues, net | 94,356 | 72,149 |
| Materials and supplies | 9,558 | 8,359 |
| Prepayments and other current assets | 9,247 | 10,153 |
| Total current assets | 128,743 | 134,700 |
| Regulatory assets | 170,426 | 165,063 |
| Deferred charges and other assets, net | 41,097 | 38,075 |
| Funds restricted for construction activity | 53,820 | 11,490 |
| Goodwill | 34,642 | 22,580 |
| | \$ 3,134,335 | \$ 2,877,903 |
| Liabilities and Stockholders' Equity | | |
| Common stockholders' equity: | | |
| Common stock at \$.50 par value, authorized 300,000,000 shares, issued 133,934,833 and 133,017,325 in 2007 and 2006 | \$ 66,967 | \$ 66,509 |
| Capital in excess of par value | 567,848 | 548,806 |
| Retained earnings | 342,110 | 319,113 |
| Treasury stock, 704,366 and 691,746 shares in 2007 and 2006 | (13,301) | (12,992) |
| Accumulated other comprehensive income | 1,315 | 194 |
| Total common stockholders' equity | 964,939 | 921,630 |
| Minority interest | 1,922 | 1,814 |
| Long-term debt, excluding current portion | 1,038,011 | 951,660 |
| Commitments and contingencies | | |
| Current liabilities: | | |
| Current portion of long-term debt | 24,293 | 31,155 |

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| | | |
|--------------------------------------------------|--------------|--------------|
| Loans payable | 195,532 | 119,150 |
| Accounts payable | 27,428 | 49,406 |
| Accrued interest | 15,752 | 14,050 |
| Accrued taxes | 26,409 | 19,350 |
| Other accrued liabilities | 26,010 | 22,500 |
| Total current liabilities | 315,424 | 255,611 |
| Deferred credits and other liabilities: | | |
| Deferred income taxes and investment tax credits | 290,945 | 273,199 |
| Customers' advances for construction | 78,026 | 76,820 |
| Regulatory liabilities | 12,335 | 11,592 |
| Other | 76,203 | 64,879 |
| Total deferred credits and other liabilities | 457,509 | 426,490 |
| Contributions in aid of construction | 356,530 | 320,698 |
| | \$ 3,134,335 | \$ 2,877,903 |

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

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

| | Nine Months Ended September 30, | |
|------------------------------------------------------|------------------------------------|------------|
| | 2007 | 2006 |
| Operating revenues | \$ 453,416 | \$ 396,648 |
| Costs and expenses: | | |
| Operations and maintenance | 190,698 | 165,876 |
| Depreciation | 61,657 | 52,419 |
| Amortization | 3,603 | 3,128 |
| Taxes other than income taxes | 33,596 | 24,991 |
| | 289,554 | 246,414 |
| Operating income | 163,862 | 150,234 |
| Other expense (income): | | |
| Interest expense, net | 50,093 | 43,668 |
| Allowance for funds used during construction | (2,118) | (2,901) |
| Gain on sale of other assets | (648) | (834) |
| Income before income taxes | 116,535 | 110,301 |
| Provision for income taxes | 46,432 | 44,020 |
| Net income | \$ 70,103 | \$ 66,281 |
| Net income | \$ 70,103 | \$ 66,281 |
| Other comprehensive income, net of tax: | | |
| Unrealized holding gain on investments | 1,121 | 326 |
| Comprehensive income | \$ 71,224 | \$ 66,607 |
| Net income per common share: | | |
| Basic | \$ 0.53 | \$ 0.51 |
| Diluted | \$ 0.53 | \$ 0.50 |
| Average common shares outstanding during the period: | | |
| Basic | 132,675 | 130,242 |

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| | | |
|------------------------------------------|-----------|-----------|
| Diluted | 133,527 | 131,310 |
| Cash dividends declared per common share | \$ 0.3550 | \$ 0.4438 |

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

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

| | Three Months Ended September 30, | |
|------------------------------------------------------|-------------------------------------|------------|
| | 2007 | 2006 |
| Operating revenues | \$ 165,491 | \$ 146,950 |
| Costs and expenses: | | |
| Operations and maintenance | 67,069 | 59,127 |
| Depreciation | 21,065 | 18,334 |
| Amortization | 1,161 | 1,126 |
| Taxes other than income taxes | 10,849 | 8,840 |
| | 100,144 | 87,427 |
| Operating income | 65,347 | 59,523 |
| Other expense (income): | | |
| Interest expense, net | 17,103 | 14,752 |
| Allowance for funds used during construction | (655) | (703) |
| Gain on sale of other assets | (260) | (91) |
| Income before income taxes | 49,159 | 45,565 |
| Provision for income taxes | 19,641 | 18,234 |
| Net income | \$ 29,518 | \$ 27,331 |
| Net income | \$ 29,518 | \$ 27,331 |
| Other comprehensive income, net of tax: | | |
| Unrealized holding gain on investments | 903 | 127 |
| Comprehensive income | \$ 30,421 | \$ 27,458 |
| Net income per common share: | | |
| Basic | \$ 0.22 | \$ 0.21 |
| Diluted | \$ 0.22 | \$ 0.21 |
| Average common shares outstanding during the period: | | |
| Basic | 133,003 | 131,660 |

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| | | |
|------------------------------------------|-----------|-----------|
| Diluted | 133,834 | 132,666 |
| Cash dividends declared per common share | \$ 0.1250 | \$ 0.2300 |

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

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

| | September 30, 2007 | December 31, 2006 |
|------------------------------------------------------------------------------------|-----------------------|----------------------|
| Common stockholders' equity: | | |
| Common stock, \$.50 par value | \$ 66,967 | \$ 66,509 |
| Capital in excess of par value | 567,848 | 548,806 |
| Retained earnings | 342,110 | 319,113 |
| Treasury stock | (13,301) | (12,992) |
| Accumulated other comprehensive income | 1,315 | 194 |
| Total common stockholders' equity | 964,939 | 921,630 |
| Long-term debt: | | |
| Long-term debt of subsidiaries (substantially secured by utility plant): | | |
| Interest Rate Range | | |
| 0.00% to 2.49% | 29,765 | 25,740 |
| 2.50% to 2.99% | 28,487 | 25,272 |
| 3.00% to 3.49% | 5,023 | 17,220 |
| 3.50% to 3.99% | 5,460 | 6,073 |
| 4.00% to 4.99% | 80,549 | 30,645 |
| 5.00% to 5.49% | 274,602 | 262,496 |
| 5.50% to 5.99% | 86,500 | 79,000 |
| 6.00% to 6.49% | 97,730 | 94,360 |
| 6.50% to 6.99% | 12,000 | 22,000 |
| 7.00% to 7.49% | 10,820 | 13,288 |
| 7.50% to 7.99% | 24,593 | 24,778 |
| 8.00% to 8.49% | 26,115 | 26,288 |
| 8.50% to 8.99% | 9,000 | 9,000 |
| 9.00% to 9.49% | 43,568 | 46,101 |
| 9.50% to 9.99% | 34,144 | 38,738 |
| 10.00% to 10.50% | 6,000 | 6,000 |
| | 774,356 | 726,999 |
| Unsecured notes payable, 4.87%, maturing in various installments 2010 through 2023 | 135,000 | 135,000 |
| Unsecured notes payable, 5.95%, due in 2023 through 2034 | 40,000 | 40,000 |
| Unsecured notes payable, 5.64%, due in 2014 through 2021 | 20,000 | 20,000 |
| Unsecured notes payable, 5.54%, due in 2013 through 2018 | 30,000 | 30,000 |
| Unsecured notes payable, 5.01%, due 2015 | 18,000 | 18,000 |
| Unsecured notes payable, 5.20%, due 2020 | 12,000 | 12,000 |
| Unsecured notes payable, 5.63%, due 2022 | 15,000 | |
| Unsecured notes payable, 5.83%, due 2037 | 15,000 | |
| Unsecured notes payable, 5.50%, due 2017 | 2,132 | |
| Notes payable, 6.05%, maturing in 2007 and 2008 | 816 | 816 |

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| | | |
|-------------------------------------------|---------------------|-------------------|
| Current portion of long-term debt | 1,062,304 24,293 | 982,815 31,155 |
| Long-term debt, excluding current portion | 1,038,011 | 951,660 |
| Total capitalization | \$ 2,002,950 | \$ 1,873,290 |

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

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

| | Common Stock | Capital in Excess of Par Value | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income | Total |
|--------------------------------------------------------------------------|-----------------|--------------------------------------|----------------------|-------------------|-------------------------------------------------|------------|
| Balance at December 31, 2006 | \$ 66,509 | \$ 548,806 | \$ 319,113 | \$ (12,992) | \$ 194 | \$ 921,630 |
| Net income | | | 70,103 | | | 70,103 |
| Other comprehensive income: | | | | | | |
| unrealized holding gain on investments, net of income tax of \$603 | | | | | 1,121 | 1,121 |
| Dividends paid | | | (47,106) | | | (47,106) |
| Sale of stock (354,254 shares) | 166 | 7,060 | | 533 | | 7,759 |
| Repurchase of stock (34,560 shares) | | | | (842) | | (842) |
| Equity Compensation Plan (50,000 shares) | 25 | (25) | | | | |
| Exercise of stock options (535,194 shares) | 267 | 6,493 | | | | 6,760 |
| Stock-based compensation | | 3,766 | | | | 3,766 |
| Employee stock plan tax benefits | | 1,748 | | | | 1,748 |
| Balance at September 30, 2007 | \$ 66,967 | \$ 567,848 | \$ 342,110 | \$ (13,301) | \$ 1,315 | \$ 964,939 |

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

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

| | Nine Months Ended September 30, | |
|------------------------------------------------------------------------------------------------------------------------|------------------------------------|---------------|
| | 2007 | 2006 |
| Cash flows from operating activities: | | |
| Net income | \$ 70,103 | \$ 66,281 |
| Adjustments to reconcile net income to net cash flows from operating activities: | | |
| Depreciation and amortization | 65,260 | 55,547 |
| Deferred income taxes | 7,861 | 8,217 |
| Gain on sale of other assets | (648) | (834) |
| Stock-based compensation | 3,308 | 2,755 |
| Net increase in receivables, inventory and prepayments | (20,492) | (14,596) |
| Net increase (decrease) in payables, accrued interest, accrued taxes and other accrued liabilities | 4,701 | (22,663) |
| Other | 3,120 | 6,994 |
| Net cash flows from operating activities | 133,213 | 101,701 |
| Cash flows from investing activities: | | |
| Property, plant and equipment additions, including allowance for funds used during construction of \$2,118 and \$2,901 | (175,783) | (183,608) |
| Acquisitions of utility systems and other, net | (41,815) | (11,339) |
| Proceeds from the sale of other assets | 3,535 | 848 |
| Additions to funds restricted for construction activity | (50,591) | (2,000) |
| Release of funds previously restricted for construction activity | 9,939 | 34,173 |
| Other | 1,942 | (278) |
| Net cash flows used in investing activities | (252,773) | (162,204) |
| Cash flows from financing activities: | | |
| Customers' advances and contributions in aid of construction | 7,854 | 8,974 |
| Repayments of customers' advances | (3,245) | (3,145) |
| Net proceeds (repayments) of short-term debt | 76,382 | (17,355) |
| Proceeds from long-term debt | 89,994 | 67,899 |
| Repayments of long-term debt | (35,172) | (23,373) |
| Change in cash overdraft position | (12,574) | 9,591 |
| Proceeds from exercised stock options | 6,760 | 6,405 |
| Stock-based compensation windfall tax benefits | 1,293 | 1,834 |
| Proceeds from issuing common stock | 7,759 | 55,515 |
| Repurchase of common stock | (842) | (806) |
| Dividends paid on common stock | (47,106) | (42,823) |
| Net cash flows from financing activities | 91,103 | 62,716 |

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| | | |
|------------------------------------------------------|-----------|-----------|
| Net increase (decrease) in cash and cash equivalents | (28,457) | 2,213 |
| Cash and cash equivalents at beginning of period | 44,039 | 11,872 |
| Cash and cash equivalents at end of period | \$ 15,582 | \$ 14,085 |

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

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

Note 1 **Basis of Presentation**

The accompanying consolidated balance sheets and statements of capitalization of Aqua America, Inc. (the Company) at September 30, 2007, the consolidated statements of income and comprehensive income for the nine months and three months ended September 30, 2007 and 2006, the consolidated statements of cash flow for the nine months ended September 30, 2007 and 2006, and the consolidated statement of common stockholders' equity for the nine months ended September 30, 2007, are unaudited, but reflect all adjustments, consisting of only normal recurring accruals, which are, in the opinion of management, necessary to present fairly the consolidated financial position, the consolidated changes in common stockholders' equity, the consolidated results of operations, and the consolidated cash flow for the periods presented. Because they cover interim periods, the statements and related notes to the financial statements do not include all disclosures and notes normally provided in annual financial statements and, therefore, should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2006 and the Quarterly Reports on Form 10-Q for the quarters ended June 30, 2007 and March 31, 2007. The results of operations for interim periods may not be indicative of the results that may be expected for the entire year.

Note 2 **Goodwill**

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

| | Regulated Segment | Other | Consolidated |
|-------------------------------|----------------------|----------|--------------|
| Balance at December 31, 2006 | \$ 18,537 | \$ 4,043 | \$ 22,580 |
| Goodwill acquired during year | 11,999 | | 11,999 |
| Other | (15) | 78 | 63 |
| Balance at September 30, 2007 | \$ 30,521 | \$ 4,121 | \$ 34,642 |

In January 2007, the Company recorded goodwill of \$10,860 upon completing its acquisition of New York Water Service Corporation. In April 2007, the Company recorded goodwill of \$1,139 upon completing the acquisition of Aquarion Water Company of Sea Cliff, Inc.

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

Note 3 **Long-term Debt and Loans Payable**

In January 2007, the Company's Pennsylvania operating subsidiary, Aqua Pennsylvania, Inc., issued \$50,000 of tax-exempt bonds secured by a supplement to its first mortgage indenture at the following terms: \$25,000 at 4.43% due 2040 and \$25,000 at 4.44% due 2041. The proceeds are restricted to funding certain capital projects during the period 2007 through 2009. In March 2007, the Company issued \$30,000 of unsecured notes of which \$15,000 are due in 2022 with an interest rate of 5.63% and \$15,000 are due in 2037 with an interest rate of 5.83%. Proceeds from the sales of these notes were used to repay short-term borrowings. During the first nine months of 2007, our operating subsidiaries issued notes payable in aggregate of \$11,888 at rates ranging from 1.0% to 5.5% due from 2017 to 2035.

Note 4 **Acquisitions**

Pursuant to our strategy to grow through acquisitions, on January 1, 2007 the Company completed the acquisition of the capital stock of New York Water Service Corporation (New York Water) for \$28,918 in cash, as adjusted pursuant to the purchase agreement primarily based on working capital at closing, and the assumption of \$23,000 of long-term debt. The acquired operation provides water service to 44,792 customers in several water systems located in Nassau County, Long Island, New York. The operating results of New York Water have been included in our consolidated financial statements beginning January 1, 2007. Under the purchase method of accounting, the purchase price is allocated to the net tangible and intangible assets based upon their estimate fair values at the date of the acquisition. The Company is in the process of finalizing the allocation of the purchase price. The purchase price allocation is as follows, subject to final adjustments:

| | |
|------------------------------------|--------------------|
| | January 1, 2007 |
| Property, plant and equipment, net | \$ 42,057 |
| Current assets | 9,207 |
| Other long-term assets | 14,384 |
| Goodwill | 10,860 |
| Total assets acquired | 76,508 |
| Current liabilities | 1,852 |
| Long-term debt | 23,000 |
| Other long-term liabilities | 22,738 |
| Total liabilities assumed | 47,590 |
| Net assets acquired | \$ 28,918 |

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

Note 5 Net Income per Common Share

Basic net income per common share is based on the weighted average number of common shares outstanding. Diluted net income per common share is based on the weighted average number of common shares outstanding and potentially dilutive shares. The dilutive effect of employee stock options and shares issuable under the forward equity sale agreement (from the date the Company entered into the forward equity sale agreement to the settlement date) is included in the computation of diluted net income per common share. The dilutive effect of stock options and shares issuable under the forward equity sale agreement is calculated using the treasury stock method and expected proceeds upon exercise of the stock options and settlement of the forward equity sale agreement. The following table summarizes the shares, in thousands, used in computing basic and diluted net income per common share:

| | Nine Months Ended September 30, | | Three Months Ended September 30, | |
|---------------------------------------------------------------------------------|------------------------------------|-------------|-------------------------------------|-------------|
| | 2007 | 2006 | 2007 | 2006 |
| Average common shares outstanding during the period for basic computation | 132,675 | 130,242 | 133,003 | 131,660 |
| Effect of dilutive securities: | | | | |
| Employee stock options | 757 | 1,052 | 672 | 958 |
| Forward equity shares | 95 | 16 | 159 | 48 |
| Average common shares outstanding during the period for diluted computation | 133,527 | 131,310 | 133,834 | 132,666 |

For the nine months and three months ended September 30, 2007, employee stock options to purchase 1,109,581 and 531,731 shares of common stock, respectively, were excluded from the calculations of diluted net income per share as the calculated proceeds from the options' exercise were greater than the average market price of the Company's common stock during these periods. For the nine months and three months ended September 30, 2006, employee stock options to purchase 599,600 shares of common stock were excluded from the calculations of diluted net income per share as the calculated proceeds from the options' exercise were greater than the average market price of the Company's common stock during these periods.

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

Note 6 Stockholders' Equity

In August 2006, the Company entered into a forward equity sale agreement for 3,525,000 shares of common stock with a third-party (the "forward purchaser"). In connection with the forward equity sale agreement, the forward purchaser borrowed an equal number of shares of the Company's common stock from stock lenders and sold the borrowed shares to the public. The Company will not receive any proceeds from the sale of its common stock by the forward purchaser until settlement of the forward equity sale agreement. The actual proceeds to be received by the Company will vary depending upon the settlement date, the number of shares designated for settlement on that settlement date and the method of settlement. The Company intends to use any proceeds received upon settlement of the forward equity sale agreement to fund the Company's future capital expenditure program and acquisitions, and for working capital and other general corporate purposes. The forward equity sale agreement is accounted for as an equity instrument and was recorded at a fair value of \$0 at inception. It will not be adjusted so long as the Company continues to meet the accounting requirements for equity instruments.

The Company may elect to settle the forward equity sale agreement by means of a physical share settlement, net cash settlement, or net share settlement, on a settlement date or dates, no later than August 1, 2008. The forward equity sale agreement provides that the forward sale price will be computed based upon the initial forward sale price of \$21.857 per share. Under limited circumstances or certain unanticipated events, the forward purchaser also has the ability to require the Company to physically settle the forward equity sale agreement in shares prior to the maturity date. The maximum number of shares that could be required to be issued by the Company to settle the forward equity sale agreement is 3,525,000 shares. As of September 30, 2007, a net cash settlement under the forward equity sale agreement would have resulted in a payment by the Company to the forward purchaser of \$1,301 or a net share settlement would have resulted in the issuance of 57,351 shares by the Company to the forward purchaser. For each increase or decrease of one dollar in the average market price of the Company's common stock above or below the forward sale price on September 30, 2007, the cash settlement option from the Company's perspective would decrease or increase by \$3,525 and the net share settlement option would decrease by 148,860 shares or increase by 162,592 shares, respectively.

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

Note 7 Stock-based Compensation

Under the Company's 2004 Equity Compensation Plan (the "2004 Plan"), as approved by the shareholders to replace the 1994 Equity Compensation Plan (the "1994 Plan"), qualified and nonqualified stock options may be granted to officers, key employees and consultants at prices equal to the market price of the stock on the day of the grant. Officers and key employees may also be granted dividend equivalents and restricted stock. Restricted stock may also be granted to non-employee members of the Board of Directors. The 2004 Plan authorizes 4,900,000 shares for issuance under the plan. A maximum of 50% of the shares available for issuance under the 2004 Plan may be issued as restricted stock and the maximum number of shares that may be subject to grants under the plans to any one individual in any one year is 200,000. Awards under the 2004 Plan are made by a committee of the Board of Directors. At September 30, 2007, 2,970,842 shares underlying stock option and restricted stock awards were still available for grant under the 2004 Plan, although under the terms of the 2004 Plan, terminated, expired or forfeited grants under the 1994 Plan and shares withheld to satisfy tax withholding requirements under the plan may be re-issued under the plan.

Stock Options During the nine months ended September 30, 2007 and 2006, the Company recognized compensation cost associated with stock options as a component of operations and maintenance expense of \$2,429 and \$2,149, respectively. During the three months ended September 30, 2007 and 2006, the Company recognized compensation cost associated with stock options as a component of operations and maintenance expense of \$794 and \$659, respectively. For the nine months ended September 30, 2007 and 2006, the Company recognized income tax benefits associated with stock options in its income statement of \$378 and \$239, respectively. For the three months ended September 30, 2007 and 2006, the Company recognized income tax benefits associated with stock options in its income statement of \$133 and \$56, respectively. In addition, the Company capitalized compensation costs associated with stock options within property, plant and equipment of \$417 and \$467 during the nine months ended September 30, 2007 and 2006; and \$133 and \$244 during the three months ended September 30, 2007 and 2006, respectively. The fair value of options was estimated at the grant date using the Black-Scholes option-pricing model. The per share weighted-average fair value at the date of grant for stock options granted during the nine months ended September 30, 2007 and 2006 was \$5.52 and \$7.82 per option, respectively. There were no stock options granted during the three months ended September 30, 2007 and 2006. The following assumptions were used in the application of this valuation model:

| | 2007 | 2006 |
|-------------------------|-------|-------|
| Expected term (years) | 5.2 | 5.2 |
| Risk-free interest rate | 4.7% | 4.7% |
| Expected volatility | 22.5% | 25.8% |
| Dividend yield | 1.95% | 1.76% |

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

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

The following table summarizes stock option transactions for the nine months ended September 30, 2007:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Life (years) | Aggregate Intrinsic Value |
|------------------------------------|-----------|------------------------------------------|--------------------------------------------------|---------------------------------|
| Options: | | | | |
| Outstanding at beginning of period | 3,364,778 | \$ 16.72 | | |
| Granted | 613,850 | 23.26 | | |
| Forfeited | (84,364) | 24.47 | | |
| Expired | (36,191) | 24.11 | | |
| Exercised | (535,194) | 12.63 | | |
| Outstanding at end of period | 3,322,879 | \$ 18.31 | 6.7 | \$ 18,455 |
| Exercisable at end of period | 2,164,370 | \$ 15.18 | 5.6 | \$ 17,459 |

Restricted Stock During the nine months ended September 30, 2007 and 2006, the Company recorded stock-based compensation related to restricted stock awards as operations and maintenance expense in the amounts of \$904 and \$605, respectively. During the three months ended September 30, 2007 and 2006, the Company recorded stock-based compensation related to restricted stock awards as operations and maintenance expense in the amounts of \$194 and \$166, respectively. The following table summarizes nonvested restricted stock transactions for the nine months ended September 30, 2007:

| | Number of Shares | Weighted Average Fair Value |
|-----------------------------------------|------------------------|-----------------------------------|
| Nonvested shares at beginning of period | 56,888 | \$ 23.98 |
| Granted | 55,000 | 23.27 |
| Vested | (37,443) | 21.85 |
| Forfeited | (5,000) | 29.46 |
| Nonvested shares at end of period | 69,445 | \$ 24.17 |

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

Note 8 Pension Plans and Other Postretirement Benefits

The Company maintains qualified defined benefit pension plans, nonqualified pension plans and other postretirement benefit plans for certain of its employees. The net periodic benefit cost is based on estimated values provided by independent actuaries. The following tables provide the components of net periodic benefit costs:

| | Pension Benefits | | | |
|------------------------------------|-------------------|----------|--------------------|----------|
| | Nine Months Ended | | Three Months Ended | |
| | September 30, | | September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Service cost | \$ 3,679 | \$ 3,587 | \$ 1,201 | \$ 1,037 |
| Interest cost | 8,652 | 7,572 | 2,871 | 2,439 |
| Expected return on plan assets | (8,378) | (7,048) | (2,791) | (2,298) |
| Amortization of transition asset | (157) | (156) | (70) | (51) |
| Amortization of prior service cost | 202 | 161 | 108 | 46 |
| Amortization of actuarial loss | 555 | 1,317 | (239) | 358 |
| Capitalized costs | (1,969) | (1,497) | (679) | (499) |
| Net periodic benefit cost | \$ 2,584 | \$ 3,936 | \$ 401 | \$ 1,032 |

| | Other Postretirement Benefits | | | |
|---------------------------------------|----------------------------------|--------|--------------------|---------|
| | Nine Months Ended | | Three Months Ended | |
| | September 30, | | September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Service cost | \$ 855 | \$ 752 | \$ 286 | \$ 192 |
| Interest cost | 1,510 | 1,186 | 504 | 351 |
| Expected return on plan assets | (1,127) | (974) | (376) | (334) |
| Amortization of transition obligation | 78 | 77 | (143) | (328) |
| Amortization of prior service cost | (211) | (210) | (12) | 155 |
| Amortization of actuarial loss | 230 | 224 | 135 | 49 |
| Amortization of regulatory asset | 114 | 114 | 38 | 38 |
| Capitalized costs | (690) | (590) | (236) | (192) |
| Net periodic benefit cost | \$ 759 | \$ 579 | \$ 196 | \$ (69) |

The Company made cash contributions of \$8,428 to its defined benefit pension plans during the first nine months of 2007 and intends to make cash contributions of \$11,403 in 2008. In addition, the Company expects to make cash contributions of approximately \$1,708 for the funding of its other postretirement benefits during 2007.

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

Note 9 Water and Wastewater Rates

During the first nine months of 2007, certain of the Company's operating divisions in New Jersey, Ohio, Virginia and four other states were granted rate increases designed to increase total operating revenues on an annual basis by approximately \$5,321.

In December 2006, the Company's operating subsidiary in Florida filed an application with the Florida Public Service Commission (FPSC) designed to increase water and wastewater rates by \$7,298 on an annual basis. In April 2007, the Company commenced billing for a portion of the requested rates, in accordance with authorization from the FPSC. On August 28, 2007, the Company reached a settlement agreement with Florida's Office of Public Counsel and the Attorney General of the State of Florida. The settlement agreement was approved by the FPSC, and among other stipulations, resulted in the Company voluntarily withdrawing its application, and agreeing to refund the additional revenue billed that was associated with this rate application. As a result of this agreement, during the third quarter of 2007, the Company recorded a revenue refund which reduced operating revenues by \$571 for the amount of revenue recognized prior to the third quarter of 2007. Additionally during the third quarter, the Company wrote-off rate case expenses of \$2,073 of expenses that were incurred and previously deferred prior to the third quarter of 2007.

In 2004, the Company's operating subsidiaries in Texas filed an application with the Texas Commission on Environmental Quality (TCEQ) to increase rates by \$11,920 over a multi-year period. The application seeks to increase annual revenues in phases and is accompanied by a plan to defer and amortize a portion of the Company's depreciation, operating and other tax expense over a similar multi-year period, such that the impact on operating income approximates the requested amount during the first years that the new rates are in effect. The application is currently pending before the TCEQ and several parties have joined the proceeding to challenge the rate request. The Company commenced billing for the requested rates and implemented the deferral plan in 2004. The additional revenue billed and collected prior to the final ruling is subject to refund based on the outcome of the ruling. The revenue recognized and the expenses deferred by the Company reflect an estimate of the final outcome of the ruling. As of September 30, 2007, the Company has deferred \$12,382 of operating costs and \$3,392 of rate case expenses and recognized \$22,941 of revenue that is subject to refund based on the outcome of the final commission order. Based on the Company's review of the present circumstances, no reserve is considered necessary for the revenue recognized to date or for the deferred rate case expense.

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

Note 10 Taxes Other than Income Taxes

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

| | Nine Months Ended | | Three Months Ended | |
|--------------------------------------|-------------------|-----------|--------------------|----------|
| | September 30, | | September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Property | \$ 17,812 | \$ 10,725 | \$ 5,732 | \$ 3,890 |
| Capital Stock | 2,573 | 2,743 | 862 | 918 |
| Gross receipts, excise and franchise | 5,982 | 5,235 | 2,048 | 1,841 |
| Payroll | 5,171 | 4,567 | 1,536 | 1,377 |
| Other | 2,058 | 1,721 | 671 | 814 |
| Total taxes other than income | \$ 33,596 | \$ 24,991 | \$ 10,849 | \$ 8,840 |

Property taxes increased during the nine months and three months ended September 30, 2007 primarily as a result of the acquisition of New York Water and the associated property taxes of \$5,193 and \$1,731, respectively.

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

Note 11 Segment Information

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

The following tables present information about the Company's reportable segment:

| | Three Months Ended September 30, 2007 | | | Three Months Ended September 30, 2006 | | |
|------------------------------------|------------------------------------------|----------|--------------|------------------------------------------|----------|--------------|
| | Regulated | Other | Consolidated | Regulated | Other | Consolidated |
| Operating revenues | \$ 162,186 | \$ 3,305 | \$ 165,491 | \$ 144,665 | \$ 2,285 | \$ 146,950 |
| Operations and maintenance expense | 64,920 | 2,149 | 67,069 | 56,517 | 2,610 | 59,127 |
| Depreciation | 21,521 | (456) | 21,065 | 18,928 | (594) | 18,334 |
| Operating income | 63,989 | 1,358 | 65,347 | 59,433 | 90 | 59,523 |
| Interest expense, net of AFUDC | 15,195 | 1,253 | 16,448 | 11,275 | 2,774 | 14,049 |
| Income tax | 19,886 | (245) | 19,641 | 19,402 | (1,168) | 18,234 |
| Net income | 29,161 | 357 | 29,518 | 28,847 | (1,516) | 27,331 |

| | Nine Months Ended September 30, 2007 | | | Nine Months Ended September 30, 2006 | | |
|------------------------------------|-----------------------------------------|----------|--------------|-----------------------------------------|----------|--------------|
| | Regulated | Other | Consolidated | Regulated | Other | Consolidated |
| Operating revenues | \$ 443,800 | \$ 9,616 | \$ 453,416 | \$ 392,449 | \$ 4,199 | \$ 396,648 |
| Operations and maintenance expense | 183,440 | 7,258 | 190,698 | 163,118 | 2,758 | 165,876 |
| Depreciation | 63,016 | (1,359) | 61,657 | 54,403 | (1,984) | 52,419 |
| Operating income | 161,075 | 2,787 | 163,862 | 147,301 | 2,933 | 150,234 |
| Interest expense, net of AFUDC | 45,076 | 2,899 | 47,975 | 32,495 | 8,272 | 40,767 |
| Income tax | 47,477 | (1,045) | 46,432 | 46,629 | (2,609) | 44,020 |
| Net income | 69,115 | 988 | 70,103 | 69,011 | (2,730) | 66,281 |
| Capital expenditures | 174,089 | 1,694 | 175,783 | 182,855 | 753 | 183,608 |

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

| | September 30, 2007 | December 31, 2006 |
|---------------|-----------------------|----------------------|
| Total assets: | | |
| Regulated | \$ 3,117,321 | \$ 2,819,385 |
| Other | 17,014 | 58,518 |
| Consolidated | \$ 3,134,335 | \$ 2,877,903 |

Note 12 Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109, which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company adopted the provisions of FIN 48 as of January 1, 2007 and has analyzed filing positions in its federal and state jurisdictions where it is required to file income tax returns, as well as for all open tax years in these jurisdictions. The Company's reserve for uncertain tax positions was insignificant upon adoption of FIN 48 and the Company did not record a cumulative effect adjustment related to the adoption of FIN 48. The Company believes its income tax filing positions and deductions will be sustained under audit and it believes it does not have significant uncertain tax positions that, in the event of adjustment, will result in a material effect on its results of operations or financial position. The Company has elected to recognize accrued interest and penalties related to uncertain tax positions as income tax expense. As of September 30, 2007, the Company's Federal income tax returns for all years through 2003 have been closed. Tax years 2004 through 2006 remain open to examination by the major taxing jurisdictions to which we are subject, however, 2004 and 2005 Federal income tax returns have been settled through examination.

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

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

Forward-looking Statements

This Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Quarterly Report contain, in addition to historical information, forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements address, among other things: our use of cash; projected capital expenditures; liquidity; possible acquisitions and other growth ventures; the completion of various construction projects; the projected timing and annual value of rate increases; the recovery of certain costs and capital investments through rate increase requests; the projected effects of recent accounting pronouncements, as well as information contained elsewhere in this report where statements are preceded by, followed by or include the words believes, expects, anticipates, plans, intends, will, continue or similar expressions. These statements are based on a number of assumptions concerning future events, and are subject to a number of uncertainties and other factors, many of which are outside our control. Actual results may differ materially from such statements for a number of reasons, including the effects of regulation, abnormal weather, changes in capital requirements and funding, acquisitions, and our ability to assimilate acquired operations. In addition to these uncertainties or factors, our future results may be affected by the factors and risk factors set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006. We undertake no obligation to update or revise forward-looking statements, whether as a result of new information, future events or otherwise.

General Information

Nature of Operations - Aqua America, Inc. (we or us), a Pennsylvania corporation, is the holding company for regulated utilities providing water or wastewater services to what we estimate to be approximately 3 million people in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, New York, Florida, Indiana, Virginia, Maine, Missouri, and South Carolina. Our largest operating subsidiary, Aqua Pennsylvania, Inc., provides water or wastewater services to approximately one-half of the total number of people we serve, which are located in the suburban areas north and west of the City of Philadelphia and in 23 other counties in Pennsylvania. Our other subsidiaries provide similar services in 12 other states. In addition, we provide water and wastewater service through operating and maintenance contracts with municipal authorities and other parties, and septage hauling services, close to our utility companies' service territories.

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

Financial Condition

During the first nine months of 2007, we had \$175,783 of capital expenditures, acquired water and wastewater systems for \$41,815, repaid \$3,245 of customer advances for construction and repaid debt and made sinking fund contributions and other loan repayments of \$35,172. The capital expenditures were related to improvements to treatment plants, new and rehabilitated water mains, tanks, hydrants, and service lines, well and booster improvements, and other.

At September 30, 2007, we had \$15,582 of cash and cash equivalents compared to \$44,039 at December 31, 2006. During the first nine months of 2007, we used the proceeds from the issuance of long-term debt, the proceeds from the issuance of common stock, internally generated funds and available working capital to fund the cash requirements discussed above and to pay dividends. In January 2007, our Pennsylvania operating subsidiary, Aqua Pennsylvania, Inc., issued \$50,000 of tax-exempt bonds secured by a supplement to its first mortgage indenture with a weighted-average maturity of 33.5 years and with a weighted-average interest rate of 4.435%. The proceeds are restricted to funding certain capital projects during the period 2007 through 2009 and resulted in an increase in the funds restricted for construction activity during the first nine months of 2007. In March 2007, the Company issued \$30,000 of unsecured notes with a weighted-average maturity of 22.5 years and a weighted-average interest rate of 5.73%. We used the proceeds from the sales of these notes to repay short-term borrowings. During the first nine months of 2007, our operating subsidiaries issued notes payable in aggregate of \$11,888 at rates ranging from 1.0% to 5.5% due from 2017 to 2035. At September 30, 2007, we had short-term lines of credit of \$249,000, of which \$53,468 was available. Effective with the September 1, 2007 payment, we increased the quarterly cash dividend on our common stock from \$0.115 per share to \$0.125 per share.

Management believes that internally generated funds along with existing credit facilities and the proceeds from the issuance of long-term debt and common stock will be adequate to meet our financing requirements for the balance of the year and beyond.

Results of Operations

Analysis of First Nine Months of 2007 Compared to First Nine Months of 2006

Revenues for the first nine months increased \$56,768 or 14.3% primarily due to additional revenues of \$26,109 associated with acquisitions, additional revenues of \$25,442 resulting from increased water and wastewater rates implemented in various operating subsidiaries, increased water consumption of \$2,245, and \$998 of additional sewer revenues. Acquisitions provided additional operating revenues in the Regulated segment of \$21,344, primarily from the New York Water Service acquisition, and \$4,765 of additional revenues in Other as provided by the acquisition of several septage businesses during 2006. The increased water consumption reflected a return to a more normal water consumption level in many of our operating subsidiaries as compared to the same period of 2006, offset partially by lower water consumption in our Texas operating subsidiaries which was associated with unfavorable wet weather conditions experienced during 2007. Heavy rainfall in Texas unfavorably impacted water revenues by approximately \$2,519 as compared to the first nine months of 2006.

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

(In thousands of dollars, except per share amounts)

Operations and maintenance expenses increased by \$24,822 or 15.0% primarily due to additional expenses associated with acquisitions of \$12,418, additional expenses resulting from the preparation and administration of rate filings of \$2,322, increased water production costs of \$1,991, additional bad debt expense of \$1,445, the receipt in the first quarter of 2006 of \$1,500 relating to a waiver of certain contractual rights without a corresponding amount in the current year, and normal increases in other operating costs, offset partially by lower insurance expenses of \$1,091 due to reduced claims. Of the total acquisition expenses, \$8,062 was associated with the New York Water Service acquisition that was completed on January 1, 2007 and the remainder was associated with other acquisitions in the Regulated segment. The additional rate filing expenses of \$2,073 during the third quarter of 2007 resulted from the complete write-off of previously deferred expenses related to the withdrawal of a rate filing in Florida. No further write-offs from this rate filing are expected. The receipt of the \$1,500 was a one-time payment recognized in the first quarter of 2006 as a reduction to operations and maintenance expense. The increased water production costs, principally purchased power and chemicals, were associated with vendor price increases.

Depreciation expense increased \$9,238 or 17.6% reflecting the utility plant placed in service since September 30, 2006, including the assets acquired through system acquisitions.

Amortization increased \$475 or 15.2% due to the amortization of the costs associated with, and other costs being recovered in, various rate filings.

Taxes other than income taxes increased by \$8,605 or 34.4% due to additional property taxes associated with the acquired operations of New York Water Service of \$5,193, and additional state and local taxes incurred in the first nine months of 2007.

Interest expense increased by \$6,425 or 14.7% primarily due to additional borrowings to finance capital projects and increased interest rates on short-term borrowings.

Allowance for funds used during construction (AFUDC) decreased by \$783 primarily due to a decrease in the average balance of utility plant construction work in progress, to which AFUDC is applied; offset partially by an increase in the AFUDC rate which is based on short-term interest rates.

Gain on sale of other assets totaled \$648 in the first nine months of 2007 and \$834 in the first nine months of 2006. The decrease of \$186 is due to the timing of sales of land.

Our effective income tax rate was 39.8% in the first nine months of 2007 and 39.9% in the first nine months of 2006. The effective income tax rate can vary over time due to changes in our expenses that are not tax-deductible.

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

Net income for the first nine months increased by \$3,822 or 5.8%, in comparison to the same period in 2006 primarily as a result of the factors described above. On a diluted per share basis, earnings increased \$0.03 or 6.0% reflecting the change in net income and a 1.7% increase in the average number of common shares outstanding. The increase in the number of shares outstanding is primarily a result of the additional shares sold or issued through the employee stock and incentive plan, dividend reinvestment plan and the 2,250,000 additional shares issued by us in public offerings in June and August 2006.

Analysis of Third Quarter of 2007 Compared to Third Quarter of 2006

Revenues for the quarter increased \$18,541 or 12.6% primarily due to additional revenues of \$4,959 resulting from increased water and wastewater rates implemented in various operating subsidiaries, additional revenues of \$10,662 associated with acquisitions, and \$2,617 of additional water revenues resulting from increased consumption.

Acquisitions provided additional operating revenues in the Regulated segment of \$9,994, primarily from the New York Water Service acquisition, and \$668 of additional revenues in Other as provided by the acquisition of several septage businesses during 2006. The increased water consumption reflected a return to a more normal water consumption level in many of our operating subsidiaries as compared to the same period of 2006, offset partially by lower water consumption in our Texas operating subsidiaries which was associated with unfavorable wet weather conditions experienced during 2007. Heavy rainfall in Texas unfavorably impacted water revenues by approximately \$2,011 as compared to the third quarter of 2006.

Operations and maintenance expenses increased by \$7,942 or 13.4% primarily due to additional expenses associated with acquisitions of \$4,346, additional expenses resulting from the preparation and administration of rate filings of \$2,073, additional bad debt expense of \$580 and normal increases in other operating costs, offset partially by reduced insurance expenses of \$970 due to a reduction in the required insurance claims reserve. Of the total acquisition expenses, \$3,724 were associated with the New York Water Service acquisition that was completed on January 1, 2007 and the remainder was associated with other acquisitions in the Regulated segment. The additional rate filing expenses of \$2,073 during the third quarter of 2007 resulted from the complete write-off of previously deferred expenses related to the withdrawal of a rate filing in Florida. No further write-offs from this rate filing are expected. Depreciation expense increased \$2,731 or 14.9% reflecting the utility plant placed in service since September 30, 2006, including the assets acquired through system acquisitions.

Amortization increased \$35 or 3.1% due to the amortization of the costs associated with, and other costs being recovered in, various rate filings.

Taxes other than income taxes increased by \$2,009 or 22.7% due to additional property taxes associated with the acquired operations of New York Water Service of \$1,731, and additional state and local taxes incurred in the third quarter of 2007.

Interest expense increased by \$2.351 or 15.9% primarily due to additional borrowings to finance capital projects. Allowance for funds used during construction (AFUDC) decreased by \$48 primarily due to a decrease in the average balance of utility plant construction work in progress, to which AFUDC is applied; offset partially by an increase in the AFUDC rate which is based on short-term interest rates.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)
(In thousands of dollars, except per share amounts)

Gain on sale of other assets totaled \$260 in the third quarter of 2007 and \$91 in the third quarter of 2006. The increase of \$169 is due to the timing of sales of land.

Our effective income tax rate was 40.0% in the third quarter of 2007 and 2006. The effective income tax rate can vary over time due to changes in our expenses that are not tax-deductible.

Net income for the quarter increased by \$2,187 or 8.0%, in comparison to the same period in 2006 primarily as a result of the factors described above. On a diluted per share basis, earnings increased \$0.01 reflecting the change in net income and a 0.9% increase in the average number of common shares outstanding. The increase in the number of shares outstanding is primarily a result of the additional shares sold or issued through the employee stock and incentive plan, dividend reinvestment plan and the 500,000 additional shares issued by us in a public offering in August 2006.

Impact of Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. (FIN) 48,

Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109, which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We adopted the provisions of FIN 48 as of on January 1, 2007 and have analyzed filing positions in its federal and state jurisdictions where we are required to file income tax returns, as well as for all open tax years in these jurisdictions. Our reserve for uncertain tax positions was insignificant upon adoption of FIN 48 and we did not record a cumulative effect adjustment related to the adoption of FIN 48. We believe our income tax filing positions and deductions will be sustained under audit and we believe we do not have significant uncertain tax positions that, in the event of adjustment, will result in a material effect on our results of operations or financial position. We have elected to recognize accrued interest and penalties related to uncertain tax positions as income tax expense. As of September 30, 2007, our Federal income tax returns for all years through 2003 have been closed. Tax years 2004 through 2006 remain open to examination by the major taxing jurisdictions to which we are subject, however, 2004 and 2005 Federal income tax returns have been settled through examination.

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

Recent Events

The City of Fort Wayne, Indiana has authorized the acquisition, by eminent domain or otherwise, of a portion of the utility system of one of the operating subsidiaries that the Company acquired in connection with the AquaSource acquisition in 2003. We had challenged whether the City was following the correct legal procedures in connection with the City's attempted condemnation, but the Indiana Supreme Court, in an opinion issued in June 2007, supported the City's position. In October 2007, the City's Board of Public Works approved proceeding with its process to condemn the portion of our utility system at a preliminary price based on the City's valuation. We have filed an appeal with the Allen County Circuit Court challenging the Board of Public Works' valuation on several bases. We intend to continue to challenge the City's valuation of this portion of our system. The portion of the system under consideration represents approximately 1% of our total customer base.

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AQUA AMERICA, INC. AND SUBSIDIARIES

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are subject to market risks in the normal course of business, including changes in interest rates and equity prices. There have been no significant changes in our exposure to market risks since December 31, 2006. Refer to Item 7A of the Company's Annual Report on Form 10-K for the year ended December 31, 2006 for additional information.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

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

(b) Changes in Internal Control over Financial Reporting

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

Part II. Other Information

Item 1. Legal Proceedings

In December 2006, the Company's operating subsidiary in Florida filed a rate application with the Florida Public Service Commission (FPSC). In April 2007, the Company commenced billing for a portion of the requested rates, in accordance with authorization from the FPSC. On August 28, 2007, the Company reached a settlement agreement with Florida's Office of Public Counsel and the Attorney General of the State of Florida. The settlement agreement was approved by the FPSC, and among other stipulations, resulted in the Company voluntarily withdrawing its application, and agreeing to refund the additional revenue billed that was associated with this rate application. As a result of this agreement, during the third quarter of 2007, the Company recorded a revenue refund and the Company wrote-off the associated rate case expenses that were incurred and previously deferred prior to the third quarter of 2007. For more information, refer to Note 9 - Water and Wastewater Rates to the Consolidated Financial Statements of Aqua America, Inc. and subsidiaries in this Quarterly Report on Form 10-Q for the quarter ended September 30, 2007.

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AQUA AMERICA, INC. AND SUBSIDIARIES

In 2004, our subsidiaries in Texas filed an application with the Texas Commission on Environmental Quality to increase rates over a multi-year period. In accordance with authorization from the Texas Commission on Environmental Quality, our subsidiaries commenced billing for the requested rates and deferred recognition of certain expenses for financial statement purposes. Several parties have joined the proceeding to challenge the rate request. In the event our request is denied completely or in part, we could be required to refund some or all of the revenue billed to-date, and write-off some or all of the regulatory asset for the expense deferral. For more information, see the description under the section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations - Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2006, and refer to "Note 9 - Water and Wastewater Rates" to the Consolidated Financial Statements of Aqua America, Inc. and subsidiaries in this Quarterly Report on Form 10-Q for the quarter ended September 30, 2007.

The City of Fort Wayne, Indiana has authorized the acquisition, by eminent domain or otherwise, of a portion of the utility system of one of the operating subsidiaries that the Company acquired in connection with the AquaSource acquisition in 2003. We had challenged whether the City was following the correct legal procedures in connection with the City's attempted condemnation, but the Indiana Supreme Court, in an opinion issued in June 2007, supported the City's position. In October 2007, the City's Board of Public Works approved proceeding with its process to condemn the portion of our utility system at a preliminary price based on the City's valuation. We have filed an appeal with the Allen County Circuit Court challenging the Board of Public Works' valuation on several bases. We intend to continue to challenge the City's valuation of this portion of our system. The portion of the system under consideration represents approximately 1% of our total customer base.

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

Item 1A. **Risk Factors**

There have been no material changes to the risks disclosed in our Annual Report on Form 10-K for the year ended December 31, 2006 ("Form 10-K") under "Part 1, Item 1A - Risk Factors" . The risks described in our Form 10-K are not the only risks facing the Company. Additional risks that we do not presently know or that we currently believe are immaterial could also impair our business or financial position.

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AQUA AMERICA, INC. AND SUBSIDIARIES

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

The following table summarizes Aqua America's purchases of its common stock for the quarter ended September 30, 2007:

| Period | Issuer Purchases of Equity Securities | | | Maximum Number of Shares that May Yet be Purchased Under the Plan or Programs (2) |
|------------------------|---------------------------------------|------------------------------|----------------------------------------------------------------------------------|-----------------------------------------------------------------------------------|
| | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | |
| July 1 - 31, 2007 | | \$ | | 548,278 |
| August 1 - 31, 2007 | 21,036 | \$ 24.98 | | 548,278 |
| September 1 - 30, 2007 | 2,475 | \$ 24.63 | | 548,278 |
| Total | 23,511 | \$ 24.95 | | 548,278 |

(1) These amounts consist of shares we purchased from our employees who elected to pay the exercise price of their stock options (and then hold shares of the stock) upon exercise by delivering to us (and, thus, selling) shares of Aqua America common stock in accordance with the terms of our equity compensation plans that were previously

approved by our shareholders and disclosed in our proxy statements. This feature of our equity compensation plans is available to all employees who receive option grants under the plans. We purchased these shares at their fair market value, as determined by reference to the closing price of our common stock on the day prior to the option exercise.

- (2) On August 5, 1997, our Board of Directors authorized a common stock repurchase program that was publicly announced on August 7, 1997, for up to 1,007,351 shares. No repurchases have been made under this program since 2000. The program has no fixed expiration date. The number of shares authorized for purchase was

adjusted as a
result of the
stock splits
effected in the
form of stock
distributions
since the
authorization
date.

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AQUA AMERICA, INC. AND SUBSIDIARIES

Item 6. Exhibits

| Exhibit No. | Description |
|-------------|---------------------------------------------------------------------------------------------------------------------|
| 31.1 | Certification of Chief Executive Officer, pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934. |
| 31.2 | Certification of Chief Financial Officer, pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934. |
| 32.1 | Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350. |
| 32.2 | Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350. |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be executed on its behalf by the undersigned thereunto duly authorized.
November 7, 2007

AQUA AMERICA, INC.

Registrant

NICHOLAS DEBENEDICTIS

Nicholas DeBenedictis
Chairman, President and Chief Executive Officer

DAVID P. SMELTZER

David P. Smeltzer
Chief Financial Officer

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EXHIBIT INDEX

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