

American Water Works Company, Inc.

Form 10-Q

November 03, 2010

[Table of Contents](#)

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

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2010

OR

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

For the transition period from            to

Commission file: number 001-34028

**AMERICAN WATER WORKS COMPANY, INC.**

(Exact name of registrant as specified in its charter)

Edgar Filing: American Water Works Company, Inc. - Form 10-Q

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

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

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

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

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

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

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

| Class                                    | Outstanding at October 29, 2010 |
|--|---------------------------------|
| Common Stock, \$0.01 par value per share | 174,873,174 shares              |

**Table of Contents**

**TABLE OF CONTENTS**

**AMERICAN WATER WORKS COMPANY, INC.**

**REPORT ON FORM 10-Q**

**FOR THE QUARTER ENDED September 30, 2010**

**INDEX**

|  |         |
|--|---------|
| <b><u>PART I. FINANCIAL INFORMATION</u></b>  | 1       |
| <u>ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS</u>   | 1-19    |
| <u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u> | 20 - 41 |
| <u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>                            | 42      |
| <u>ITEM 4. CONTROLS AND PROCEDURES</u>   | 42      |
| <b><u>PART II. OTHER INFORMATION</u></b>   | 42      |
| <u>ITEM 1. LEGAL PROCEEDINGS</u>   | 42      |
| <u>ITEM 1A. RISK FACTORS</u>   | 42      |
| <u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>                           | 42      |
| <u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>   | 42      |
| <u>ITEM 4. [RESERVED]</u>  | 42      |
| <u>ITEM 5. OTHER INFORMATION</u>   | 42      |
| <u>ITEM 6. EXHIBITS</u>  | 43      |
| <b><u>SIGNATURES</u></b>   | 44      |
| <b><u>EXHIBITS INDEX</u></b>   | 44      |
| EXHIBIT 10.1   |         |
| EXHIBIT 10.2   |         |
| EXHIBIT 31.1   |         |
| EXHIBIT 31.2   |         |
| EXHIBIT 32.1   |         |
| EXHIBIT 32.2   |         |
| EXHIBIT 101  |         |

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

|   | <b>September 30,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|---|-------------------------------|------------------------------|
| <b>ASSETS</b>   |                               |                              |
| Property, plant and equipment   |                               |                              |
| Utility plant at original cost, net of accumulated depreciation of \$3,349,819 at September 30 and \$3,168,078 at December 31 | \$ 10,872,916                 | \$ 10,523,844                |
| Nonutility property, net of accumulated depreciation of \$133,694 at September 30 and \$117,245 at December 31                | 140,431                       | 153,549                      |
| <b>Total property, plant and equipment</b>  | <b>11,013,347</b>             | <b>10,677,393</b>            |
| Current assets  |                               |                              |
| Cash and cash equivalents   | 23,501                        | 22,256                       |
| Restricted funds  | 99,974                        | 41,020                       |
| Utility customer accounts receivable  | 201,354                       | 149,417                      |
| Allowance for uncollectible accounts  | (21,182)                      | (19,035)                     |
| Unbilled utility revenues   | 150,927                       | 130,262                      |
| Non-Regulated trade and other receivables, net  | 81,671                        | 75,086                       |
| Income taxes receivable   | 6,394                         | 17,920                       |
| Materials and supplies  | 31,345                        | 29,521                       |
| Other   | 53,415                        | 52,680                       |
| <b>Total current assets</b>   | <b>627,399</b>                | <b>499,127</b>               |
| Regulatory and other long-term assets   |                               |                              |
| Regulatory assets   | 1,011,554                     | 952,020                      |
| Restricted funds  | 26,330                        | 20,212                       |
| Goodwill  | 1,250,692                     | 1,250,381                    |
| Other   | 54,353                        | 53,518                       |
| <b>Total regulatory and other long-term assets</b>  | <b>2,342,929</b>              | <b>2,276,131</b>             |
| <b>TOTAL ASSETS</b>   | <b>\$ 13,983,675</b>          | <b>\$ 13,452,651</b>         |

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

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

|   | <b>September 30,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|---|-------------------------------|------------------------------|
| <b>CAPITALIZATION AND LIABILITIES</b>   |                               |                              |
| Capitalization  |                               |                              |
| Common stock (\$.01 par value, 500,000 shares authorized, 174,860 and 174,630 shares outstanding at September 30 and December 31, respectively) | \$ 1,749                      | \$ 1,746                     |
| Paid-in-capital   | 6,151,349                     | 6,140,077                    |
| Accumulated deficit   | (1,960,806)                   | (2,076,287)                  |
| Accumulated other comprehensive loss  | (61,086)                      | (64,677)                     |
| Common stockholders' equity   | 4,131,206                     | 4,000,859                    |
| Preferred stock without mandatory redemption requirements   | 4,547                         | 4,557                        |
| Total stockholders' equity  | 4,135,753                     | 4,005,416                    |
| Long-term debt  |                               |                              |
| Long-term debt  | 5,371,548                     | 5,288,180                    |
| Redeemable preferred stock at redemption value  | 23,802                        | 23,946                       |
| Total capitalization  | 9,531,103                     | 9,317,542                    |
| Current liabilities   |                               |                              |
| Short-term debt   | 181,841                       | 119,497                      |
| Current portion of long-term debt   | 43,984                        | 54,068                       |
| Accounts payable  | 166,388                       | 138,609                      |
| Taxes accrued, including income taxes of \$0 at September 30 and \$1,777 at December 31   | 57,002                        | 45,552                       |
| Interest accrued  | 103,119                       | 60,128                       |
| Other   | 189,090                       | 189,538                      |
| Total current liabilities   | 741,424                       | 607,392                      |
| Regulatory and other long-term liabilities  |                               |                              |
| Advances for construction   | 617,147                       | 633,509                      |
| Deferred income taxes   | 1,050,293                     | 851,677                      |
| Deferred investment tax credits   | 31,415                        | 32,590                       |
| Regulatory liabilities  | 337,296                       | 322,281                      |
| Accrued pension expense   | 388,876                       | 431,010                      |
| Accrued postretirement benefit expense  | 230,214                       | 236,045                      |
| Other   | 45,575                        | 47,325                       |
| Total regulatory and other long-term liabilities  | 2,700,816                     | 2,554,437                    |
| Contributions in aid of construction  | 1,010,332                     | 973,280                      |
| Commitments and contingencies (See Note 9)  |                               |                              |

|   |               |               |
|---|---------------|---------------|
| <b>TOTAL CAPITALIZATION AND LIABILITIES</b> | \$ 13,983,675 | \$ 13,452,651 |
|---|---------------|---------------|

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

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

|  | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |              |
|--|---------------------------|-------------|--------------------------|--------------|
|  | <b>September 30,</b>      |             | <b>September 30,</b>     |              |
|  | <b>2010</b>               | <b>2009</b> | <b>2010</b>              | <b>2009</b>  |
| Operating revenues   | \$ 786,946                | \$ 679,956  | \$ 2,046,222             | \$ 1,842,866 |
| Operating expenses   |                           |             |                          |              |
| Operation and maintenance  | 378,034                   | 340,862     | 1,053,320                | 985,861      |
| Depreciation and amortization  | 79,431                    | 74,854      | 232,156                  | 216,939      |
| General taxes  | 55,316                    | 50,618      | 164,610                  | 154,814      |
| (Gain) loss on sale of assets  | 210                       | (784)       | 133                      | (976)        |
| Impairment charge  | 0                         | 0           | 0                        | 450,000      |
| Total operating expenses, net  | 512,991                   | 465,550     | 1,450,219                | 1,806,638    |
| Operating income   | 273,955                   | 214,406     | 596,003                  | 36,228       |
| Other income (expenses)  |                           |             |                          |              |
| Interest, net  | (74,858)                  | (74,124)    | (232,307)                | (219,791)    |
| Allowance for other funds used during construction   | 2,586                     | 2,290       | 7,144                    | 9,208        |
| Allowance for borrowed funds used during construction  | 1,814                     | 1,674       | 4,465                    | 5,537        |
| Amortization of debt expense   | (1,285)                   | (2,135)     | (3,233)                  | (5,158)      |
| Other, net   | 511                       | (310)       | 2,508                    | (605)        |
| Total other income (expenses)  | (71,232)                  | (72,605)    | (221,423)                | (210,809)    |
| Income (loss) before income taxes  | 202,723                   | 141,801     | 374,580                  | (174,581)    |
| Provision for income taxes   | 78,609                    | 50,165      | 146,907                  | 94,873       |
| Net income (loss)  | \$ 124,114                | \$ 91,636   | \$ 227,673               | \$ (269,454) |
| Other comprehensive income, net of tax:  |                           |             |                          |              |
| Pension plan amortized to periodic benefit cost:   |                           |             |                          |              |
| Prior service cost, net of tax of \$13 and \$7 for the three months ended and \$38 and \$22 for the nine months ended, respectively      | 20                        | 11          | 59                       | 34           |
| Actuarial loss, net of tax of \$698 and \$958 for the three months ended and \$2,094 and \$2,874 for the nine months ended, respectively | 1,092                     | 1,499       | 3,276                    | 4,496        |
| Foreign currency translation adjustment  | 348                       | 503         | 256                      | 1,377        |
| Other comprehensive income   | 1,460                     | 2,013       | 3,591                    | 5,907        |
| Comprehensive income (loss)  | \$ 125,574                | \$ 93,649   | \$ 231,264               | \$ (263,547) |
| Income (loss) per common share:  |                           |             |                          |              |
| Basic  | \$ 0.71                   | \$ 0.52     | \$ 1.30                  | \$ (1.62)    |

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

|  |         |         |         |           |
|--|---------|---------|---------|-----------|
| Diluted  | \$ 0.71 | \$ 0.52 | \$ 1.30 | \$ (1.62) |
| Average common shares outstanding during the period: |         |         |         |           |
| Basic  | 174,859 | 174,595 | 174,785 | 165,992   |
| Diluted  | 175,062 | 174,691 | 174,919 | 165,992   |
| Dividends per common share                           | \$ 0.22 | \$ 0.21 | \$ 0.64 | \$ 0.61   |

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



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

|   | <b>Nine Months Ended<br/>September 30,</b> |              |
|---|--|--------------|
|   | <b>2010</b>                                | <b>2009</b>  |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |  |              |
| Net income (loss)   | \$ 227,673                                 | \$ (269,454) |
| Adjustments   |  |              |
| Depreciation and amortization   | 232,156                                    | 216,939      |
| Impairment charge   | 0  | 450,000      |
| Amortization of removal costs net of salvage  | 32,225                                     | 30,417       |
| Provision for deferred income taxes   | 175,090                                    | 104,373      |
| Amortization of deferred investment tax credits   | (1,175)                                    | (1,204)      |
| Provision for losses on utility accounts receivable   | 16,218                                     | 17,791       |
| Allowance for other funds used during construction  | (7,144)                                    | (9,208)      |
| Loss (gain) on sale of assets   | 133  | (976)        |
| Pension and non-pension post retirement benefits  | 67,007                                     | 82,246       |
| Other, net  | (15,601)                                   | (18,025)     |
| Changes in assets and liabilities   |  |              |
| Receivables and unbilled utility revenues   | (93,258)                                   | (52,798)     |
| Income taxes receivable   | 11,526                                     | 0            |
| Other current assets  | (2,559)                                    | (25,771)     |
| Pension and non-pension post retirement benefit contributions   | (110,739)                                  | (90,427)     |
| Accounts payable  | (6,548)                                    | (9,123)      |
| Taxes accrued, including income taxes   | 5,716                                      | 13,652       |
| Interest accrued  | 42,991                                     | 44,451       |
| Other current liabilities   | 13,316                                     | (11,332)     |
| Net cash provided by operating activities   | 587,027                                    | 471,551      |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |  |              |
| Capital expenditures  | (522,090)                                  | (592,894)    |
| Acquisitions  | (1,670)                                    | (650)        |
| Proceeds from sale of assets and securities   | 150  | 1,127        |
| Removal costs from property, plant and equipment retirements, net   | (28,270)                                   | (20,167)     |
| Net restricted funds released   | 45,928                                     | 87,623       |
| Other   | 0  | (1,250)      |
| Net cash used in investing activities   | (505,952)                                  | (526,211)    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |  |              |
| Proceeds from long-term debt  | 162,541                                    | 336,994      |
| Repayment of long-term debt   | (196,449)                                  | (176,032)    |
| Net borrowings (repayments) under short-term debt agreements  | 78,998                                     | (223,375)    |
| Proceeds from issuance of common stock (net of 2009 expenses of \$7,824)  | 0  | 242,301      |
| Proceeds from employee stock plan issuances and DRIP  | 3,823                                      | 1,583        |
| Advances and contributions for construction, net of refunds of \$28,775 and \$20,041 at September 30, 2010 and 2009 | 4,975                                      | 13,349       |

Edgar Filing: American Water Works Company, Inc. - Form 10-Q

|  |            |            |
|--|------------|------------|
| Change in cash overdraft position                                  | (16,654)   | (34,354)   |
| Debt issuance costs  | (5,089)    | (6,713)    |
| Redemption of preferred stock                                      | (150)      | (140)      |
| Dividends paid   | (111,825)  | (100,664)  |
| Net cash (used in) provided by financing activities                | (79,830)   | 52,949     |
| Net increase (decrease) in cash and cash equivalents               | 1,245      | (1,711)    |
| Cash and cash equivalents at beginning of period                   | 22,256     | 9,542      |
| Cash and cash equivalents at end of period                         | \$ 23,501  | \$ 7,831   |
| <b>Non-cash investing activity:</b>                                |            |            |
| Capital expenditures acquired on account but unpaid at quarter-end | \$ 96,383  | \$ 51,267  |
| <b>Non-cash financing activity:</b>                                |            |            |
| Long-term debt   | \$ 111,000 | \$ 151,431 |
| Advances and contributions   | \$ 21,474  | \$ 64,383  |

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

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

(In thousands, except per share data)

|   | Common Stock |              | Paid-in<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury Stock |         | Mandatory<br>Redemption<br>Requirements | Total<br>Stockholders<br>Equity |
|---|--------------|--------------|--------------------|------------------------|---|----------------|---------|---|---------------------------------|
|   | Shares       | Par<br>Value |                    |                        |   | Shares         | At Cost |   |                                 |
| <b>Balance at December 31, 2009</b>                                 | 174,630      | \$ 1,746     | \$ 6,140,077       | \$ (2,076,287)         | \$ (64,677)                                   | 0              | \$ 0    | \$ 4,557                                | \$ 4,005,416                    |
| Net income  |              |              |                    | 227,673                |   |                |         |   | 227,673                         |
| Stock-based compensation and DRIP activity, net of expenses of \$69 | 230          | 3            | 11,272             | (367)                  |   | 0              | 0       |   | 10,908                          |
| Preferred stock redemption  |              |              |                    |                        |   |                |         | (10)                                    | (10)                            |
| Other comprehensive income, net of tax of \$2,132                   |              |              |                    |                        | 3,591   |                |         |   | 3,591                           |
| Dividends   |              |              |                    | (111,825)              |   |                |         |   | (111,825)                       |
| <b>Balance at September 30, 2010</b>                                | 174,860      | \$ 1,749     | \$ 6,151,349       | \$ (1,960,806)         | \$ (61,086)                                   | 0              | \$ 0    | \$ 4,547                                | \$ 4,135,753                    |
| <b>Balance at December 31, 2008</b>                                 | 160,000      | \$ 1,600     | \$ 5,888,253       | \$ (1,705,594)         | \$ (82,251)                                   | 0              | \$ (7)  | \$ 4,557                                | \$ 4,106,558                    |
| Net loss  |              |              |                    | (269,454)              |   |                |         |   | (269,454)                       |
| Common stock offering, net of expenses of \$7,824                   | 14,500       | 145          | 242,156            |                        |   |                |         |   | 242,301                         |
| Stock-based compensation activity                                   | 100          | 1            | 7,362              | (208)                  |   | 0              | 6       |   | 7,161                           |
| Other comprehensive income, net of tax of \$2,896                   |              |              |                    |                        | 5,907   |                |         |   | 5,907                           |
| Dividends   |              |              |                    | (100,664)              |   |                |         |   | (100,664)                       |
| <b>Balance at September 30, 2009</b>                                | 174,600      | \$ 1,746     | \$ 6,137,771       | \$ (2,075,920)         | \$ (76,344)                                   | 0              | \$ (1)  | \$ 4,557                                | \$ 3,991,809                    |

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

## **Table of Contents**

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

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

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

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

The accompanying Consolidated Balance Sheet of American Water Works Company, Inc. and Subsidiary Companies (the Company) at September 30, 2010, the Consolidated Statements of Operations and Comprehensive Income for the three and nine months ended September 30, 2010 and 2009, the Consolidated Statements of Cash Flows for the nine months ended September 30, 2010 and 2009, and the Consolidated Statement of Changes in Stockholders' Equity for the nine months ended September 30, 2010 and 2009, are unaudited, but reflect all adjustments, which are, in the opinion of management, necessary to present fairly the consolidated financial position, the consolidated changes in stockholders' equity, the consolidated results of operations and comprehensive income, and the consolidated cash flows for the periods presented. All adjustments are of a normal, recurring nature, except as otherwise disclosed. Because they cover interim periods, the unaudited consolidated financial statements and related notes to the consolidated financial statements do not include all disclosures and notes normally provided in annual financial statements and, therefore, should be read in conjunction with the Company's Consolidated Financial Statements and related Notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the year, due primarily to the seasonality of the Company's operations.

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

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

In January 2010, the Financial Accounting Standards Board (FASB) issued authoritative guidance that requires new disclosures of (i) the amounts of significant transfers into and out of Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers and (ii) information in the reconciliation of recurring Level 3 measurements (those using significant unobservable inputs) about purchases, sales, issuances, and settlements on a gross basis. This update also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. This guidance is effective for interim and annual periods beginning after December 15, 2009, except for the requirement to disclose information about purchases, sales, issuances and settlements in the reconciliation of Level 3 measurements, which does not become effective until interim and annual periods beginning after December 15, 2010. As this guidance clarifies and provides for additional disclosure requirements only, the adoption of this guidance does not have an impact on the Company's results of operations, financial position or cash flows.

##### **Consolidation of Variable Interest Entities**

In June 2009, the FASB issued authoritative guidance that replaces the quantitative-based risk and rewards calculation for determining which reporting entity has a controlling financial interest in a variable interest entity with a qualitative approach. This revised guidance also requires additional disclosures about a reporting entity's involvement in variable interest entities. This guidance is effective for the Company beginning January 1, 2010. These changes did not have an impact on the Company's results of operations, financial position or cash flows; however, these changes could impact the accounting for the Company's interests in a variable interest entity in the future.

#### **Note 3: Goodwill**

At September 30, 2010 the Company's goodwill totaled \$1,250,692. The Company's annual goodwill impairment test is conducted at November 30 of each calendar year and interim reviews are performed when the Company determines that a triggering event that would more likely than not reduce the fair value of a reporting unit below its carrying value has occurred. The Company concluded no such triggering event occurred during the nine months ended September 30, 2010. Accordingly, no interim review was performed for this period.

During the first quarter of 2009, the Company's stock 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 qualitative and quantitative factors, management concluded that this sustained decline in market value below the

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

market value that existed at the 2008 annual impairment test was an interim triggering event and performed an interim impairment test. The Company's calculated market capitalization at March 31, 2009 was \$1,186,000 below its aggregated carrying value of its reporting units.

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 \$450,000 as a goodwill impairment charge for the three months ended March 31, 2009.

**Table of Contents**

The following table summarizes the nine-month changes in the Company's goodwill by reporting unit:

|                                      | Regulated Unit      |                           | Non-Regulated Units |                           | Cost                | Consolidated<br>Accumulated<br>Impairment | Total Net           |
|--------------------------------------|---------------------|---------------------------|---------------------|---------------------------|---------------------|---|---------------------|
|                                      | Cost                | Accumulated<br>Impairment | Cost                | Accumulated<br>Impairment |                     |   |                     |
| Balance at January 1, 2010           | \$ 3,565,913        | \$ (2,443,628)            | \$ 235,715          | \$ (107,619)              | \$ 3,801,628        | \$ (2,551,247)                            | \$ 1,250,381        |
| Reclassifications and other activity | 36                  | 0                         | 275                 | 0                         | 311                 | 0   | 311                 |
| <b>Balance at September 30, 2010</b> | <b>\$ 3,565,949</b> | <b>\$ (2,443,628)</b>     | <b>\$ 235,990</b>   | <b>\$ (107,619)</b>       | <b>\$ 3,801,939</b> | <b>\$ (2,551,247)</b>                     | <b>\$ 1,250,692</b> |
| Balance at January 1, 2009           | \$ 3,565,215        | \$ (1,995,380)            | \$ 235,549          | \$ (105,867)              | \$ 3,800,764        | \$ (2,101,247)                            | \$ 1,699,517        |
| Impairment losses                    | 0                   | (448,248)                 | 0                   | (1,752)                   | 0                   | (450,000)                                 | (450,000)           |
| Reclassifications and other activity | 550                 | 0                         | 0                   | 0                         | 550                 | 0   | 550                 |
| <b>Balance at September 30, 2009</b> | <b>\$ 3,565,765</b> | <b>\$ (2,443,628)</b>     | <b>\$ 235,549</b>   | <b>\$ (107,619)</b>       | <b>\$ 3,801,314</b> | <b>\$ (2,551,247)</b>                     | <b>\$ 1,250,067</b> |

The Company may be required to recognize an impairment of goodwill in the future due to market conditions or other factors related to the Company's performance. These market events could include a decline over a period of time of the Company's stock price, a decline over a period of time in valuation multiples of comparable water utilities, the lack of an increase in the Company's market price consistent with its peer companies, or decreases in control premiums. A decline in the forecasted results in 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). 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.

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

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.

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 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.



**Table of Contents**

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.

**Note 4: Stockholders' Equity****Common Stock**

On March 23, 2010, the Company filed a Form S-3 Registration Statement with the SEC to register 5,000 shares of the Company's common stock issuable under American Water Stock Direct, a dividend reinvestment and direct stock purchase plan (the "DRIP"). Under the DRIP, stockholders may reinvest cash dividends and purchase additional Company common stock, up to certain limits, through a transfer agent without commission fees. The Company's transfer agent may buy newly issued shares directly from the Company or shares held in the Company's treasury. The transfer agent may also buy shares in the public markets or in privately negotiated transactions. Purchases generally will be made and credited to DRIP accounts once each week. The Company issued 40 shares of common stock with proceeds of \$869 during the first nine months of 2010 under the DRIP.

In March and June 2010, the Company made a cash dividend payment of \$0.21 per share to all common shareholders of record as of February 18, 2010 and May 18, 2010, amounting to \$36,679 and \$36,689, respectively. In September 2010, the Company made a cash dividend payment of \$0.22 per share to all common shareholders of record as of August 18, 2010, amounting to \$38,457.

In March 2009 and June 2009, the Company made a cash dividend payment of \$0.20 per share to all common shareholders of record as of February 18, 2009 and May 18, 2009, amounting to \$32,000 and \$32,006, respectively. In September 2009, the Company made a cash dividend payment of \$0.21 per share to all common shareholders of record as of August 18, 2009, amounting to \$36,658.

On October 29, 2010, the Company declared a quarterly cash dividend payment of \$0.22 per share payable on December 1, 2010 to all shareholders of record as of November 18, 2010.

**Stock Based Compensation**

The Company has granted stock option and restricted stock unit awards to non-employee directors, officers and other key employees of the Company pursuant to the terms of its 2007 Omnibus Equity Compensation Plan (the "Plan"). As of September 30, 2010, a total of 11,723 shares are available for grant under the Plan. Shares issued under the Plan may be authorized but unissued shares of Company stock or reacquired shares of Company stock, including shares purchased by the Company on the open market for purposes of the Plan.

The Company recognizes compensation expense for stock awards over the vesting period of the award. The following table presents stock-based compensation expense recorded in operations and maintenance expense in the accompanying Consolidated Statements of Operations for the three and nine months ended September 30, 2010 and 2009:

|   | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|--------|------------------------------------|----------|
|   | 2010                                | 2009   | 2010                               | 2009     |
| Stock options   | \$ 1,323                            | \$ 705 | \$ 3,177                           | \$ 2,536 |
| Restricted stock units  | 1,551                               | 746    | 4,437                              | 2,942    |
| Employee stock purchase plan                                  | 94                                  | 97     | 265                                | 307      |
| Stock-based compensation in operation and maintenance expense | 2,968                               | 1,548  | 7,879                              | 5,785    |
| Income tax benefit  | (1,157)                             | (604)  | (3,073)                            | (2,257)  |
| After-tax stock-based compensation expense                    | \$ 1,811                            | \$ 944 | \$ 4,806                           | \$ 3,528 |

Edgar Filing: American Water Works Company, Inc. - Form 10-Q

There were no significant stock-based compensation costs capitalized during the nine months ended September 30, 2010 and 2009, respectively.

**Table of Contents****Stock Options**

Stock options granted in 2008 included 1,470 stock options that were subject to performance-based vesting requirements. In February 2009, the Company cancelled 311 of these stock options related to the first performance vesting period because the performance goals were not fully met at December 31, 2008. In February 2010, the Company cancelled 459 of these stock options related to the second performance vesting period because the second performance goals were not fully met at December 31, 2009. The Company continues to recognize expense on the remaining stock options during the service period, which ends December 31, 2010.

In the first quarter of 2010, the Company granted 867 non-qualified stock options to certain employees under the Plan. The stock options vest ratably over a three-year service period from January 1, 2010. These awards have no performance vesting conditions and the grant date fair value is amortized through expense over the requisite service period using the straight-line method.

On August 15, 2010, the Company's Board of Directors elected a new President and Chief Executive Officer (CEO) of the Company. In connection with his election to these offices, the Company's new CEO was granted 25 non-qualified stock options that cliff vest two years from the date of grant. Additionally, he was granted 53 non-qualified stock options that vest ratably over a three-year period beginning January 1, 2010. These awards have no performance vesting conditions and the grant date fair value is amortized through expense over the requisite service period using the straight-line method.

Also on August 15, 2010, the Company's former President and Chief Executive Officer resigned as an officer and director of the Company. Pursuant to his resignation, the Company cancelled options to purchase 33 shares of Company stock, accelerated the vesting of 247 options, extended the termination dates of vested options and recognized additional expense related to the modifications that is recorded in operations and maintenance expense in the accompanying Consolidated Statements of Operations for the three and nine months ended September 30, 2010.

The following table presents the weighted average assumptions used in the pricing model for 2010 grants and the resulting weighted average grant date fair value of stock options granted:

|                         |          |
|-------------------------|----------|
| Dividend yield          | 3.83 %   |
| Expected volatility     | 31.77 %  |
| Risk-free interest rate | 2.14 %   |
| Expected life (years)   | 4.29     |
| Exercise price          | \$ 22.01 |
| Grant date fair value   | \$ 4.33  |

Stock options granted under the Plan have maximum terms of seven years, vest over periods ranging from one to three years, and are granted with exercise prices equal to the market value of the Company's common stock on the date of grant. As of September 30, 2010, \$4,166 of total unrecognized compensation cost related to the non-vested stock options is expected to be recognized over the weighted-average period of 1.4 years. The following table summarizes stock option activity for the nine months ended September 30, 2010:

|   | Shares | Weighted<br>Average<br>Exercise Price<br>(per share) | Weighted<br>Average<br>Remaining<br>Life (years) | Aggregate<br>Intrinsic<br>Value |
|---|--------|--|--|---------------------------------|
| Options outstanding at January 1, 2010    | 2,724  | \$ 21.19   |  |                                 |
| Granted                                   | 945    | 22.01  |  |                                 |
| Cancelled                                 | (459)  | 21.50  |  |                                 |
| Forfeited or expired                      | (135)  | 21.48  |  |                                 |
| Exercised                                 | (64)   | 21.33  |  |                                 |
| Options outstanding at September 30, 2010 | 3,011  | \$ 21.39   | 5.00   | \$ 5,675                        |

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

|                                       |       |    |       |      |    |       |
|---------------------------------------|-------|----|-------|------|----|-------|
| Exercisable at September 30, 2010 (a) | 1,048 | \$ | 21.23 | 4.27 | \$ | 2,135 |
|---------------------------------------|-------|----|-------|------|----|-------|

(a) Includes stock options issued to retired employees

Cash received for stock options exercised during the nine months ended September 30, 2010 was \$1,230 and the intrinsic value of the options was \$52.

### **Restricted Stock Units**

Restricted stock units granted in 2008 included 190 restricted stock units that were subject to performance-based vesting requirements. In February 2009, the Company cancelled 39 of these restricted stock units related to the first performance vesting period because the performance goals were not fully met at December 31, 2008. In February 2010, the Company cancelled 60 of these restricted stock units related to the second performance vesting period because the second performance goals were not fully met at December 31, 2009. The Company continues to recognize expense on the remaining restricted stock units during the service period, which ends December 31, 2010.

**Table of Contents**

In the first quarter of 2010, the Company granted 243 restricted stock units to certain employees under the Plan. The restricted stock units vest ratably over the three year performance period beginning January 1, 2010 (the Performance Period); however, distribution of the shares is contingent upon the achievement of internal performance measures and, separately, certain market thresholds over the Performance Period. The restricted stock units granted with performance and service conditions are valued at the market value of the Company's common stock on the date of grant. The restricted stock units granted with market and service conditions are valued using a Monte Carlo model.

On May 7, 2010, the Company granted 19 restricted stock units to non-employee directors under the Plan. The restricted stock units vested on the date of grant; however, distribution of the shares will be made within 30 days of the earlier of August 11, 2011 or the participant's separation from service. The grant date fair value of these restricted stock units was \$20.71.

On August 27, 2010, the Company's new CEO was granted 12 restricted stock units that vest over the period beginning August 27, 2010 and ending December 31, 2010; however, distribution of the shares is contingent upon the achievement of internal performance measures and, separately, certain market thresholds over the vesting period. The restricted stock units granted with performance and service conditions are valued at the market value of the Company's common stock on the date of grant. The restricted stock units granted with market and service conditions are valued using a Monte Carlo model.

Also in August 2010, the Company accelerated the vesting of 12 restricted stock units granted in 2008 to the Company's former CEO. Additionally the Company cancelled 9 restricted stock units granted in 2009 and 2010, the remaining outstanding awards will be subject to the Company's achievement of internal performance measures and certain market thresholds over the applicable three-year performance periods as if he had remained in the employ of the Company during the entire performance periods. The Company recognized additional expense related to the modifications that is recorded in operations and maintenance expense in the accompanying Consolidated Statements of Operations for the three and nine months ended September 30, 2010.

On September 24, 2010, the Company granted 6 restricted stock units to non-employee directors under the Plan. The restricted stock units vested on the date of grant; however, distribution of the shares will be made within 30 days of the earlier of October 15, 2011 or the participant's separation from service. The grant date fair value of these restricted stock units was \$23.49.

The value of restricted stock awards at the date of the grant is amortized through expense over the requisite service period using the straight-line method for the restricted stock units with service and/or performance vesting. The grant date fair value of the restricted stock awards that have (a) market and/or performance and service conditions and (b) vest ratably is amortized through expense over the requisite service period using the graded-vesting method. As of September 30, 2010, \$3,474 of total unrecognized compensation cost related to the non-vested restricted stock units is expected to be recognized over the weighted-average remaining life of 0.8 years.

The following table summarizes restricted stock unit activity for the nine months ended September 30, 2010:

|                                       | Shares | Weighted Average<br>Grant Date<br>Fair Value<br>(per share) |
|---------------------------------------|--------|---|
| Nonvested total at January 1, 2010    | 402    | \$ 21.77  |
| Granted                               | 280    | 23.23   |
| Distributed                           | (55)   | 20.68   |
| Cancelled                             | (60)   | 21.50   |
| Forfeited                             | (26)   | 23.03   |
| Undistributed vested awards           | (46)   | 22.45   |
| Nonvested total at September 30, 2010 | 495    | \$ 22.62  |

The aggregate intrinsic value of restricted stock units distributed during the nine months ended September 30, 2010 was \$1,179, on which the Company recognized an income tax benefit of \$14 which has been recorded in the accompanying Consolidated Balance Sheets.

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

If dividends are declared with respect to shares of the Company's common stock before the restricted stock units are distributed, the Company credits a liability for the value of the dividends that would have been paid if the restricted stock units were shares of Company common stock. When the restricted stock units are distributed, the Company pays the employee a lump sum cash payment equal to the value of the dividend equivalents accrued. The Company accrued dividend equivalents totaling \$367 and \$208 to retained earnings during the nine months ended September 30, 2010 and 2009, respectively.

### **Employee Stock Purchase Plan**

Under the Nonqualified Employee Stock Purchase Plan (the ESPP), employees can use payroll deductions to acquire Company stock at the lesser of 90% of the fair market value of (a) the beginning or (b) the end of each three-month purchase period. As of September 30, 2010 there were 1,740 shares of common stock reserved for issuance under the ESPP. During the nine months ended September 30, 2010, the Company issued 92 shares under the ESPP.

**Table of Contents****Note 5: Long-Term Debt**

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

|  | Rate         | Weighted<br>Average Rate | Maturity<br>Date | September 30,<br>2010 | December 31,<br>2009 |
|--|--------------|--------------------------|------------------|-----------------------|----------------------|
| Long-term debt of American Water Capital Corp.<br>( AWCC ) |              |                          |                  |                       |                      |
| Private activity bonds and government funded debt(a)       |              |                          |                  |                       |                      |
| Fixed rate   | 4.85%-6.75%  | 5.72%                    | 2018-2040        | \$ 322,610            | \$ 200,975           |
| Senior notes   |              |                          |                  |                       |                      |
| Fixed rate   | 5.39%-10.00% | 6.26%                    | 2011-2039        | 3,087,701             | 3,115,853            |
| Long-term debt of other subsidiaries                       |              |                          |                  |                       |                      |
| Private activity bonds and government funded debt          |              |                          |                  |                       |                      |
| Fixed rate   | 0.00%-6.20%  | 4.53%                    | 2011-2039        | 1,192,003             | 1,197,611            |
| Floating rate(b)   | 0.85%-1.05%  | 0.91%                    | 2015             | 8,560                 | 8,560                |
| Mortgage bonds   |              |                          |                  |                       |                      |
| Fixed rate   | 5.48%-9.71%  | 7.48%                    | 2011-2039        | 744,736               | 754,966              |
| Mandatory redeemable preferred stock                       | 4.60%-9.75%  | 8.39%                    | 2013-2036        | 24,067                | 24,207               |
| Notes payable and other(c)                                 | 4.90%-14.57% | 7.50%                    | 2011-2026        | 6,008                 | 6,561                |
| Long-term debt   |              |                          |                  | 5,385,685             | 5,308,733            |
| Unamortized debt discount, net(d)                          |              |                          |                  | 50,114                | 57,461               |
| Fair value adjustment to interest rate hedge               |              |                          |                  | 3,535                 | 0                    |
| Total long-term debt                                       |              |                          |                  | \$ 5,439,334          | \$ 5,366,194         |

- (a) As of December 31, 2009, the Company held \$10,635 of floating rate debt in its treasury, as it had not been able to re-issue the debt to investors at acceptable interest rates. On July 27, 2010, the Company re-issued this debt as fixed rate of 5.25% due 2028.
- (b) Represents variable rate tax-exempt bonds remarketed for periods up to 270 days. The \$8,560 balance is classified as current portion of long-term debt in the accompanying Consolidated Balance Sheets because it was repurchased by the Company during the first quarter of 2009 when no investor was willing to purchase it at market rates. This debt was subsequently remarketed as floating rate debt in the second quarter of 2009.
- (c) Includes capital lease obligations of \$5,230 and \$5,679 at September 30, 2010 and December 31, 2009, respectively.
- (d) Includes fair value adjustments previously recognized in acquisition purchase accounting.

The following long-term debt was issued in 2010:

| Company                          | Type  | Interest Rate | Maturity  | Amount     |
|----------------------------------|---|---------------|-----------|------------|
| American Water Capital Corp. (1) | Private activity bonds and government funded debt<br>fixed rate | 4.85%-5.38%   | 2028-2040 | \$ 121,635 |
| Other subsidiaries               | Private activity bonds and government funded debt<br>fixed rate | 0.00%-5.60%   | 2021-2034 | 151,906    |
| Total issuances                  |   |               |           | \$ 273,541 |

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

- (1) Includes \$111,000 of proceeds from issuances which are initially kept in Trust, pending the Company's certification that it has incurred qualifying capital expenditures. These issuances have been presented as a non-cash financing activity on the accompanying Consolidated Statements of Cash Flows. Subsequent release of all or a lesser portion of these funds by the applicable Trust are reflected as the release of restricted funds, and are included in investing activities in the accompanying Consolidated Statement of Cash Flows.



## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

The following long-term debt was retired through optional redemption or payment at maturity during 2010:

| Company                         | Type   | Interest Rate | Maturity  | Amount     |
|---------------------------------|--|---------------|-----------|------------|
| American Water Capital Corp.    | Senior notes-fixed rate                                      | 6.00%-6.87%   | 2011-2039 | \$ 28,152  |
| Other subsidiaries              | Private activity bonds and government funded debt-fixed rate | 0.00%-6.88%   | 2010-2036 | 157,514    |
| Other subsidiaries              | Mortgage bond  | 7.86%-8.98%   | 2010-2011 | 10,230     |
| Other subsidiaries              | Mandatory redeemable preferred stock                         | 4.60%-6.00%   | 2013-2019 | 140        |
| Other                           | Capital leases & other                                       |               |           | 553        |
| Total retirements & redemptions |  |               |           | \$ 196,589 |

**Table of Contents**

Interest, net includes interest income of approximately \$2,531 and \$7,450 for the three and nine months ended September 30, 2010, respectively, and \$2,404 and \$7,366 for the three and nine months ended September 30, 2009, respectively.

On July 12, 2010, the Company entered into an interest rate swap to hedge \$100,000 of its 6.085% fixed rate debt maturing 2017. The Company will pay variable interest of six-month LIBOR plus 3.422%. The Company uses a combination of fixed-rate and variable-rate debt to manage interest rate exposure.

At September 30, 2010 and December 31, 2009, the Company had a \$100,000 and \$0 notional amount variable interest rate swap fair value hedge outstanding, respectively. The following table provides a summary of the derivative fair value balance recorded by the Company as of September 30, 2010 and the line item in the Consolidated Balance Sheet in which such amount is recorded:

|                                       | September 30,<br>2010 | December 31,<br>2009 |
|---------------------------------------|-----------------------|----------------------|
| Balance sheet classification          |                       |                      |
| Regulatory and other long-term assets |                       |                      |
| Other                                 | \$ 3,228              | \$ 0                 |
| Long-term debt                        |                       |                      |
| Long-term debt                        | \$ 3,535              | \$ 0                 |

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

| Income Statement Classification | Gain (Loss) on Swap                         | Gain (Loss) on Borrowings                      | Hedge<br>Ineffectiveness                    |
|---------------------------------|---|--|---|
|                                 | Three Months Ended<br>September 30,<br>2010 | Three Months<br>Ended<br>September 30,<br>2010 | Three Months Ended<br>September 30,<br>2010 |
| Interest, net                   | \$ 3,228                                    | \$ (3,535)                                     | \$ (307)                                    |

  

| Income Statement Classification | Gain (Loss) on<br>Swap                        | Gain (Loss) on<br>Borrowings                  | Hedge<br>Ineffectiveness                      |
|---------------------------------|---|---|---|
|                                 | Nine Months<br>Ended<br>September 30,<br>2010 | Nine Months<br>Ended<br>September 30,<br>2010 | Nine Months<br>Ended<br>September 30,<br>2010 |
| Interest, net                   | \$ 3,228                                      | \$ (3,535)                                    | \$ (307)                                      |

On November 1, 2010, a regulated subsidiary of the Company closed on a refinancing of two bond issues of \$35,000 and \$40,000 with maturity dates in 2029 and 2025 and interest rates of 4.88% and 4.70%, respectively.

**Note 6: Short-Term Debt**

The components of short-term debt are as follows:

|   | September 30,<br>2010 | December 31,<br>2009 |
|---|-----------------------|----------------------|
| Commercial paper, net of \$7 and \$5 discount, respectively | \$ 163,993            | \$ 84,995            |
| Bank overdraft  | 17,848                | 34,502               |

Edgar Filing: American Water Works Company, Inc. - Form 10-Q

|                       |            |            |
|-----------------------|------------|------------|
| Total short-term debt | \$ 181,841 | \$ 119,497 |
|-----------------------|------------|------------|

**Table of Contents**

The Company had no outstanding borrowings on its revolving credit line as of September 30, 2010 and December 31, 2009, respectively.

**Note 7: Income Taxes**

The Company's estimated annual effective tax rate for the nine months ended September 30, 2010 was 39.7% compared to 39.6% for the nine months ended September 30, 2009, excluding various discrete items including goodwill impairment. The Company's actual effective tax rates for the three months ended September 30, 2010 and 2009 were 38.8% and 35.4%, respectively. The Company's actual effective rates for the nine months ended September 30, 2010 and 2009 were 39.2% and (54.3%), respectively.

The 2009 nine month rate reflects the tax effects of goodwill impairments as discrete items as the Company considers these charges as infrequently occurring or unusual.

The Patient Protection and Affordable Care Act (the "PPACA") became law on March 23, 2010, and the Health Care and Education Reconciliation Act of 2010 became law on March 30, 2010, which makes various amendments to certain aspects of the PPACA (together, the "Acts"). The PPACA effectively changes the tax treatment of federal subsidies paid to sponsors of retiree health benefit plans that provide a benefit that is at least actuarially equivalent to the benefits under Medicare Part D. As a result of the Acts, these subsidy payments will effectively become taxable in tax years beginning after December 31, 2012.

Although this change does not take effect immediately, companies are required to recognize the full accounting impact in their financial statements in the period in which the legislation was enacted. As a result, in the first quarter of 2010, the Company followed its original accounting for the underfunded status of other postretirement benefits for the Medicare Part D adjustment and recorded a reduction in its deferred tax assets and an increase in its regulatory assets amounting to \$27,128.

**Note 8: Pension and Other Postretirement Benefits**

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

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|-----------|------------------------------------|-----------|
|   | 2010                                | 2009      | 2010                               | 2009      |
| <b>Components of net periodic pension benefit cost</b>              |                                     |           |                                    |           |
| Service cost  | \$ 7,669                            | \$ 7,107  | \$ 23,006                          | \$ 21,320 |
| Interest cost   | 16,901                              | 15,730    | 50,702                             | 47,189    |
| Expected return on plan assets                                      | (14,189)                            | (10,556)  | (42,564)                           | (31,668)  |
| Amortization of:  |                                     |           |                                    |           |
| Prior service cost  | 81                                  | 45        | 242                                | 136       |
| Actuarial loss  | 4,476                               | 5,992     | 13,427                             | 17,976    |
| Net periodic pension benefit cost                                   | \$ 14,938                           | \$ 18,318 | \$ 44,813                          | \$ 54,953 |
| <b>Components of net periodic other postretirement benefit cost</b> |                                     |           |                                    |           |
| Service cost  | \$ 3,665                            | \$ 3,293  | \$ 10,997                          | \$ 9,879  |
| Interest cost   | 8,037                               | 7,295     | 24,112                             | 21,885    |
| Expected return on plan assets                                      | (6,093)                             | (4,659)   | (18,279)                           | (13,978)  |
| Amortization of:  |                                     |           |                                    |           |
| Transition obligation   | 43                                  | 43        | 130                                | 130       |
| Prior service (credit) cost   | (295)                               | (296)     | (885)                              | (886)     |
| Actuarial loss  | 2,040                               | 2,289     | 6,119                              | 6,866     |
| Net periodic other postretirement benefit cost                      | \$ 7,397                            | \$ 7,965  | \$ 22,194                          | \$ 23,896 |

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

The Company contributed \$81,700 to its defined benefit pension plan in the first nine months of 2010. In October, the Company contributed \$14,900 completing 2010 contributions. In addition, the Company contributed \$29,039 for the funding of its other postretirement plans in the first nine months of 2010 and expects to contribute \$9,680 during the balance of 2010.

### **Note 9: Commitments and Contingencies**

The Company is also routinely involved in legal actions incident to the normal conduct of its business. At September 30, 2010, the Company has accrued approximately \$4,300 as probable costs and it is reasonably possible that additional losses could range up to \$12,900 for these matters. For certain matters, the Company is unable to estimate possible losses. The Company believes that damages or settlements, if any, recovered by plaintiffs in such claims or actions will not have a material adverse effect on the Company's results of operations, financial position or cash flows.

**Table of Contents**

The Company enters into agreements for the provision of services to water and wastewater facilities for the United States military, municipalities and other customers. The Company's military services agreements expire between 2051 and 2060 and have remaining performance commitments as measured by estimated remaining contract revenue of \$2,104,000 at September 30, 2010. The Company's Operations and Maintenance agreements with municipalities and other customers expire between 2010 and 2048 and have remaining performance commitments as measured by estimated remaining contract revenue of \$1,243,000 at September 30, 2010. Some of the Company's long-term contracts to operate and maintain a municipality's, federal government's or other party's water or wastewater treatment and delivery facilities include responsibility for certain major maintenance for some of those facilities, in exchange for an annual fee. Unless specifically required to perform certain maintenance activities, the maintenance costs are recognized when the maintenance is performed.

**Note 10: Environmental Matters**

The Company's water and wastewater operations are subject to federal, state, local and foreign requirements relating to environmental protection and as such the Company periodically becomes subject to environmental claims in the normal course of business. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated. Remediation costs accrued amounted to \$6,730 and \$7,947 at September 30, 2010 and December 31, 2009, respectively. Included in the balance of the accrual was \$6,600 at September 30, 2010 and \$7,700 at December 31, 2009 related to a conservation agreement entered into by a subsidiary of the Company with the National Oceanic and Atmospheric Administration (NOAA) requiring the Company to, among other provisions, implement certain measures to protect the steelhead trout and its habitat in the Carmel River watershed in the state of California. The Company has agreed to pay \$1,100 annually from 2010 through 2016; the 2010 payment was made in June. The payments will be used to improve habitat conditions for the steelhead trout in the Carmel River Watershed and will end upon a regional desalination plant becoming operational and the subsidiary's diversions from the Carmel River coming within permitted limits. The Company pursues recovery of incurred costs through all appropriate means, including regulatory recovery through customer rates. The Company's Regulatory assets at September 30, 2010 include \$11,026 related to the NOAA agreement, including an additional \$3,500 granted for recovery during the three months ended September 30, 2010.

**Note 11: Net Income (Loss) per Common Share**

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

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |              |
|---|-------------------------------------|-----------|------------------------------------|--------------|
|   | 2010                                | 2009      | 2010                               | 2009         |
| Basic   |                                     |           |                                    |              |
| Net income (loss)   | \$ 124,114                          | \$ 91,636 | \$ 227,673                         | \$ (269,454) |
| Less: Distributed earnings to common shareholders (a)                 | 38,580                              | 36,719    | 112,155                            | 100,865      |
| Less: Distributed earnings to participating securities                | 13                                  | 4         | 36                                 | 0            |
| Undistributed earnings  | 85,521                              | 54,913    | 115,482                            | (370,319)    |
| Undistributed earnings allocated to common shareholders (b)           | 85,491                              | 54,907    | 115,444                            | (370,319)    |
| Undistributed earnings allocated to participating securities          | 30                                  | 6         | 38                                 | 0            |
| Total income (loss) available to common shareholders, basic (a) + (b) | \$ 124,071                          | \$ 91,626 | \$ 227,599                         | \$ (269,454) |
| Weighted average common shares outstanding, basic                     | 174,859                             | 174,595   | 174,785                            | 165,992      |
| Basic net income (loss) per common share                              | \$ 0.71                             | \$ 0.52   | \$ 1.30                            | \$ (1.62)    |



**Table of Contents**

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

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |              |
|---|-------------------------------------|-----------|------------------------------------|--------------|
|   | 2010                                | 2009      | 2010                               | 2009         |
| <b>Diluted</b>  |                                     |           |                                    |              |
| Total income (loss) available to common shareholders, basic   | \$ 124,071                          | \$ 91,626 | \$ 227,599                         | \$ (269,454) |
| Undistributed earnings allocated to participating securities  | 30                                  | 6         | 38                                 | 0            |
| Total income (loss) available to common shareholders, diluted | \$ 124,101                          | \$ 91,632 | \$ 227,637                         | \$ (269,454) |
| Weighted average common shares outstanding, basic             | 174,859                             | 174,595   | 174,785                            | 165,992      |
| Stock-based compensation:                                     |                                     |           |                                    |              |
| Restricted stock units  | 183                                 | 92        | 128                                | 0            |
| Stock options   | 18                                  | 0         | 5                                  | 0            |
| Employee stock purchase plan                                  | 2                                   | 4         | 1                                  | 0            |
| Weighted average common shares outstanding, diluted           | 175,062                             | 174,691   | 174,919                            | 165,992      |
| Diluted net income (loss) per common share                    | \$ 0.71                             | \$ 0.52   | \$ 1.30                            | \$ (1.62)    |

Options to purchase 1,873 and 2,122 shares of the Company's common stock were excluded from the calculation of diluted common shares outstanding because they were anti-dilutive for the three-month periods ended September 30, 2010 and 2009, respectively. There were 144 and 83 restricted stock units excluded from the calculation of diluted common shares outstanding for the three months ended September 30, 2010 and 2009, respectively, because certain performance conditions were not satisfied. Additionally 633 stock options were excluded from the three months ended September 30, 2009 diluted common shares outstanding calculation because certain performance conditions were not met. Options to purchase 1,873 shares of the Company's common stock and 147 restricted stock units were excluded from the calculation of diluted common shares outstanding for the nine months ended September 30, 2010 because they were anti-dilutive. All of the potentially dilutive securities were excluded from the nine months ended September 30, 2009 because they were anti-dilutive.

**Note 12: Fair Value of Assets and Liabilities****Fair Value of Financial Instruments**

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

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

**Preferred stock with mandatory redemption requirements and long-term debt:** The fair values of preferred stock with mandatory redemption requirements and long-term debt are determined by a valuation model which is based on a conventional discounted cash flow methodology and utilizes assumptions of current market rates. As a majority of the Company's debts do not trade in active markets, the fair values are highly dependent upon market conditions surrounding the measurement date. The Company calculated a base yield curve using a risk-free rate (a US Treasury securities yield curve) plus a credit spread that is based on the following two factors: an average of the Company's own publicly-traded debt securities and the current market rates for US Utility BBB+ debt securities. The Company used these yield curve assumptions to derive a base yield and then adjusted the base yield for specific features of the debt securities for differences in credit profile, collateral, tax treatment and



## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

call features.

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

| <b>As of September 30, 2010</b>                         | <b>Carrying<br/>Amount</b> | <b>Fair Value</b> |
|---|----------------------------|-------------------|
| Preferred stocks with mandatory redemption requirements | \$ 24,020                  | \$ 28,503         |
| Long-term debt (excluding capital lease obligations)    | 5,410,084                  | 6,263,710         |
|   |                            |                   |
| <b>As of December 31, 2009</b>                          | <b>Carrying<br/>Amount</b> | <b>Fair Value</b> |
| Preferred stocks with mandatory redemption requirements | \$ 24,164                  | \$ 26,257         |
| Long-term debt (excluding capital lease obligations)    | 5,336,351                  | 5,633,384         |

**Table of Contents****Recurring Fair Value Measurements**

The following table presents assets and liabilities measured and recorded at fair value on a recurring basis and their level within the fair value hierarchy as of September 30, 2010 and December 31, 2009, respectively:

| Recurring Fair Value Measures         | At Fair Value as of September 30, 2010 |                   |         |                   |
|---------------------------------------|--|-------------------|---------|-------------------|
|                                       | Level 1                                | Level 2           | Level 3 | Total             |
| <b>Assets:</b>                        |  |                   |         |                   |
| Restricted funds                      | \$ 126,304                             |                   |         | \$ 126,304        |
| Rabbi trust investments               |  | \$ 1,808          |         | 1,808             |
| Deposits                              | 1,513                                  |                   |         | 1,513             |
| Mark-to-market derivative asset       |  | 3,228             |         | 3,228             |
| <b>Total assets</b>                   | <b>127,817</b>                         | <b>5,036</b>      |         | <b>132,853</b>    |
| <b>Liabilities:</b>                   |  |                   |         |                   |
| Deferred compensation obligation      |  | 8,560             |         | 8,560             |
| <b>Total liabilities</b>              |  | <b>8,560</b>      |         | <b>8,560</b>      |
| <b>Total net assets (liabilities)</b> | <b>\$ 127,817</b>                      | <b>\$ (3,524)</b> |         | <b>\$ 124,293</b> |
| <br>                                  |  |                   |         |                   |
| Recurring Fair Value Measures         | At Fair Value as of December 31, 2009  |                   |         |                   |
|                                       | Level 1                                | Level 2           | Level 3 | Total             |
| <b>Assets:</b>                        |  |                   |         |                   |
| Restricted funds                      | \$ 61,232                              |                   |         | \$ 61,232         |
| Rabbi trust investments               |  | \$ 2,551          |         | 2,551             |
| Deposits                              | 11,612                                 |                   |         | 11,612            |
| <b>Total assets</b>                   | <b>72,844</b>                          | <b>2,551</b>      |         | <b>75,395</b>     |
| <b>Liabilities:</b>                   |  |                   |         |                   |
| Deferred compensation obligation      |  | 8,881             |         | 8,881             |
| <b>Total liabilities</b>              |  | <b>8,881</b>      |         | <b>8,881</b>      |
| <b>Total net assets (liabilities)</b> | <b>\$ 72,844</b>                       | <b>\$ (6,330)</b> |         | <b>\$ 66,514</b>  |

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

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

**Deposits** Deposits includes escrow funds and certain other deposits held in trust. The Company includes cash deposits in other current assets. The December 31, 2009 balance included \$10,170 for an escrow account related to an agreement the Company's New Jersey regulated subsidiary had entered into with the City of Trenton, New Jersey to purchase certain assets of Trenton's water system located in four surrounding townships. The purchase agreement was contested in litigation with a group of Trenton residents, and ultimately put to a voter referendum. The result of the

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

referendum was unfavorable to the Company, and as a result, the agreement to purchase the assets has been terminated. The escrow deposit, plus accrued interest, was returned to the Company on June 30, 2010.

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

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

### **Non-recurring Fair Value Measurements**

As discussed in Note 3, the Company recognized a goodwill impairment charge of \$450,000 for the nine months ended September 30, 2009. The Company's goodwill valuation model includes significant unobservable inputs and falls within level 3 of the fair value hierarchy.

### **Note 13: Segment Information**

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

**Table of Contents**

The following table includes the Company's summarized segment information:

|                               | As of or for the Three Months Ended<br>September 30, 2010 |               |            |              |
|-------------------------------|---|---------------|------------|--------------|
|                               | Regulated   | Non-Regulated | Other      | Consolidated |
| Net operating revenues        | \$ 713,080  | \$ 80,310     | \$ (6,444) | \$ 786,946   |
| Depreciation and amortization | 72,373  | 1,854         | 5,204      | 79,431       |
| Total operating expenses, net | 448,694   | 71,499        | (7,202)    | 512,991      |
| Adjusted EBIT (1)             | 264,935   | 9,157         |            |              |
| Total assets                  | 12,186,238  | 244,394       | 1,553,043  | 13,983,675   |
| Capital expenditures          | 193,540   | 1,271         | 0          | 194,811      |

|                               | As of or for the Three Months Ended<br>September 30, 2009 |               |            |              |
|-------------------------------|---|---------------|------------|--------------|
|                               | Regulated   | Non-Regulated | Other      | Consolidated |
| Net operating revenues        | \$ 620,999  | \$ 65,233     | \$ (6,276) | \$ 679,956   |
| Depreciation and amortization | 69,382  | 1,522         | 3,950      | 74,854       |
| Total operating expenses, net | 417,568   | 59,086        | (11,104)   | 465,550      |
| Adjusted EBIT (1)             | 203,898   | 6,563         |            |              |
| Total assets                  | 11,490,753  | 242,709       | 1,612,247  | 13,345,709   |
| Capital expenditures          | 191,921   | 799           | 0          | 192,720      |

|                               | As of or for the Nine Months Ended<br>September 30, 2010 |               |             |              |
|-------------------------------|--|---------------|-------------|--------------|
|                               | Regulated  | Non-Regulated | Other       | Consolidated |
| Net operating revenues        | \$ 1,834,883   | \$ 230,153    | \$ (18,814) | \$ 2,046,222 |
| Depreciation and amortization | 211,709  | 5,562         | 14,885      | 232,156      |
| Total operating expenses, net | 1,263,191  | 214,285       | (27,257)    | 1,450,219    |
| Adjusted EBIT (1)             | 573,381  | 18,504        |             |              |
| Total assets                  | 12,186,238   | 244,394       | 1,553,043   | 13,983,675   |
| Capital expenditures          | 516,598  | 5,492         | 0           | 522,090      |

|                               | As of or for the Nine Months Ended<br>September 30, 2009 |               |             |              |
|-------------------------------|--|---------------|-------------|--------------|
|                               | Regulated  | Non-Regulated | Other       | Consolidated |
| Net operating revenues        | \$ 1,673,346   | \$ 187,029    | \$ (17,509) | \$ 1,842,866 |
| Depreciation and amortization | 203,231  | 4,296         | 9,412       | 216,939      |
| Impairment charge             | 0  | 0             | 450,000     | 450,000      |
| Total operating expenses, net | 1,215,511  | 171,587       | 419,540     | 1,806,638    |
| Adjusted EBIT (1)             | 459,355  | 16,665        |             |              |
| Total assets                  | 11,490,753   | 242,709       | 1,612,247   | 13,345,709   |
| Capital expenditures          | 589,371  | 3,523         | 0           | 592,894      |

- (1) 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 flow for periods presented and should not be considered as an alternative to net income as an indicator of the Company's operating performance or 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.

The following table reconciles Adjusted EBIT, as defined by the Company, to income (loss) before income taxes:

Edgar Filing: American Water Works Company, Inc. - Form 10-Q

|   | <b>For the Three Months Ended<br/>September 30, 2010</b> |                      |                           |
|---|--|----------------------|---------------------------|
|   | <b>Regulated</b>   | <b>Non-Regulated</b> | <b>Total<br/>Segments</b> |
| Adjusted EBIT   | \$ 264,935   | \$ 9,157             | \$ 274,092                |
| Add:  |  |                      |                           |
| Allowance for other funds used during construction    | 2,586  |                      | 2,586                     |
| Allowance for borrowed funds used during construction | 1,814  |                      | 1,814                     |
| Less:   |  |                      |                           |
| Interest, net   | (61,548)   | 274                  | (61,274)                  |
| Amortization of debt expense                          | (1,145)  | 0                    | (1,145)                   |
| Segments income before income taxes                   | \$ 206,642   | \$ 9,431             | 216,073                   |
| Interest, net   |  |                      | (13,584)                  |
| Other   |  |                      | 234                       |
| <b>Income before income taxes</b>                     |  |                      | <b>\$ 202,723</b>         |

**Table of Contents**

|   | <b>For the Three Months Ended<br/>September 30, 2009</b> |                      |                           |
|---|--|----------------------|---------------------------|
|   | <b>Regulated</b>   | <b>Non-Regulated</b> | <b>Total<br/>Segments</b> |
| Adjusted EBIT   | \$ 203,898   | \$ 6,563             | \$ 210,461                |
| Add:  |  |                      |                           |
| Allowance for other funds used during construction    | 2,290  |                      | 2,290                     |
| Allowance for borrowed funds used during construction | 1,674  |                      | 1,674                     |
| Less:   |  |                      |                           |
| Interest, net   | (57,710)   | 690                  | (57,020)                  |
| Amortization of debt expense                          | (1,995)  | 0                    | (1,995)                   |
| Segments income before income taxes                   | \$ 148,157   | \$ 7,253             | 155,410                   |
| Interest, net   |  |                      | (17,104)                  |
| Other   |  |                      | 3,495                     |
| Income before income taxes                            |  |                      | \$ 141,801                |

|   | <b>For the Nine Months Ended<br/>September 30, 2010</b> |                      |                           |
|---|---|----------------------|---------------------------|
|   | <b>Regulated</b>  | <b>Non-Regulated</b> | <b>Total<br/>Segments</b> |
| Adjusted EBIT   | \$ 573,381  | \$ 18,504            | \$ 591,885                |
| Add:  |   |                      |                           |
| Allowance for other funds used during construction    | 7,144   |                      | 7,144                     |
| Allowance for borrowed funds used during construction | 4,465   |                      | 4,465                     |
| Less:   |   |                      |                           |
| Interest, net   | (185,437)   | 1,175                | (184,262)                 |
| Amortization of debt expense                          | (2,816)   | 0                    | (2,816)                   |
| Segments income before income taxes                   | \$ 396,737  | \$ 19,679            | 416,416                   |
| Interest, net   |   |                      | (48,045)                  |
| Other   |   |                      | 6,209                     |
| Income before income taxes                            |   |                      | \$ 374,580                |

|   | <b>For the Nine Months Ended<br/>September 30, 2009</b> |                      |                           |
|---|---|----------------------|---------------------------|
|   | <b>Regulated</b>  | <b>Non-Regulated</b> | <b>Total<br/>Segments</b> |
| Adjusted EBIT   | \$ 459,355  | \$ 16,665            | \$ 476,020                |
| Add:  |   |                      |                           |
| Allowance for other funds used during construction    | 9,208   |                      | 9,208                     |
| Allowance for borrowed funds used during construction | 5,537   |                      | 5,537                     |
| Less:   |   |                      |                           |
| Interest, net   | (171,527)   | 2,389                | (169,138)                 |
| Amortization of debt expense                          | (4,739)   | 0                    | (4,739)                   |
| Segments income before income taxes                   | \$ 297,834  | \$ 19,054            | 316,888                   |

**Table of Contents**

|                          | <b>For the Nine Months Ended<br/>September 30, 2009</b> |                      | <b>Total<br/>Segments</b> |
|--------------------------|---|----------------------|---------------------------|
|                          | <b>Regulated</b>  | <b>Non-Regulated</b> |                           |
| Impairment charge        |   |                      | (450,000)                 |
| Interest, net            |   |                      | (50,653)                  |
| Other                    |   |                      | 9,184                     |
| Loss before income taxes |   |                      | \$ (174,581)              |

**Table of Contents**

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

Certain matters within this Quarterly Report on Form 10-Q include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements included in this Form 10-Q, other than statements of historical fact, may constitute forward-looking statements. Forward-looking statements can be identified by the use of words such as may, should, will, could, estimates, predicts, potential, continue, anticipates, believes, plans, and similar expressions. Forward-looking statements may involve known and unknown risks, uncertainties and other factors that may cause the actual results or performance to differ from those projected in the forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. Factors that could cause or contribute to differences in results and outcomes from those in our forward-looking statements include, without limitation, those items discussed in the Risk Factors section or other sections in the Company's Form 10-K for the year ended December 31, 2009 filed with the Securities and Exchange Commission (SEC), and subsequent periodic reports, including this report. All forward-looking statements are expressly qualified in their entirety by such risk factors. We undertake no obligation, other than as required by law, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

**GENERAL**

American Water Works Company, Inc. (herein referred to as American Water or the Company) is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers. Our Regulated Businesses that provide these services are generally subject to economic regulation by state regulatory agencies in the states in which they operate. We report the results of these businesses in our Regulated Businesses segment. We also provide services that are not subject to economic regulation by state regulatory agencies. We report the results of these businesses in our Non-Regulated Businesses segment. For further description of our businesses see the Business section found in our Form 10-K for the year ended December 31, 2009 filed with the SEC.

You should read the following discussion in conjunction with our Consolidated Financial Statements and related Notes included elsewhere in this Quarterly Report on Form 10-Q and in our Form 10-K for the year ended December 31, 2009 as updated or amended in subsequent filed reports with the SEC.

**OVERVIEW**

*Financial Results* American Water's net income was \$124.1 million for the three months ended September 30, 2010 as compared to net income of \$91.6 million for the three months ended September 30, 2009. Diluted earnings per average common share were \$0.71 for the three months ended September 30, 2010 compared to \$0.52 for the three months ended September 30, 2009.

American Water's net income was \$227.7 million for the nine months ended September 30, 2010 compared to a net loss of \$269.5 million for the nine months ended September 30, 2009. The Company recognized goodwill impairment charges, net of tax, of \$443.0 million for the nine months ended September 30, 2009. Diluted earnings per average common share was \$1.30 for the nine months ended September 30, 2010 compared to a diluted loss of (\$1.62) for the nine months ended September 30, 2009.

Revenues for the three months ended September 30, 2010 increased by \$107.0 million compared to the same period in the prior year. This was primarily due to increased revenues in our Regulated Businesses of \$92.1 million, which was mainly attributable to rate increases and increased consumption, and an increase in our Non-Regulated Businesses' revenues of \$15.1 million, which was primarily attributable to higher revenues in the Contract Operations Group of \$13.2 million. The increase in Contract Operations Group revenues was primarily due to revenues of \$9.3 million attributable to our entry into the industrial Operations and Maintenance (O&M) market through an acquisition in December of 2009, hereafter referred to as the Contract Operations Acquisition, and increased military contract revenues of \$8.1 million due to incremental contract work at two military bases as well as new contracts at two additional bases.

Operating expenses for the three months ended September 30, 2010 were \$513.0 million compared to \$465.6 million for the three months ended September 30, 2009. This \$47.4 million increase was primarily driven by increased operating expenses in our Regulated Businesses' operation and maintenance costs of \$23.8 million due to an increase in production and employee costs, increased operating and maintenance expenses in our Non-Regulated Businesses of \$10.9 million corresponding to an increase in revenue, higher depreciation expense of \$4.6 million and



Edgar Filing: American Water Works Company, Inc. - Form 10-Q

increased general taxes of \$4.7 million for the three months ended September 30, 2010 compared to the same period in the prior year.

---

**Table of Contents**

Income tax expense increased by \$28.4 million, which was mainly the result of higher taxable income for the three months ended September 30, 2010.

Revenues for the nine months ended September 30, 2010 increased by \$203.4 million compared to the same period in the prior year. This was primarily due to increased revenues in our Regulated Businesses of \$161.5 million, which was largely attributable to rate increases and increased consumption, and an increase in our Non-Regulated Businesses revenues of \$43.1 million, which was primarily attributable to higher revenues in the Contract Operations Group of \$38.6 million. The increase in Contract Operations Group revenues was primarily due to revenues of \$30.1 million attributable to the Contract Operations Acquisition as well as increased military contract revenues of \$15.8 million partially offset by lower O&M and design and build contract revenues. The increase in the military contract revenues was mainly attributable to incremental contract work at two military bases as well as new contracts at two additional bases.

Operating expenses for the nine months ended September 30, 2010 were \$1,450.2 million compared to \$1,806.6 million for the nine months ended September 30, 2009. Excluding the impairment charge of \$450.0 million, all other operating expenses totaled \$1,356.6 million for the nine months ended September 30, 2009. The \$93.6 million increase from 2009 to 2010 was primarily driven by an increase in our Non-Regulated Businesses of \$42.7 million and increased operating expenses in our Regulated Businesses of \$47.7 million for the nine months ended September 30, 2010 compared to the nine months ended September 30, 2009. The increase in the Non-Regulated Businesses operating expenses was primarily the result of higher operating and maintenance expenses of \$39.4 million, corresponding with the increased revenue. The Regulated Businesses increase in operating expenses was mainly driven by higher operations and maintenance expenses of \$30.7 million primarily as a result of increased production and employee related costs, higher depreciation expense of \$8.5 million and increased general taxes of \$7.8 million.

Other items affecting income (loss) before income taxes for the nine months ended September 30, 2010 as compared to the same period in the prior year include increased interest expense of \$12.5 million attributable to the 2009 issuances of long-term debt and decreased allowance for funds used during construction ( AFUDC ) of \$3.1 million attributable to construction projects being placed in service in certain of our subsidiaries. Other income was higher compared to 2009 by \$3.1 million which was attributable to the release of the remaining balance of a loss reserve of \$1.3 million as well as changes in the market value of Company-held deferred compensation. In addition, income tax expense increased by \$52.0 million, which was mainly the result of higher taxable income for the nine months ended September 30, 2010. Additionally, the income tax expense included tax benefits of \$7.0 million associated with the impairment charge recorded in the nine months ended September 30, 2009

*Rate Case Development* During the three months ended September 30, 2010, we received authorization for additional annualized revenues from a general rate case in a Virginia subsidiary of \$0.6 million and additional annualized revenue of \$0.2 million from a general rate increase in Michigan. In addition, new rates which would provide for an additional \$25.8 million and \$6.9 million of annualized revenues were put into effect under bond subject to refund for our Kentucky and Virginia subsidiaries, respectively. There is no assurance that the bonded amount, or any portion thereof, will be approved. In addition to the above general rate case increases, additional annualized revenues of \$3.1 million and \$0.2 million resulting from infrastructure charges in our Pennsylvania and New York subsidiaries, respectively, became effective. On February 25, 2010, our New Jersey subsidiary filed a petition with the Board of Public Utilities ( Board ) for approval to recover rates through a surcharge of approximately \$3.3 million on an annual basis for an increase in purchased water and sewer treatment cost. On August 4, 2010, the Board authorized the Company to recover in rates a surcharge of approximately \$3.1 million on an annual basis for purchased water and sewer treatment costs.

During the three months ended September 30, 2010, we filed one general rate case for our operating subsidiary in Tennessee requesting additional annualized revenues of \$10.0 million.

In October 2010, additional annualized revenue of \$3.6 million and \$5.4 million resulting from infrastructure charges in our Pennsylvania and Indiana subsidiaries, respectively, became effective.

As of October 29, 2010, including the three states for which interim rates are in effect, we were awaiting final orders in nine states requesting additional annualized revenues of \$216.7 million. There is no assurance that the filed amount, or any portion thereof, of any requested increases will be granted.

*Financing Activities* During the nine months ended September 30, 2010, we met our capital resource requirements with internally generated cash as well as funds from external sources primarily through commercial paper borrowings under our credit facilities.

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

On July 9, 2010, our New Jersey regulated subsidiary closed on a refunding of four outstanding bond issues totaling \$150.0 million. In order to accomplish the refunding, the New Jersey Economic Development Authority issued three new series of bonds on behalf of our New Jersey regulated subsidiary. The new bonds have coupon rates of 5.60%, 5.10% and 4.45% and mature in 2034, 2023 and 2023, respectively. Also, in July 2010, we entered into an interest rate swap agreement with a notional amount of \$100.0 million, the purpose of which was to mitigate interest cost at the parent company relating to debt that was incurred by our prior owners and was not used in any manner to finance the cash needs of our subsidiaries. On July 27, 2010, we remarketed the \$10.6 million of variable rate debt that was held in the Company's treasury as fixed rate bonds with a coupon rate of 5.25% and a maturity date of 2028.

**Table of Contents**

Also during the three months ended September 30, 2010, American Water Capital Corp. ( AWCC ) closed on two offerings totaling \$60 million. The first offering of \$35 million in tax-exempt bonds issued through the State of California Pollution Control Financing Authority was closed on August 18, 2010 and has a coupon rate of 5.25% with a 30-year maturity and a 10-year call option. The proceeds from this bond offering are required to be used to fund specific California-American Water Company projects. The second offering of \$25 million in tax-exempt water facility revenue bonds issued through the Indiana Finance Authority was closed on September 16, 2010 and has a coupon rate 4.85% with a 30-year maturity and a 10-year call option. The proceeds from this bond offering are required to be used to fund water facility projects in Indiana-American Water Company's service territory.

On November 1, 2010, our New Jersey regulated subsidiary closed on a refinancing of two bond issues of \$35.0 million and \$40.0 million, with original coupon rates of 5.95% and 5.60% and maturity dates of 2029 and 2025, respectively. The two new bond issues of \$35.0 million and \$40.0 million have interest rates of 4.88% and 4.70% and maturity dates of 2029 and 2025, respectively.

*Other Matters*

*Dividend* On March 1, 2010 and June 2, 2010, the Company made cash dividend payments of \$0.21 per share to all common shareholders of record as of February 18, 2010 and May 18, 2010, respectively. On September 1, 2010, the Company made a cash dividend payment of \$0.22 per share to all common shareholders of record as of August 18, 2010, amounting to \$38.5 million.

In March and June of 2009, the Company made cash dividend payments of \$0.20 per share to all common shareholders of record as of February 18, 2009 and May 18, 2009, respectively. In September 2009, the Company made a cash dividend payment of \$0.21 per share to all common shareholders of record as of August 18, 2009, amounting to \$36.7 million.

On October 29, 2010, the Company declared a quarterly cash dividend payment of \$0.22 per share payable on December 1, 2010 to all shareholders of record as of November 18, 2010.

On October 19, 2010, the California Public Utilities Commission issued new rules governing affiliate transactions and the use of regulated utility assets for non-tariffed utility services. Potential impacts of the new rules on the Company and California American Water Company's operations and relationships with its affiliates are currently under review.

**Results of Operations***Three Months Ended September 30, 2010 Compared To Three Months Ended September 30, 2009*

| <b>(In thousands, except per share data)</b>       | <b>For the three months ended<br/>September 30,</b> |             | <b>Favorable<br/>(Unfavorable)<br/>Change</b> |
|--|---|-------------|---|
|  | <b>2010</b>   | <b>2009</b> |   |
| Operating revenues                                 | \$ 786,946  | \$ 679,956  | \$ 106,990                                    |
| Operating expenses                                 |   |             |   |
| Operation and maintenance                          | 378,034   | 340,862     | (37,172)                                      |
| Depreciation and amortization                      | 79,431  | 74,854      | (4,577)                                       |
| General taxes                                      | 55,316  | 50,618      | (4,698)                                       |
| (Gain) loss on sale of assets                      | 210   | (784)       | (994)   |
| Total operating expenses, net                      | 512,991   | 465,550     | (47,441)                                      |
| Operating income                                   | 273,955   | 214,406     | 59,549  |
| Other income (expenses)                            |   |             |   |
| Interest, net                                      | (74,858)  | (74,124)    | (734)   |
| Allowance for other funds used during construction | 2,586   | 2,290       | 296   |

Edgar Filing: American Water Works Company, Inc. - Form 10-Q

|   |                 |                 |              |
|---|-----------------|-----------------|--------------|
| Allowance for borrowed funds used during construction       | 1,814           | 1,674           | 140          |
| Amortization of debt expense                                | (1,285)         | (2,135)         | 850          |
| Other, net  | 511             | (310)           | 821          |
| <b>Total other income (expenses)</b>                        | <b>(71,232)</b> | <b>(72,605)</b> | <b>1,373</b> |
| Income before income taxes                                  | 202,723         | 141,801         | 60,922       |
| Provision for income taxes                                  | 78,609          | 50,165          | (28,444)     |
| Net income  | \$ 124,114      | \$ 91,636       | \$ 32,478    |
| <b>Income per common share:</b>                             |                 |                 |              |
| Basic   | \$ 0.71         | \$ 0.52         |              |
| Diluted   | \$ 0.71         | \$ 0.52         |              |
| <b>Average common shares outstanding during the period:</b> |                 |                 |              |
| Basic   | 174,859         | 174,595         |              |
| Diluted   | 175,062         | 174,691         |              |

**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 three months ended September 30, |                             |                         |                             |
|--------------------|--|-----------------------------|-------------------------|-----------------------------|
|                    | 2010                                     |                             | 2009                    |                             |
|                    | Regulated<br>Businesses                  | Non-Regulated<br>Businesses | Regulated<br>Businesses | Non-Regulated<br>Businesses |
|                    | (In thousands)                           |                             |                         |                             |
| Operating revenues | \$ 713,080                               | \$ 80,310                   | \$ 620,999              | \$ 65,233                   |
| Adjusted EBIT(1)   | \$ 264,935                               | \$ 9,157                    | \$ 203,898              | \$ 6,563                    |

- (1) Adjusted EBIT, a non-GAAP measure, 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 flow for the periods presented and should not be considered as an alternative to net income as an indicator of the Company's operating performance or 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. For the reconciliation of Adjusted EBIT, as defined by the Company, to income before income taxes, see Financial Statement Note 13.

**Operating revenues** Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers as well as sales to public authorities. The table below details the additional annualized revenues resulting from rate authorizations, including infrastructure charges, which were granted in the third quarter of 2010.

| State                                   | Annualized Rate<br>Increases Granted<br>(In millions) |
|---|---|
| <i>General rate case:</i>               |   |
| Kentucky*                               | \$ 25.8   |
| Virginia*                               | 7.5   |
| Michigan                                | 0.2   |
| <i>Subtotal- General Rate Cases</i>     | 33.5  |
| <i>Infrastructure Charges:</i>          |   |
| Pennsylvania                            | 3.1   |
| <i>Subtotal- Infrastructure Charges</i> | 3.1   |
| <i>Total</i>                            | \$ 36.6   |

\* Rate case not yet finalized; however, new rates were put into effect under bond subject to refund for the total Kentucky amount of \$25.8 million and \$6.9 million of the Virginia amount. There is no assurance that the bonded amount, or any portion thereof, will be approved.

Operating revenues increased by \$107.0 million, or 15.7%, for the three months ended September 30, 2010 compared to the three months ended September 30, 2009. Regulated Businesses' revenues increased by \$92.1 million, or 14.8%, for the three months ended September 30, 2010 compared to the same period in the prior year. The Non-Regulated Businesses' revenues for the three months ended September 30, 2010 increased by \$15.1 million, or 23.1%, compared to the three months ended September 30, 2009.

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

The increase in the Regulated Businesses for the three months ended September 30, 2010 compared to the three months ended September 30, 2009 was primarily due to rate increases obtained through rate authorizations for a number of our operating companies of which the third quarter 2010 impact was approximately \$52.8 million. Revenues for the three months ended September 30, 2010 increased by approximately \$37.6 million due to higher demand as compared to the same period in the prior year. Most of this consumption increase occurred in our regulated subsidiaries in the Mid-Atlantic region of the United States as a result of the warmer/drier weather. Offsetting these increases was a decrease in surcharge and balancing account revenues of \$1.6 million.

**Table of Contents**

The increase in revenues from the Non-Regulated Businesses was primarily attributable to higher revenues in our Contract Operations Group totaling \$13.2 million as a result of the Contract Operations Acquisition which contributed \$9.3 million to the increase as well as incremental revenues associated with military construction and O&M projects of \$8.1 million partially offset by lower revenues associated with our O&M and design and build contracts.

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

| Customer Class       | For the three months ended September 30,    |        |            |        |                            |        |         |        |
|----------------------|---|--------|------------|--------|----------------------------|--------|---------|--------|
|                      | 2010<br>Operating Revenues                  |        | 2009 *     |        | 2010<br>Water Sales Volume |        | 2009 *  |        |
|                      | (Dollars in thousands, gallons in millions) |        |            |        |                            |        |         |        |
| Water service:       |   |        |            |        |                            |        |         |        |
| Residential          | \$ 414,505                                  | 58.1%  | \$ 353,397 | 56.9%  | 65,010                     | 53.4%  | 60,714  | 53.6%  |
| Commercial           | 143,305                                     | 20.1%  | 126,515    | 20.4%  | 27,983                     | 23.0%  | 26,265  | 23.2%  |
| Industrial           | 31,431                                      | 4.4%   | 27,955     | 4.5%   | 11,876                     | 9.8%   | 10,149  | 9.0%   |
| Public and other     | 84,249                                      | 11.8%  | 74,779     | 12.0%  | 16,742                     | 13.8%  | 16,114  | 14.2%  |
| Other water revenues | 4,972                                       | 0.7%   | 6,820      | 1.1%   |                            |        |         |        |
| Total water revenues | 678,462                                     | 95.1%  | 589,466    | 94.9%  | 121,611                    | 100.0% | 113,242 | 100.0% |
| Wastewater service   | 23,900                                      | 3.4%   | 22,655     | 3.7%   |                            |        |         |        |
| Other revenues       | 10,718                                      | 1.5%   | 8,878      | 1.4%   |                            |        |         |        |
|                      | \$ 713,080                                  | 100.0% | \$ 620,999 | 100.0% |                            |        |         |        |

\* Certain reclassifications have been made between customer classes to conform with 2010 presentation.

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.

**Water Services** Water service operating revenues from residential customers for the three months ended September 30, 2010 totaled \$414.5 million, a \$61.1 million increase, or 17.3%, over the same period of 2009, mainly due to rate increases and an increase in sales volume. The volume of water sold to residential customers increased by 7.1% for the three months ended September 30, 2010 to 65.0 billion gallons, from 60.7 billion gallons for the same period in 2009. We believe this increase is attributable to warmer and drier weather during the quarter primarily in the Mid-Atlantic region of the United States compared to the three months ended September 30, 2009.

Water service operating revenues from commercial water customers for the three months ended September 30, 2010 increased by \$16.8 million, or 13.3%, to \$143.3 million mainly due to rate increases in addition to an increase in sales volume compared to the same period in 2009. The volume of water sold to commercial customers increased by 6.5% for the three months ended September 30, 2010 to 28.0 billion gallons, from 26.3 billion gallons for the three months ended September 30, 2009.

Water service operating revenues from industrial customers totaled \$31.4 million for the three months ended September 30, 2010, an increase of \$3.5 million, or 12.4%, from those recorded for the same period of 2009 mainly due to rate increases in addition to an increase in sales volume. The volume of water sold to industrial customers totaled 11.9 billion gallons for the three months ended September 30, 2010, an increase of 17.0% from the 10.1 billion gallons for the three months ended September 30, 2009. We believe this increase to be associated with slight improvements in the economic environment in communities that we serve.

Water service operating revenues from public and other customers, including municipal governments, other governmental entities and resale customers increased \$9.5 million, or 12.7%, for the three months ended September 30, 2010 to \$84.2 million compared to the same period in the



## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

prior year mainly due to rate increases. Revenues from municipal governments for fire protection services and customers requiring special private fire service facilities totaled \$31.2 million for the three months ended September 30, 2010, an increase of \$2.2 million over the same period of 2009. Revenues generated by sales to governmental entities and resale customers for the three months ended September 30, 2010 totaled \$53.0 million, an increase of \$7.2 million from the three months ended September 30, 2009.

**Table of Contents**

**Wastewater services** Our subsidiaries provide wastewater services in 12 states. Revenues from these services increased by \$1.2 million, or 5.5%, to \$23.9 million for the three months ended September 30, 2010. The increase was attributable to increases in rates charged to customers in a number of our operating companies.

**Other revenues** Other revenues include such items as reconnection charges, initial application service fees, rental revenues, revenue collection services for others and similar items. For the three months ended September 30, 2010, other revenues increased by \$1.8 million mainly due to an increase in work for a managed contract as well as rental revenue compared to the same period in the prior year.

**Operation and maintenance** Operation and maintenance expense increased \$37.2 million, or 10.9%, for the three months ended September 30, 2010 compared to the same period in the prior year.

Operation and maintenance expenses for the three months ended September 30, 2010 and 2009, by major expense category, were as follows:

|                                    | For the three months ended September 30, |                   |                        |              |
|------------------------------------|--|-------------------|------------------------|--------------|
|                                    | 2010                                     | 2009              | Increase<br>(Decrease) | Percentage   |
|                                    | (In thousands)                           |                   |                        |              |
| Production costs                   | \$ 95,746                                | \$ 86,673         | \$ 9,073               | 10.5%        |
| Employee-related costs             | 157,085                                  | 139,633           | 17,452                 | 12.5%        |
| Operating supplies and services    | 62,937                                   | 60,227            | 2,710                  | 4.5%         |
| Maintenance materials and services | 37,270                                   | 31,723            | 5,547                  | 17.5%        |
| Customer billing and accounting    | 12,909                                   | 12,690            | 219                    | 1.7%         |
| Other                              | 12,087                                   | 9,916             | 2,171                  | 21.9%        |
| <b>Total</b>                       | <b>\$ 378,034</b>                        | <b>\$ 340,862</b> | <b>\$ 37,172</b>       | <b>10.9%</b> |

As is noted in the various expense category commentaries below, a driver of the increase in operations and maintenance expense is higher expenses in our Non-Regulated Businesses associated with the combined effects of our Contract Operations Acquisition and its related reorganization and transitional costs totaling \$8.5 million.

Production costs, including fuel and power, purchased water, chemicals and waste disposal increased by \$9.1 million, or 10.5%, for the three months ended September 30, 2010 compared to the same period in the prior year. Production costs, by major expense type were as follows:

|                 | For the three months ended September 30, |                  |                        |              |
|-----------------|--|------------------|------------------------|--------------|
|                 | 2010                                     | 2009             | Increase<br>(Decrease) | Percentage   |
|                 | (In thousands)                           |                  |                        |              |
| Fuel and power  | \$ 33,166                                | \$ 30,804        | \$ 2,362               | 7.7%         |
| Purchased water | 34,618                                   | 29,367           | 5,251                  | 17.9%        |
| Chemicals       | 19,061                                   | 18,130           | 931                    | 5.1%         |
| Waste disposal  | 8,901                                    | 8,372            | 529                    | 6.3%         |
| <b>Total</b>    | <b>\$ 95,746</b>                         | <b>\$ 86,673</b> | <b>\$ 9,073</b>        | <b>10.5%</b> |

Fuel and power costs increased in our Regulated Businesses by \$2.1 million primarily due to higher electricity and fuel prices as well as increased production volumes. The increase in purchased water is primarily associated with our Regulated Businesses and is attributable to rate increases resulting from higher costs incurred by our suppliers. The majority of this purchased water increase is in states which permit us to pass-through this increase to our customers outside of a full rate proceeding. The increase in chemical costs is primarily attributable to increased consumption slightly offset by lower chemical costs in our Regulated Businesses as a result of favorable contract pricing.

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

Employee-related costs including wage and salary, group insurance, and pension expense increased \$17.5 million or 12.5% for the three months ended September 30, 2010, compared to the same period in the prior year. These employee-related costs represented 41.6% and 41.0% of operation and maintenance expenses for the three months ended September 30, 2010 and 2009, respectively.

**Table of Contents**

|                    | For the three months ended September 30, |                   |                        |              |
|--------------------|--|-------------------|------------------------|--------------|
|                    | 2010                                     | 2009              | Increase<br>(Decrease) | Percentage   |
|                    | (In thousands)                           |                   |                        |              |
| Salaries and wages | \$ 114,991                               | \$ 99,778         | \$ 15,213              | 15.2%        |
| Pensions           | 15,849                                   | 13,573            | 2,276                  | 16.8%        |
| Group insurance    | 20,647                                   | 20,575            | 72                     | 0.3%         |
| Other benefits     | 5,598                                    | 5,707             | (109)                  | (1.9)%       |
| <b>Total</b>       | <b>\$ 157,085</b>                        | <b>\$ 139,633</b> | <b>\$ 17,452</b>       | <b>12.5%</b> |

The increase in salaries and wages can be attributed to additional employees as a result of the Contract Operations Acquisition, totaling approximately \$3.9 million, as well as wage increases, higher incentive compensation, increased severance expenses and increased overtime costs in certain of our regulated operating companies. Pension expense increased for the three months ended September 30, 2010 due to increased pension contributions by certain of our regulated operating companies whose costs are recovered based on Employee Retirement Income Security Act of 1974 ( ERISA ) minimum funding requirements. This increase was partially offset by a decrease in the amortization of actuarial losses attributable to higher than expected returns on plan assets in 2009.

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 September 30, 2010, these costs increased by \$2.7 million, or 4.5%, compared to the same period in 2009.

|                              | For the three months ended September 30, |                  |                        |             |
|------------------------------|--|------------------|------------------------|-------------|
|                              | 2010                                     | 2009*            | Increase<br>(Decrease) | Percentage  |
|                              | (In thousands)                           |                  |                        |             |
| Contracted services          | \$ 23,869                                | \$ 20,578        | \$ 3,291               | 16.0%       |
| Office supplies and services | 16,652                                   | 15,855           | 797                    | 5.0%        |
| Transportation               | 8,611                                    | 8,763            | (152)                  | (1.7)%      |
| Rents                        | 6,149                                    | 5,793            | 356                    | 6.1%        |
| Other                        | 7,656                                    | 9,238            | (1,582)                | (17.1)%     |
| <b>Total</b>                 | <b>\$ 62,937</b>                         | <b>\$ 60,227</b> | <b>\$ 2,710</b>        | <b>4.5%</b> |

\* Certain reclassifications have been made between categories in order for 2009 to conform with 2010 presentation.

Contracted services increased for the three months ended September 30, 2010 compared to the same period in 2009 primarily due to increased construction related activity in the Contract Operations Group related to military contracts which corresponds with the increased revenues. Office supplies and services increased primarily due to the Contract Operations Acquisition. The decrease in the Other category is mainly attributable to the establishment of a regulatory asset for a \$3.5 million payment previously made by our California operating company to the California Department of Fish and Game ( CDFG ) on behalf of the National Oceanographic and Atmospheric Administration ( NOAA ) as a result of an advice letter issued by the California Public Utility Commission which now allows for rate recovery of such payment. This reduction was offset by reserves of \$1.4 million for costs deemed not recoverable at this time in one of our operating companies as well as increased costs associated with the Contract Operations Acquisition.

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, increased \$5.5 million or by 17.5%, for the three months ended September 30, 2010 compared to the same period in the prior year.

| For the three months ended September 30, |      |            |
|--|------|------------|
| 2010                                     | 2009 | Percentage |

Edgar Filing: American Water Works Company, Inc. - Form 10-Q

|                                   |                  |                  | Increase<br>(Decrease) |              |
|-----------------------------------|------------------|------------------|------------------------|--------------|
|                                   | (In thousands)   |                  |                        |              |
| Maintenance services and supplies | \$ 26,543        | \$ 21,450        | \$ 5,093               | 23.7%        |
| Removal costs, net                | 10,727           | 10,273           | 454                    | 4.4%         |
| <b>Total</b>                      | <b>\$ 37,270</b> | <b>\$ 31,723</b> | <b>\$ 5,547</b>        | <b>17.5%</b> |

The Regulated Businesses' maintenance materials and service costs increased by \$3.7 million for the three months ended September 30, 2010. In addition to higher removal costs, maintenance services and supplies increased due to higher levels of meter testing, pump, tank and well maintenance, and paving costs throughout our regulated subsidiaries. The Non-Regulated Businesses' expense increased \$1.8 million primarily due to increased costs in our Homeowner Services Group, associated with an increase in its customer base.

**Table of Contents**

Customer billing and accounting expenses increased by \$0.2 million, or 1.7% for the three months ended September 30, 2010 compared to the same period in the prior year.

|                                | For the three months ended September 30, |           |                        |            |
|--------------------------------|--|-----------|------------------------|------------|
|                                | 2010                                     | 2009      | Increase<br>(Decrease) | Percentage |
|                                | (In thousands)                           |           |                        |            |
| Uncollectible accounts expense | \$ 5,884                                 | \$ 5,924  | \$ (40)                | (0.7)%     |
| Postage                        | 3,327                                    | 3,261     | 66                     | 2.0%       |
| Other                          | 3,698                                    | 3,505     | 193                    | 5.5%       |
| Total                          | \$ 12,909                                | \$ 12,690 | \$ 219                 | 1.7%       |

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs decreased by \$2.2 million, or 21.9%, in 2010.

|                     | For the three months ended September 30, |          |                        |            |
|---------------------|--|----------|------------------------|------------|
|                     | 2010                                     | 2009     | Increase<br>(Decrease) | Percentage |
|                     | (In thousands)                           |          |                        |            |
| Insurance           | \$ 9,084                                 | \$ 6,904 | \$ 2,180               | 31.6%      |
| Regulatory expenses | 3,003                                    | 3,012    | (9)                    | (0.3)%     |
| Total               | \$ 12,087                                | \$ 9,916 | \$ 2,171               | 21.9%      |

The increase in insurance expense is primarily due to favorable claims experience in 2009.

**Depreciation and amortization** Depreciation and amortization expense increased by \$4.6 million, or 6.1%, for the three months ended September 30, 2010 compared to the same period in the prior year as a result of additional utility plant being placed in service.

**General taxes** General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, increased by \$4.7 million, or 9.3%, in the three months ended September 30, 2010 compared to the three months ended September 30, 2009. This increase was mainly due to higher gross receipts taxes of \$1.9 million, primarily in our New Jersey regulated subsidiary. Also contributing to the increase were higher payroll taxes resulting from the increase in salaries and wages as well as increased capital stock and property tax expenses.

**Other income (expenses)** Interest expense, net of interest income, which is the primary component of our other income (expenses), increased by \$0.7 million, or 1.0%, for the three months ended September 30, 2010 compared to the same period in the prior year. The increase is primarily due to the refinancing of short-term debt with long-term debt during 2009 as well as increased borrowing associated with capital expenditures. During 2009 a significant portion of this debt was refinanced to long-term fixed rate debt whose rates are higher than the short-term rates that existed for the three months ended September 30, 2009. This increase was offset by the recognition of \$3.6 million of the fair value uplift for a debt issuance that was called for early redemption in July 2010.

**Provision for income taxes** The effective tax rates for the three months ended September 30, 2010 and 2009 were 38.8% and 35.4% respectively. Our consolidated provision for income taxes increased \$28.4 million, or 56.7%, to \$78.6 million for the three months ended September 30, 2010. The increase is primarily due to the fact that the 2009 effective tax rate included an impact of tax law changes in one of our subsidiaries as well as other discrete items.

**Net income** Net income for the three months ended September 30, 2010 was \$124.1 million compared to a net income of \$91.6 million for the three months ended September 30, 2009. The variation between the periods is the result of the aforementioned changes.



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

*Nine Months Ended September 30, 2010 Compared To Nine Months Ended September 30, 2009*

| (In thousands, except per share data)                 | For the nine months ended<br>September 30, |              | Favorable<br>(Unfavorable)<br>Change |
|---|--|--------------|--------------------------------------|
|   | 2010                                       | 2009         |                                      |
| Operating revenues                                    | \$ 2,046,222                               | \$ 1,842,866 | \$ 203,356                           |
| Operating expenses                                    |  |              |                                      |
| Operation and maintenance                             | 1,053,320                                  | 985,861      | (67,459)                             |
| Depreciation and amortization                         | 232,156                                    | 216,939      | (15,217)                             |
| General taxes   | 164,610                                    | 154,814      | (9,796)                              |
| Gain (loss) on sale of assets                         | 133  | (976)        | (1,109)                              |
| Impairment charge                                     | 0  | 450,000      | 450,000                              |
| Total operating expenses, net                         | 1,450,219                                  | 1,806,638    | 356,419                              |
| Operating income                                      | 596,003                                    | 36,228       | 559,775                              |
| Other income (expenses)                               |  |              |                                      |
| Interest, net   | (232,307)                                  | (219,791)    | (12,516)                             |
| Allowance for other funds used during construction    | 7,144                                      | 9,208        | (2,064)                              |
| Allowance for borrowed funds used during construction | 4,465                                      | 5,537        | (1,072)                              |
| Amortization of debt expense                          | (3,233)                                    | (5,158)      | 1,925                                |
| Other, net  | 2,508                                      | (605)        | 3,113                                |
| Total other income (expenses)                         | (221,423)                                  | (210,809)    | (10,614)                             |
| Income (loss) before income taxes                     | 374,580                                    | (174,581)    | 549,161                              |
| Provision for income taxes                            | 146,907                                    | 94,873       | (52,034)                             |
| Net income (loss)                                     | \$ 227,673                                 | \$ (269,454) | \$ 497,127                           |
| Income (loss) per common share:                       |  |              |                                      |
| Basic   | \$ 1.30                                    | \$ (1.62)    |                                      |
| Diluted   | \$ 1.30                                    | \$ (1.62)    |                                      |
| Average common shares outstanding during the period:  |  |              |                                      |
| Basic   | 174,785                                    | 165,992      |                                      |
| Diluted   | 174,919                                    | 165,992      |                                      |

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 nine months ended September 30, |                             |                         |                             |
|--------------------|---|-----------------------------|-------------------------|-----------------------------|
|                    | Regulated<br>Businesses                 | Non-Regulated<br>Businesses | Regulated<br>Businesses | Non-Regulated<br>Businesses |
|                    | (In thousands)                          |                             |                         |                             |
| Operating revenues | \$ 1,834,883                            | \$ 230,153                  | \$ 1,673,346            | \$ 187,029                  |



## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

|                  |            |           |            |           |
|------------------|------------|-----------|------------|-----------|
| Adjusted EBIT(1) | \$ 573,381 | \$ 18,504 | \$ 459,355 | \$ 16,665 |
|------------------|------------|-----------|------------|-----------|

- (1) Adjusted EBIT, a non-GAAP measure, 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 flow for the periods presented and should not be considered as an alternative to net income as an indicator of the Company's operating performance or 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. For the reconciliation of Adjusted EBIT, as defined by the Company, to income (loss) before income taxes, see Financial Statement Note 13.

**Operating revenues** Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers as well as sales to public authorities. The table below details the annualized revenues resulting from rate authorizations, including infrastructure charges, which were granted during the first nine months of 2010.

**Table of Contents**

| <b>State</b>                            | <b>Annualized Rate<br/>Increases Granted<br/>(In millions)</b> |
|---|--|
| <i>General rate case:</i>               |  |
| Illinois                                | \$ 40.7  |
| Indiana                                 | 31.5   |
| Missouri                                | 24.8   |
| Kentucky*                               | 25.8   |
| California                              | 14.6   |
| Virginia*                               | 7.5  |
| Ohio                                    | 2.6  |
| New Mexico                              | 0.5  |
| Michigan                                | 0.2  |
| <i>Subtotal- General Rate Cases</i>     | 148.2  |
| <i>Infrastructure Charges:</i>          |  |
| Pennsylvania                            | 4.9  |
| Missouri                                | 3.2  |
| Illinois                                | 0.7  |
| New York                                | 0.4  |
| <i>Subtotal- Infrastructure Charges</i> | 9.2  |
| <i>Total</i>                            | \$ 157.4   |

\* Rate case not yet finalized; however, new rates were put into effect under bond subject to refund for the total Kentucky amount of \$25.8 million and \$6.9 million of the Virginia amount. There is no assurance that the bonded amount, or any portion thereof, will be approved.

Our results of operations are significantly impacted by rates authorized by the state regulatory commissions in the states in which we operate. Operating revenues increased by \$203.4 million, or 11.0%, for the nine months ended September 30, 2010 compared to the nine months ended September 30, 2009. Regulated Businesses revenues increased by \$161.5 million, or 9.7%, for the nine months ended September 30, 2010 compared to the same period in the prior year. The Non-Regulated Businesses revenues for the nine months ended September 30, 2010 increased by \$43.1 million, or 23.1%, compared to the nine months ended September 30, 2009.

The increase in revenues from the Regulated Businesses for the nine months ended September 30, 2010 compared to the nine months ended September 30, 2009 was primarily due to rate increases obtained through rate authorizations for a number of our operating companies of which the year-to-date 2010 impact was approximately \$107.7 million. In addition, for the nine months ended September 30, 2010, surcharge and balancing account revenues increased by \$3.8 million and sewer and fire service revenues increased by \$2.0 million compared to the same period in the prior year. Revenues for the nine months ended September 30, 2010 increased by approximately \$41.1 million due to higher demand as compared to the same period in the prior year, mainly due to increased volumes in our subsidiaries in the Mid-Atlantic region of the United States.

The net increase in revenues from the Non-Regulated Businesses was primarily attributable to an increase in Contract Operations Group revenues primarily due to higher revenues totaling \$30.1 million resulting from the Contract Operations Acquisition as well as incremental revenues associated with military construction and O&M projects of \$15.8 million as a result of being fully operational at Fort Hood and Fort Polk and the addition of Fort Meade and Fort Belvoir contracts. These increases were partially offset by lower revenues associated with our O&M and design and build contracts. In addition, our Homeowner Services Group revenues increased by \$4.2 million mainly as a result of increased product penetration within its existing customer base.

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

Edgar Filing: American Water Works Company, Inc. - Form 10-Q

| Customer Class       | For the nine months ended September 30,     |        |              |        | 2009*              |        |         |        |
|----------------------|---|--------|--------------|--------|--------------------|--------|---------|--------|
|                      | 2010  |        | 2009 *       |        | 2010               |        | 2009*   |        |
|                      | Operating Revenues                          |        |              |        | Water Sales Volume |        |         |        |
|                      | (Dollars in thousands, gallons in millions) |        |              |        |                    |        |         |        |
| Water service:       |   |        |              |        |                    |        |         |        |
| Residential          | \$ 1,050,833                                | 57.3%  | \$ 958,263   | 57.3%  | 156,493            | 52.6%  | 154,150 | 53.3%  |
| Commercial           | 356,619                                     | 19.4%  | 326,242      | 19.5%  | 67,046             | 22.6%  | 65,149  | 22.5%  |
| Industrial           | 85,451                                      | 4.7%   | 76,402       | 4.5%   | 30,822             | 10.4%  | 27,404  | 9.5%   |
| Public and other     | 223,417                                     | 12.2%  | 205,651      | 12.3%  | 42,960             | 14.4%  | 42,430  | 14.7%  |
| Other water revenues | 19,741                                      | 1.1%   | 16,805       | 1.0%   |                    |        |         |        |
| Total water revenues | 1,736,061                                   | 94.7%  | 1,583,363    | 94.6%  | 297,321            | 100.0% | 289,133 | 100.0% |
| Wastewater service   | 70,372                                      | 3.8%   | 66,397       | 4.0%   |                    |        |         |        |
| Other revenues       | 28,450                                      | 1.5%   | 23,586       | 1.4%   |                    |        |         |        |
|                      | \$ 1,834,883                                | 100.0% | \$ 1,673,346 | 100.0% |                    |        |         |        |

\* Certain reclassifications have been made between customer classes to conform with 2010 presentation.

**Table of Contents**

The following discussion related to water services indicates the increase in the Regulated Businesses' revenues and associated water sales volumes in gallons by customer class.

**Water Services** Water service operating revenues from residential customers for the nine months ended September 30, 2010 totaled \$1,050.8 million, a \$92.6 million increase, or 9.7%, over the same period of 2009, mainly due to rate increases and an increase in sales volume. The volume of water sold to residential customers increased by 1.5% for the nine months ended September 30, 2010 to 156.5 billion gallons, from 154.2 billion gallons for the same period in 2009. We believe this increase is attributable to warmer and drier weather in the Mid-Atlantic region of the United States primarily in the third quarter of 2010 compared to the same period in the prior year.

Water service operating revenues from commercial water customers for the nine months ended September 30, 2010 increased by \$30.4 million, or 9.3%, to \$356.6 million, mainly due to rate increases in addition to an increase in sales volume compared to the same period in 2009. The volume of water sold to commercial customers increased by 2.9% for the nine months ended September 30, 2010, to 67.0 billion gallons, from 65.1 billion gallons for the nine months ended September 30, 2009.

Water service operating revenues from industrial customers totaled \$85.5 million for the nine months ended September 30, 2010, an increase of \$9.0 million, or 11.8%, from those recorded for the same period of 2009 mainly due to rate increases in addition to an increase in sales volume. The volume of water sold to industrial customers totaled 30.8 billion gallons for the nine months ended September 30, 2010, an increase of 12.5% from the 27.4 billion gallons for the nine months ended September 30, 2009.

Water service operating revenues from public and other customers, including municipal governments, other governmental entities and resale customers increased \$17.8 million, or 8.6%, for the nine months ended September 30, 2010 to \$223.4 million from \$205.7 million in the same period in 2009 mainly due to rate increases. Revenues from municipal governments for fire protection services and customers requiring special private fire service facilities totaled \$90.0 million for the nine months ended September 30, 2010, an increase of \$5.3 million over the same period of 2009. Revenues generated by sales to governmental entities and resale customers for the nine months ended September 30, 2010 totaled \$133.4 million, an increase of \$12.5 million from the nine months ended September 30, 2009.

**Wastewater services** Our subsidiaries provide wastewater services in 12 states. Revenues from these services increased by \$4.0 million, or 6.0%, to \$70.4 million for the nine months ended September 30, 2010, from \$66.4 million for the same period of 2009. The increase was attributable to increases in rates charged to customers in a number of our operating companies.

**Other revenues** Other revenues include such items as reconnection charges, initial application service fees, rental revenues, revenue collection services for others and similar items. For the nine months ended September 30, 2010, these revenues increased by \$4.9 million mainly due to an increase in work for a managed contract as well as rental revenue compared to the same period in the prior year.

**Operation and maintenance** Operation and maintenance expense increased \$67.5 million, or 6.8%, for the nine months ended September 30, 2010 compared to the same period in the prior year.

Operation and maintenance expenses for the nine months ended September 30, 2010 and 2009, by major expense category, were as follows:

|                                    | For the nine months ended September 30, |                   |                        |             |
|------------------------------------|---|-------------------|------------------------|-------------|
|                                    | 2010                                    | 2009              | Increase<br>(Decrease) | Percentage  |
|                                    | (In thousands)                          |                   |                        |             |
| Production costs                   | \$ 250,122                              | \$ 232,861        | \$ 17,261              | 7.4%        |
| Employee-related costs             | 445,675                                 | 405,404           | 40,271                 | 9.9%        |
| Operating supplies and services    | 178,159                                 | 175,687           | 2,472                  | 1.4%        |
| Maintenance materials and services | 112,157                                 | 95,728            | 16,429                 | 17.2%       |
| Customer billing and accounting    | 37,029                                  | 36,689            | 340                    | 0.9%        |
| Other                              | 30,178                                  | 39,492            | (9,314)                | (23.6)%     |
| <b>Total</b>                       | <b>\$ 1,053,320</b>                     | <b>\$ 985,861</b> | <b>\$ 67,459</b>       | <b>6.8%</b> |



**Table of Contents**

As is noted in the various expense category commentaries below, a major driver of the increase in operations and maintenance expense is higher expenses in our Non-Regulated Businesses associated with the combined effects of our Contract Operations Acquisition and its related reorganization and transitional costs of \$29.3 million.

Production costs, including fuel and power, purchased water, chemicals and waste disposal increased by \$17.3 million, or 7.4%, for the nine months ended September 30, 2010 compared to the same period in the prior year. Production costs, by major expense type were as follows:

|                 | For the nine months ended September 30, |                   |                        |             |
|-----------------|---|-------------------|------------------------|-------------|
|                 | 2010                                    | 2009              | Increase<br>(Decrease) | Percentage  |
|                 | (In thousands)                          |                   |                        |             |
| Fuel and power  | \$ 88,574                               | \$ 84,196         | \$ 4,378               | 5.2%        |
| Purchased water | 85,636                                  | 74,568            | 11,068                 | 14.8%       |
| Chemicals       | 47,597                                  | 49,519            | (1,922)                | (3.9)%      |
| Waste disposal  | 28,315                                  | 24,578            | 3,737                  | 15.2%       |
| <b>Total</b>    | <b>\$ 250,122</b>                       | <b>\$ 232,861</b> | <b>\$ 17,261</b>       | <b>7.4%</b> |

The increase in our fuel and power costs was primarily driven by higher costs in our Non-Regulated Business of \$3.0 million, most of which is attributable to our Contract Operations Acquisition. Fuel and power costs increased in the Regulated Business by \$1.4 million primarily corresponding with the increase in usage. The increase in purchased water, which is primarily associated with our Regulated Businesses, is due to rate increases resulting from higher costs incurred by our suppliers. The majority of this purchased water increase is in states which permit us to pass-through this increase to our customers outside of a full rate proceeding. The decrease in chemical costs is primarily attributable to lower chemical costs in our Regulated Businesses as a result of favorable contract pricing. Waste disposal costs increased primarily due to increased rates in one of our Regulated operating companies as well as higher disposal costs attributable to the Contract Operations Acquisition, which accounted for \$1.6 million of the increase.

Employee-related costs including wage and salary, group insurance, and pension expense increased \$40.3 million, or 9.9%, for the nine months ended September 30, 2010, compared to the same period in the prior year. These employee-related costs represented 42.3% and 41.1% of operation and maintenance expenses for the nine months ended September 30, 2010 and 2009, respectively.

|                    | For the nine months ended September 30, |                   |                        |             |
|--------------------|---|-------------------|------------------------|-------------|
|                    | 2010                                    | 2009              | Increase<br>(Decrease) | Percentage  |
|                    | (In thousands)                          |                   |                        |             |
| Salaries and wages | \$ 326,622                              | \$ 288,550        | \$ 38,072              | 13.2%       |
| Pensions           | 40,609                                  | 41,873            | (1,264)                | (3.0)%      |
| Group insurance    | 60,267                                  | 59,285            | 982                    | 1.7%        |
| Other benefits     | 18,177                                  | 15,696            | 2,481                  | 15.8%       |
| <b>Total</b>       | <b>\$ 445,675</b>                       | <b>\$ 405,404</b> | <b>\$ 40,271</b>       | <b>9.9%</b> |

The increase in salaries and wages and other benefits was primarily due to the addition of employees as a result of the Contract Operations Acquisition totaling approximately \$12.3 million and \$2.2 million, respectively. The remainder of the increase in salaries and wages was due to wage increases, higher incentive compensation and severance expense as well as increased overtime costs of \$3.9 million in certain of our regulated operating companies. Pension expense decreased for the nine months ended September 30, 2010 due to a decrease in the amortization of actuarial losses attributable to higher than expected returns on plan assets in 2009. This increase was partially offset by increased pension contributions by certain of our regulated operating companies whose costs are recovered based on Employee Retirement Income Security Act of 1974 ( ERISA ) minimum funding requirements.



**Table of Contents**

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 nine months ended September 30, 2010, these costs increased by \$2.5 million, or 1.4%, compared to the same period in 2009.

|                              | For the nine months ended September 30, |                   |                        |             |
|------------------------------|---|-------------------|------------------------|-------------|
|                              | 2010                                    | 2009*             | Increase<br>(Decrease) | Percentage  |
| (In thousands)               |   |                   |                        |             |
| Contracted services          | \$ 59,744                               | \$ 59,442         | \$ 302                 | 0.5%        |
| Office supplies and services | 50,998                                  | 47,565            | 3,433                  | 7.2%        |
| Transportation               | 25,005                                  | 22,497            | 2,508                  | 11.1%       |
| Rents                        | 18,681                                  | 16,473            | 2,208                  | 13.4%       |
| Other                        | 23,731                                  | 29,710            | (5,979)                | (20.1)%     |
| <b>Total</b>                 | <b>\$ 178,159</b>                       | <b>\$ 175,687</b> | <b>\$ 2,472</b>        | <b>1.4%</b> |

\* Certain reclassifications have been made between categories in order for 2009 to conform with 2010 presentation.

Contracted services increased slightly for the nine months ended September 30, 2010 compared to the same period in 2009 due to increased construction activity in the Contract Operations Group related to military contracts. Offsetting this increase was lower temporary labor expenses due to the filling of vacant positions and a reduction in our legal and accounting expenses. Office supplies and services increased primarily due to costs related to marketing programs for our Homeowner Services Group in addition to our Contract Operations Acquisition. The increase in transportation costs was due to higher gasoline prices during the nine months ended September 30, 2010 compared to the same period in 2009. The decrease in the Other category is primarily due to the aforementioned advice letter approval for rate recovery of a \$3.5 million payment to the CDFG on behalf of NOAA in the third quarter of 2010.

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, increased \$16.4 million, or by 17.2%, for the nine months ended September 30, 2010 compared to the same period in the prior year.

|                                   | For the nine months ended September 30, |                  |                        |              |
|-----------------------------------|---|------------------|------------------------|--------------|
|                                   | 2010                                    | 2009             | Increase<br>(Decrease) | Percentage   |
| (In thousands)                    |   |                  |                        |              |
| Maintenance services and supplies | \$ 79,932                               | \$ 65,311        | \$ 14,621              | 22.4%        |
| Removal costs, net                | 32,225                                  | 30,417           | 1,808                  | 5.9%         |
| <b>Total</b>                      | <b>\$ 112,157</b>                       | <b>\$ 95,728</b> | <b>\$ 16,429</b>       | <b>17.2%</b> |

The Regulated Businesses maintenance materials and service costs increased by \$8.2 million for the nine months ended September 30, 2010. In addition to higher removal costs, tank painting expenses for our New Jersey subsidiary were higher by \$1.5 million. The remaining increase for the Regulated Business was due to higher levels of meter testing, pump, tank and well maintenance, and paving costs throughout our regulated subsidiaries. The Non-Regulated Businesses expense increased \$8.2 million primarily due to an increased cost for Homeowner Services Group of \$2.6 million associated with an increase in its customer base, higher maintenance expenses in the Contract Operations Group including increased cost associated with the Contract Operations Acquisition of \$2.4 million and our military contracts resulting from incremental construction projects and growth mainly related to the Fort Meade and Fort Belvoir locations.

Customer billing and accounting expenses increased by \$0.3 million, or 0.9%, for the nine months ended September 30, 2010 compared to the same period in the prior year.



|                                | For the nine months ended September 30, |               |                        |            |
|--------------------------------|---|---------------|------------------------|------------|
|                                | 2010                                    | 2009          | Increase<br>(Decrease) | Percentage |
|                                | (In thousands)                          |               |                        |            |
| Uncollectible accounts expense | \$ 16,356                               | \$ 17,337     | \$ (981)               | (5.7)%     |
| Postage                        | 9,834                                   | 9,304         | 530                    | 5.7%       |
| Other                          | 10,839                                  | 10,048        | 791                    | 7.9%       |
| <br>Total                      | <br>\$ 37,029                           | <br>\$ 36,689 | <br>\$ 340             | <br>0.9%   |

The decrease in the uncollectible accounts expense was the result of lower uncollectible accounts expense in our Regulated Businesses of \$1.0 million due to improved collections in our receivables in excess of 120 days partially offset by increased reserves due to higher revenues.

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs decreased by \$9.3 million, or 23.6%, in 2010.

**Table of Contents**

|                     | For the nine months ended September 30, |                  |                        |                |
|---------------------|---|------------------|------------------------|----------------|
|                     | 2010                                    | 2009             | Increase<br>(Decrease) | Percentage     |
|                     | (In thousands)                          |                  |                        |                |
| Insurance           | \$ 21,351                               | \$ 27,496        | \$ (6,145)             | (22.3)%        |
| Regulatory expenses | 8,827                                   | 11,996           | (3,169)                | (26.4)%        |
| <b>Total</b>        | <b>\$ 30,178</b>                        | <b>\$ 39,492</b> | <b>\$ (9,314)</b>      | <b>(23.6)%</b> |

The decrease in insurance expense is primarily due to the positive resolution of prior years' claims in 2010 compared to 2009. Regulatory expenses decreased due to the inclusion of \$3.5 million of expense for the nine months ended September 30, 2009 which related to rate case expenses associated with our California subsidiary.

**Depreciation and amortization** Depreciation and amortization expense increased by \$15.2 million, or 7.0%, for the nine months ended September 30, 2010 compared to the same period in the prior year as a result of additional utility plant being placed in service.

**General taxes** General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, increased by 9.8 million, or 6.3%, in the nine months ended September 30, 2010 compared to the nine months ended September 30, 2009. This increase was due to higher gross receipts taxes of \$5.6 million, primarily in our New Jersey regulated subsidiary and higher payroll taxes of \$2.6 million resulting from increased wages and salaries for the nine months ended September 30, 2009 compared to the same period in the prior year.

**Impairment charge** No impairment charge was recorded for the nine months ended September 30, 2010. For the nine months ended September 30, 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. The impairment charge, which was recorded in the first quarter of 2009, was primarily related to the high degree of stock market volatility experienced and the sustained period for which the Company's market price was below its carrying value.

**Other income (expenses)** Interest expense, net of interest income, which is the primary component of our other income (expenses), increased by \$12.5 million, or 5.7%, for the nine months ended September 30, 2010 compared to the same period in 2009. The increase is primarily due to the refinancing of short-term debt with long-term debt during 2009 as well as increased borrowing associated with capital expenditures. As a result of the 2008 market disruptions, the Company's short-term debt borrowings during the first half of 2009 were higher than usual. During 2009, a significant portion of this debt was refinanced to long-term fixed rate debt whose rates are higher than the short-term rates that existed for the nine months ended September 30, 2009. Partially offsetting this increase was the recognition of \$3.6 million of fair value uplift for a debt issuance that was called for early redemption in September 2010. Also, in addition to the increase in interest expense, AFUDC decreased by \$3.1 million for the nine months ended September 30, 2010 compared to the same period in 2009 as a result of plant being placed into service, primarily in our Arizona and Indiana regulated subsidiaries. Furthermore, other income increased due to increased joint venture income and changes in the market value of Company-held deferred compensation. Other income (expense) also reflects the release of the remaining balance of a loss reserve of \$1.3 million as a result of the resolution of outstanding issues and uncertainties that occurred during the nine months ended September 30, 2010.

**Provision for income taxes** Our consolidated provision for income taxes increased \$52.0 million, or 54.8%, to \$146.9 million for the nine months ended September 30, 2010. The effective tax rates for the nine months ended September 30, 2010 and 2009 were 39.2% and (54.3%) respectively. Included in the 2010 and 2009 income tax expense were tax benefits of \$1.6 million and \$14.2 million, respectively, attributable to certain discrete items, including the tax effects of the 2009 goodwill impairment charge. The Company's estimated annual effective tax rate for the nine months ended September 30, 2010 was 39.7% compared to 39.6% for 2009, excluding the impact of the various discrete items.

**Net income (loss)** Net income for the nine months ended September 30, 2010 was \$227.7 million compared to a net loss of \$269.5 million for the nine months ended September 30, 2009. The variation between the periods is the result of the aforementioned changes.

**Liquidity and Capital Resources**

We regularly evaluate cash requirements for current operations, commitments, development activities and capital expenditures. Our business is very capital intensive and requires significant capital resources. A portion of these capital resources are provided by internally generated cash flows from operations. When necessary, we obtain additional funds from external sources in the debt and equity capital markets and through

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

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. We rely on these revolving credit facilities and the capital markets to fulfill our short-term liquidity needs, to issue letters of credit and to back our commercial paper program. Disruptions in the credit markets may discourage lenders from meeting their existing lending

**Table of Contents**

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. See the Credit Facilities and Short-Term Debt section below for further discussion.

In order to meet our short-term liquidity needs, we primarily issue commercial paper which is backed by AWCC's revolving credit facilities. AWCC had \$814.0 million available as of October 29, 2010, that we can use to fulfill our short-term liquidity needs, to issue letters of credit and back our \$135.6 million outstanding commercial paper. As of October 29, 2010, the Company can issue additional commercial paper of \$564.4 million. 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.

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.

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 \$114.0 million as of September 30, 2010. We expect to fund future maturities of long-term debt through cash flow from operations, issuance of debt and issuance of equity. Since we continue to make investments equal to or greater than our cash flows from operating activities, we have no plans to reduce debt significantly.

On February 17, 2009, the American Recovery and Reinvestment Tax Act of 2009, which we refer to as the Act, became law. As a result of the Act, we have applied and will continue, as long as available, to apply for subsidized financing under the Act or other governmental subsidized funds in many of the states where we operate. During the nine months ended September 30, 2010, we received \$5.5 million in grants and loans of \$3.5 million and \$2.0 million, respectively, related to applications filed in 2009. To date we have drawn down \$6.5 million in grants and loans, leaving \$2.3 million to be drawn in the future. In addition, we were awarded approximately \$11.4 million in low-interest financing from the Pennsylvania Infrastructure Investment Authority ( PENNVEST ). These PENNVEST awards will be used to fund a portion of the Rock Run water treatment plant upgrade as well as other specified projects. Also during the three months ended September 30, 2010, we had draws of \$0.3 million from a low interest loan through the Ohio State Revolving Loan Authority, bringing the total draws on that loan to date to \$1.3 million. Lastly, in 2010, NJAWC applied for \$21.0 million of funds through the New Jersey Environmental Infrastructure Trust. As of October 29, 2010, \$1.5 million has been awarded, but no funds have been received.

***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.

Cash flows from operating activities have been a reliable, steady source of cash funding, sufficient to meet operating requirements, our dividend payments 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 as needed. There can be no assurance that we will be able to access such markets successfully on favorable terms or at all. Operating cash flows can be negatively affected by changes in our rate regulated environments or changes in our customers 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 nine months ended September 30, 2010 were \$587.0 million compared to \$471.6 million for the nine months ended September 30, 2009.

**Table of Contents**

The following table provides a summary of the major items affecting our cash flows from operating activities for the nine months ended September 30, 2010 and 2009:

|   | <b>For the nine months ended<br/>September 30,</b> |                |
|---|--|----------------|
|   | <b>2010</b>  | <b>2009</b>    |
|   | <b>(In thousands)</b>                              |                |
| Net income (loss)                                   | \$ 227,673   | \$ (269,454)   |
| Add (subtract):                                     |  |                |
| Non-cash operating activities (1)                   | 498,909  | 872,353        |
| Changes in working capital (2)                      | (28,816)   | (40,921)       |
| Pension and postretirement healthcare contributions | (110,739)  | (90,427)       |
| <br>Net cash flows provided by operations           | <br>\$ 587,027                                     | <br>\$ 471,551 |

- (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 for the nine months ended September 30, 2010 compared to the same period in 2009 is primarily due to an increase in revenues.

For the nine months ended September 30, 2010 and 2009, we made pension and postretirement benefit contributions to the plan trusts amounting to \$81.7 million and \$29.0 million, respectively. In October 2010, we made our final pension contribution for 2010 in the amount of \$14.9 million. We currently expect to make additional postretirement benefit contributions of \$9.7 million for the remainder of 2010.

Currently, we are at an impasse in negotiations of our national benefits agreement with most of the labor unions representing employees in our Regulated Businesses. The current agreement expired on July 31, 2010, however negotiations have not produced a new agreement. The Company has begun to implement our last best and final offer in order not to disrupt health care coverage for our employees. At this time, we don't believe that this circumstance will result in a system wide work stoppage. However, management has developed contingency plans that will be implemented as necessary if a work stoppage or strike does occur. Management does not expect that such a work stoppage or strike would have a material adverse impact on our results of operations, financial position or cash flows of the Company.

**Cash Flows from Investing Activities**

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

|   | <b>For the nine months ended<br/>September 30,</b> |                  |
|---|--|------------------|
|   | <b>2010</b>  | <b>2009</b>      |
|   | <b>(In thousands)</b>                              |                  |
| Net capital expenditures                        | \$ (522,090)                                       | \$ (592,894)     |
| Other investing activities, net (1)             | 16,138   | 66,683           |
| <br>Net cash flows used in investing activities | <br>\$ (505,952)                                   | <br>\$ (526,211) |

- (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 nine months ended September 30, 2010 and 2009 were \$506.0 million and \$526.2 million, respectively. Capital expenditures decreased \$70.8 million to \$522.1 million for the nine months ended September 30, 2010 from \$592.9 million for the nine months ended September 30, 2009. This decrease was the result of delayed construction in 2010, due to the severe weather conditions in certain states in which we operate in the first quarter of 2010 as well as a decrease in water treatment plant expenditures, as a number of facilities were under construction in 2009 and had significant expenditures. We estimate that Company-funded capital investment will be approximately \$800 million to \$1 billion in 2010. Based on current projections for the remainder of 2010, we believe we will be at the lower end of this range. 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.

The change in Other investing activities in 2010 is the result of the change in the net restricted funds released attributable primarily to the drawdown of the restricted funds by our Kentucky and Pennsylvania operating companies.

**Table of Contents**

Our infrastructure investment plan consists of both infrastructure renewal programs, where we replace infrastructure as needed, and major capital investment projects, where we construct new water and wastewater treatment and delivery facilities to meet new customer growth and water quality regulations. 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 operations. Generally, acquisitions are funded initially with short-term debt and later refinanced with the proceeds from long-term debt or equity offerings.

Our projected capital expenditures and other investments are subject to periodic review and revision to reflect changes in economic conditions and other factors.

In 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 with total estimated construction costs of \$164 million. Projects costs amounting to \$162 million were placed in service during September 2010.

In regards to our business transformation initiative to enhance existing processes and upgrade supporting outdated systems, in the second quarter of 2010, we completed our evaluation of appropriate software solutions and selected SAP AG for our enterprise-wide system. Additionally, in October 2010, we selected a nationally recognized system integrator with experience in both SAP and large system implementations. For the remainder of 2010, we expect to work with the system integrator to analyze our business requirements and align them with the SAP supporting applications.

Current estimates indicate that costs for the program could total up to \$280 million. The current goal is to have all applications implemented by the end of 2014. Any capital expenditures associated with this initiative are included in the \$800 million to \$1 billion capital investment spending outlined above.

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

***Cash Flows from Financing Activities***

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

The following long-term debt was issued in the first nine months of 2010:

| Company                      | Type   | Interest Rate | Maturity | Use of Proceeds | Amount (In thousands) |
|------------------------------|--|---------------|----------|-----------------|-----------------------|
| American Water Capital Corp. | Private activity bonds and government funded debt fixed rate | 5.38%         | 2040     | a               | \$ 26,000             |
| American Water Capital Corp. | Private activity bonds and government funded debt fixed rate | 5.25%         | 2040     | b               | 25,000                |
| American Water Capital Corp. | Private activity bonds and government funded debt fixed rate | 5.25%         | 2040     | c               | 35,000                |
| American Water Capital Corp. | Private activity bonds and government funded debt fixed rate | 4.85%         | 2040     | d               | 25,000                |
| American Water Capital Corp. | Private activity bonds and government funded debt fixed rate | 5.25%         | 2028     | e               | 10,635                |

Edgar Filing: American Water Works Company, Inc. - Form 10-Q

|                    | rate             |            |               |           |   |            |
|--------------------|------------------|------------|---------------|-----------|---|------------|
| Other subsidiaries | Private activity | fixed rate | 4.45% - 5.60% | 2023-2034 | f | 150,000    |
| Other subsidiaries | Private activity | fixed rate | 0.00% - 2.31% | 2021-2030 | g | 1,906      |
| Total issuances    |                  |            |               |           |   | \$ 273,541 |

Note: Private activity type defined as private activity bonds and government funded debt.



**Table of Contents**

- (a) On June 24, 2010, AWCC closed an offering of \$26 million in tax-exempt water facility revenue bonds issued by Owen County, Kentucky. The bonds have a coupon rate of 5.38% with a maturity of 2040 and a 10-year call option. The proceeds from the bond offering will be used to repay short-term debt related to the construction of the water treatment and transmission facility located in Owen County, Kentucky, as well as to pay remaining costs of acquisition, construction, installation and equipping of the water treatment and transmission facility.
  - (b) On May 27, 2010, AWCC closed an offering of \$25 million in tax-exempt water facility revenue bonds issued by the Illinois Finance Authority. The bonds have a coupon rate of 5.25% with a maturity of 2040 and a 10-year call option. The proceeds from the bond offering will be used to fund water facility projects in Champaign, Livingston, Logan, Madison, Peoria, and St. Clair counties in Illinois.
  - (c) On August 18, 2010, AWCC closed an offering of \$35 million in tax-exempt bonds issued through the State of California Pollution Control Financing Authority. The bonds have a coupon rate of 5.25% with a 30-year maturity and a 10-year call option. The proceeds from bond offering will be used to fund specific California-American Water Company projects.
  - (d) On September 16, 2010, AWCC closed an offering of \$25 million in tax-exempt water facility revenue bonds issued through the Indiana Finance Authority. The bonds have a coupon rate of 4.85% with a 30-year maturity and a 10-year call option. The proceeds from the bonds will be used to fund a water facility project in Indiana-American Water Company's service territory.
  - (e) Represents \$10.6 million of variable rate debt that was held in the Company's treasury at June 30, 2010 because no investors were willing to purchase the bonds. On July 27, 2010, this variable rate debt was remarketed as fixed rate bonds with a coupon rate of 5.25% and a maturity date of 2028.
  - (f) On July 9, 2010, our operating subsidiary, New Jersey American-Water Company, Inc. (NJAWC), closed on a refunding of four outstanding bonds issuances. To accomplish this refunding, the New Jersey Economic Development Authority issued three new services of bonds on behalf of NJAWC. The new bonds have coupon rates of 5.60%, 5.10% and 4.45% and maturities of 2034, 2023 and 2023, respectively.
  - (g) Proceeds received from various financing/development authorities. The proceeds will be used to fund certain projects
- The following long-term debt was retired through optional redemption, sinking fund provisions or payment at maturity during the first nine months of 2010:

| Company                         | Type   | Interest Rate | Maturity  | Amount (In thousands) |
|---------------------------------|--|---------------|-----------|-----------------------|
| American Water Capital Corp.    | Senior notes-fixed rate                                | 6.00% - 6.87% | 2011-2039 | \$ 28,152             |
| Other subsidiaries              | Mortgage bonds-fixed rate                              | 7.86% - 8.98% | 2010-2011 | 10,230                |
| Other subsidiaries              | Private activity-fixed rate and government funded debt | 0.00% - 6.88% | 2010-2036 | 157,514               |
| Other subsidiaries              | Mandatory redeemable preferred stock                   | 4.60% - 6.00% | 2013-2019 | 140                   |
| Other                           | Capital leases & other                                 |               |           | 553                   |
| Total retirements & redemptions |  |               |           | \$ 196,589            |

**Table of Contents**

As previously noted, on July 9, 2010, our New Jersey regulated subsidiary closed on a refunding of four outstanding bond issues totaling \$150 million. The new bonds have coupon rates of 5.60%, 5.10% and 4.45% and mature in 2034, 2023 and 2023, respectively. Estimated annual interest expense savings of \$1.2 million are expected as a result of this refunding and has been taken into consideration during the on-going negotiations in connection with the current outstanding rate case.

In July 2010, we entered into an interest rate swap agreement with a notional amount of \$100.0 million. This interest rate swap agreement effectively converted the interest on \$100.0 million of outstanding 6.085% fixed rate debt maturing 2017 to a variable rate of six-month LIBOR plus 3.422%. This interest rate swap agreement was designated as a fair value hedge in accordance with authoritative accounting guidance. Subject to market conditions at the time, we would consider entering into additional agreements of this nature in the foreseeable future. For the three and nine months ended September 30, 2010, the net impact of the interest rate swap, including the hedge ineffectiveness portion, reduced interest expense by \$0.2 million.

As previously noted, on November 1, 2010, our New Jersey regulated subsidiary closed on refinancing of two outstanding bond issues totaling \$75.0 million. The new bonds have interest rates of 4.88% and 4.70% and mature in 2029 and 2025. Estimated annual interest expense savings of \$0.7 million have been taken into consideration during the on-going negotiations in connection with the current outstanding rate case.

From time to time and as market conditions warrant, we may engage in long-term debt retirements via tender offers, open market repurchases or other viable alternatives to strengthen our balance sheets.

**Credit Facilities and Short-Term Debt**

The components of short-term debt were as follows:

|                              | <b>September 30,<br/>2010<br/>(In thousands)</b> |
|------------------------------|--|
| Commercial paper, net        | \$ 163,993                                       |
| Bank overdraft               | 17,848   |
| <b>Total short-term debt</b> | <b>\$ 181,841</b>                                |

At September 30, 2010, AWCC had the following sub-limits and available capacity under the revolving credit facility and indicated amounts of outstanding commercial paper.

|                    | <b>Credit Facility<br/>Commitment<br/>(In thousands)</b> | <b>Available<br/>Credit Facility<br/>Capacity<br/>(In thousands)</b> | <b>Letter of Credit<br/>Sublimit<br/>(In thousands)</b> | <b>Available<br/>Letter of Credit<br/>Capacity<br/>(In thousands)</b> | <b>Outstanding<br/>Commercial<br/>Paper<br/>(Net of Discount)<br/>(In thousands)</b> | <b>Credit<br/>Line<br/>Borrowings<br/>(In thousands)</b> |
|--------------------|--|--|---|---|--|--|
| September 30, 2010 | \$ 850,000   | \$ 814,038   | \$ 150,000  | \$ 114,038  | \$ 163,993   |  |

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

The weighted average interest rate on short-term borrowings for the nine months ended September 30, 2010 was approximately 0.42% compared to 0.85% for the nine months ended September 30, 2009.

AWCC has entered into a \$10.0 million committed revolving line of credit with PNC Bank, N.A which expires on December 31, 2010, unless extended. Currently, we expect to renew this line of credit at similar interest rates prior to the termination date. This line is used primarily for short-term working capital needs. Interest rates on advances under this line of credit are based on one month LIBOR plus 175 basis points. In

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

addition, there is a fee of 25 basis points charged quarterly on the portion of the commitment that is undrawn. As of October 29, 2010, we had no outstanding borrowings under this revolving line of credit. If this line of credit were not extended beyond its current maturity date of December 31, 2010, AWCC would continue to have access to its \$840.0 million unsecured revolving credit facility described below.

**Table of Contents**

AWCC, our finance subsidiary, entered into an \$840.0 million senior unsecured credit facility syndicated among a group of 11 banks with JPMorgan Chase Bank, N.A. acting as administrative agent.

| <b>Bank</b>                           | <b>Commitment Amount<br/>Through<br/>September 15,<br/>2012</b> | <b>Commitment Amount<br/>Through<br/>September 15, 2013</b> |
|---------------------------------------|---|---|
|                                       | (In thousands)  |   |
| JPMorgan Chase Bank, N.A.             | \$ 115,000  | \$  |
| Citibank, N.A.                        | 115,000   | 115,000   |
| Citizens Bank of Pennsylvania         | 80,000  | 80,000  |
| Credit Suisse                         | 80,000  | 80,000  |
| William Street Commitment Corporation | 80,000  | 80,000  |
| Bank of America, N.A.                 | 80,000  | 80,000  |
| Morgan Stanley Bank                   | 80,000  | 80,000  |
| UBS Loan Finance LLC                  | 80,000  | 80,000  |
| National City Bank                    | 50,000  | 50,000  |
| PNC Bank, National Association        | 40,000  | 40,000  |
| The Bank of New York Mellon           | 40,000  |   |
|                                       | \$ 840,000  | \$ 685,000  |

If any lender defaults in its obligation to fund advances, the Company may request the other lenders to assume the defaulting lender's commitment or replace such defaulting lender by designating an assignee willing to assume the commitment, however the remaining lenders have no obligation to assume a defaulting lender's commitment and we can provide no assurances that we will replace a defaulting lender. As of October 29, 2010, AWCC had no outstanding borrowings under its lines of credit, \$36.0 million of outstanding letters of credit under this credit facility and \$135.6 million of commercial paper outstanding.

**Capital Structure**

Our capital structure was as follows:

|   | <b>At<br/>September 30,<br/>2010</b> | <b>At<br/>December 31,<br/>2009</b> |
|---|--------------------------------------|-------------------------------------|
| Common stockholders' equity and preferred stock without mandatory redemption rights | 42%                                  | 42%                                 |
| Long-term debt and redeemable preferred stock at redemption value                   | 56%                                  | 56%                                 |
| Short-term debt and current portion of long-term debt                               | 2%                                   | 2%                                  |
|   | 100%                                 | 100%                                |

**Debt Covenants**

Our debt agreements contain financial and non-financial covenants. To the extent that we are not in compliance, we or our subsidiaries may be restricted in our ability to pay dividends, issue debt or access our revolving credit lines. We were in compliance with our covenants as of September 30, 2010. However our California and Ohio subsidiaries did not meet the interest coverage test of at least 1.5x for the twelve months ended September 30, 2010 under the mortgage indenture and therefore they would be unable to issue new secured debt. Our failure to comply with restrictive covenants under our credit facilities could trigger repayment obligations. Long-term debt indentures contain a number of covenants that, among other things, limit, subject to certain exceptions, the Company from issuing debt secured by the Company's assets.

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

The revolving credit facility requires us to maintain a ratio of consolidated debt to consolidated capitalization of not more than 0.70 to 1.00. As of September 30, 2010, our ratio was 0.58 and therefore we were in compliance with the ratio.

### *Security Ratings*

Our access to the capital markets, including the commercial paper market, and respective financing costs in those markets depend on the securities ratings of the entity that is accessing the capital markets. We primarily access the capital markets, including the commercial paper market, through AWCC. However, we do issue debt at our regulated subsidiaries, primarily in the form of tax exempt securities, to lower our overall cost of debt. The following table shows the Company's securities ratings as of September 30, 2010:

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

Moody's rating outlook for both American Water and AWCC is stable.

---

## **Table of Contents**

On July 28, 2010, Standard & Poor's reaffirmed its ratings.

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

As part of the normal course of business, we routinely enter into contracts for the purchase and sale of water, energy, fuels and other services. These contracts either contain express provisions or otherwise permit us and our counterparties to demand adequate assurance of future performance when there are reasonable grounds for doing so. In accordance with the contracts and applicable contract law, if we are downgraded by a credit rating agency, especially if such downgrade is to a level below investment grade, it is possible that a counterparty would attempt to rely on such a downgrade as a basis for making a demand for adequate assurance of future performance. Depending on the Company's net position with a counterparty, the demand could be for the posting of collateral. In the absence of expressly agreed provisions that specify the collateral that must be provided, the obligation to supply the collateral requested will be a function of the facts and circumstances of the Company's situation at the time of the demand. If we can reasonably claim that we are willing and financially able to perform our obligations, it may be possible to argue successfully that no collateral should be posted or that only an amount equal to two or three months of future payments should be sufficient. We do not expect to post any collateral which will have a material adverse impact on the Company's results of operation, financial position or cash flows.

### ***Dividends***

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. Generally, 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.

On March 1, 2010, the Company made a cash dividend payment of \$0.21 per share to all common shareholders of record as of February 18, 2010, amounting to \$36.7 million. On June 1, 2010, the Company made a cash dividend payment of \$0.21 per share to all common shareholders of record as of May 18, 2010, amounting to \$36.7 million. On September 1, 2010, the Company made a cash dividend payment of \$0.22 per share to all common shareholders of record as of August 18, 2010, amounting to \$38.5 million.

In March 2009 and June 2009, the Company made a cash dividend payment of \$0.20 per share to all common shareholders of record as of February 18, 2009 and May 18, 2009, respectively. In September 2009, the Company made a cash dividend payment of \$0.21 per share to all common shareholders of record as of August 18, 2009, amounting to \$36.7 million.

On October 29, 2010, the Company declared a quarterly cash dividend payment of \$0.22 per share payable on December 1, 2010 to all shareholders of record as of November 18, 2010.

On March 23, 2010, we announced a dividend reinvestment and direct stock purchase plan which enables stockholders to reinvest cash dividends and purchase additional Company common shares without any brokerage commissions or service charges.

### ***Current Credit Market Position***

The Company believes it has sufficient liquidity should there be a disruption of the capital and credit markets. The Company funds liquidity needs for capital investment, working capital and other financial commitments through cash flows from operations, public and private debt offerings, commercial paper markets and credit facilities with \$850.0 million in aggregate total commitments from a diversified group of banks. As of October 29, 2010, we had \$814.0 million available to fulfill our short-term liquidity needs, to issue letters of credit and back our outstanding commercial paper. As of October 29, 2010, the Company can issue additional commercial paper of \$564.4 million which is backed by the credit facilities. The Company closely monitors the financial condition of the financial institutions associated with its credit facilities.

## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

The Company expects to have access to liquidity in the capital markets on favorable terms before the maturity dates of its current credit facilities and the Company does not expect a significant number of its lenders to default on their commitments thereunder. In addition, the Company can delay major capital investments or pursue financing from other sources to preserve liquidity, if necessary. The Company believes it can rely upon cash flows from operations to meet its obligations and fund its minimum required capital investments for an extended period of time.

### ***Market Risk***

We are exposed to market risk associated with changes in commodity prices, equity prices and interest rates. We are exposed to risks from changes in interest rates as a result of our issuance of variable and fixed rate debt and commercial paper. We manage our interest rate exposure by limiting our variable rate exposure and by monitoring the effects of market changes in interest rates. We

## **Table of Contents**

also have the ability to enter into financial derivative instruments, which could include instruments such as, but not limited to, interest rate swaps, swaptions, and U.S. Treasury lock agreements to manage and mitigate interest rate risk exposure. As of September 30, 2010, a hypothetical increase of interest rates by 1% associated with variable-rate debt and commercial paper would result in a \$0.4 million decrease in our pre-tax earnings for the year ended December 31, 2010.

As previously noted above, in July 2010, we entered into an interest rate swap agreement with a notional amount of \$100.0 million. This agreement effectively converted the interest on \$100.0 million of outstanding 6.085% fixed rate debt maturing 2017 to a variable rate of six-month LIBOR plus 3.422%. We entered into this interest rate swap to mitigate interest cost at the parent company relating to debt that was incurred by our prior owners and was not used in any manner to finance the cash needs of our subsidiaries. As the swap interest rates are fixed through April 2011, a hypothetical 1% increase in the interest rates associated with the interest swap agreement would result in no impact on our pre-tax earnings for the year December 31, 2010. This calculation holds all other variables constant and assumes only the discussed changes in interest rates.

Our risks associated with price increases for chemicals, electricity and other commodities are reduced through contractual arrangements and the ability to recover price increases through rates. Non-performance by these commodity suppliers could have a material adverse impact on our results of operations, cash flows and financial position.

The market price of our common stock may experience fluctuations, many of which are unrelated to our operating performance. In particular, our stock price may be affected by general market movements as well as developments specifically related to the water and wastewater industry. These could include, among other things, interest rate movements, quarterly variations or changes in financial estimates by securities analysts and governmental or regulatory actions. This volatility may make it difficult for us to access the capital markets in the future through additional offerings of our common stock, regardless of our financial performance, and such difficulty may preclude us from being able to take advantage of certain business opportunities or meet business obligations.

We are exposed to credit risk through our water, wastewater and other water-related activities for both our Regulated and Non-Regulated Businesses. Our Regulated Businesses serve residential, commercial, industrial and municipal customers while our Non-Regulated Businesses engage in business activities with developers, government entities and other customers. Our primary credit risk is exposure to customer default on contractual obligations and the associated loss that may be incurred due to the nonpayment of customer accounts receivable balances. Our credit risk is managed through established credit and collection policies which are in compliance with applicable regulatory requirements and involve monitoring of customer exposure and the use of credit risk mitigation measures, such as letters of credit or prepayment arrangements. Our credit portfolio is diversified with no significant customer or industry concentrations. In addition, our Regulated Businesses are generally able to recover all prudently incurred costs including uncollectible customer accounts receivable expenses and collection costs through rates.

The Company's retirement trust assets are exposed to the market prices of fixed income and equity securities. Changes to the retirement trust asset value can impact the Company's pension and other benefits expense, funded status and future minimum funding requirements. Our risk is reduced through our ability to recover pension and other benefit costs through rates. In addition, pension and other benefits liabilities decrease as fixed income asset values decrease (fixed income yields rise) since the rate at which we discount pension and other retirement trust asset future obligations is highly correlated to fixed income yields.

We are also exposed to a potential national economic recession or further deterioration in local economic conditions in the markets in which we operate. The credit quality of our customer accounts receivable is dependent on the economy and the ability of our customers to manage through unfavorable economic cycles and other market changes. In addition, as a result of the downturn in the economy and heightened sensitivity of the impact of additional rate increases on certain customers, there can be no assurances that regulators will grant sufficient rate authorizations. Therefore our ability to fully recover operating expenses, recover our investment and provide an appropriate return on invested capital made in our Regulated Businesses may be adversely impacted.

### ***Application of Critical Accounting Policies and Estimates***

Our financial condition, results of operations and cash flows are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. See Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates, in our Form 10-K for the year ended December 31, 2009 filed with the SEC for a discussion of the critical accounting policies.

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



## Edgar Filing: American Water Works Company, Inc. - Form 10-Q

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

## **Table of Contents**

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

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

### **ITEM 4. CONTROLS AND PROCEDURES** *Evaluation of Disclosure Controls and Procedures*

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

Our management, including the Chief Executive Officer and the Chief Financial Officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) of the Exchange Act) as of September 30, 2010 pursuant to 15d-15(e) under the Exchange Act.

Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2010, our disclosure controls and procedures were effective at a reasonable level of assurance. Our disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

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

There have been no changes in our internal control over financial reporting that occurred during the nine months ended September 30, 2010, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## **PART II. OTHER INFORMATION**

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

Previously reported under Part I, Item 3 "Legal Proceedings" in the Company's Form 10-K for the year ended December 31, 2009.

In addition, in October, 2010 a proceeding was commenced against American Water Canada Corporation, our Canadian subsidiary, and its client alleging the violation of the Ontario Safe Drinking Water Act, in connection with the temporary failure of an alum pump used for disinfection of the Elgin Area drinking water system. The Company believes it has valid defenses to these allegations and intends to vigorously defend them. While it is possible the consequence of the proceeding could result in penalties, the Company does not anticipate they will be material.

### **ITEM 1A. RISK FACTORS**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in the "Risk Factors" in the Company's Form 10-K for the year ended December 31, 2009, and our other public filings, which could materially affect our business, financial condition or future results. There have been no material changes from risk factors previously disclosed in "Risk Factors" in the Company's Form 10-K for the year ended December 31, 2009 and our quarterly report for the period ended June 30, 2010 filed on August 4, 2010.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**  
None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**  
None

**ITEM 4. [RESERVED]**

**ITEM 5. OTHER INFORMATION**  
None

**Table of Contents**

**ITEM 6. EXHIBITS**

**Exhibit**

| <b>Number</b> | <b>Exhibit Description</b>   |
|---------------|--|
| *10.1         | American Water Works Company, Inc. Executive Severance Policy, dated as of December 16, 2008   |
| *10.2         | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan September 2010 Form of Stock Unit Grant Agreement for Non-Employee Directors  |
| *31.1         | Certification of Jeffrey Sterba, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act  |
| *31.2         | Certification of Ellen C. Wolf, Senior Vice President and Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act   |
| *32.1         | Certification of Jeffrey Sterba, President and Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act  |
| *32.2         | Certification of Ellen C. Wolf, Senior Vice President and Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act   |
| 101           | The following financial statements from American Water Works Company, Inc. s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2010, filed with the Securities and Exchange Commission on November 3, 2010, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations and Comprehensive Income; (iii) the Consolidated Statements of Cash Flows; (iv) the Consolidated Statement of Changes in Stockholders Equity; and (v) the Notes to Consolidated Financial Statements. |

\* filed herewith.

**Table of Contents**

**Signatures**

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

|                            |   |
|----------------------------|---|
|                            | American Water Works Company, Inc.<br>(Registrant)  |
| November 3, 2010<br>(Date) | /s/ Jeffry Sterba<br>Jeffry Sterba<br>President and Chief Executive Officer<br>(Principal Executive Officer)                            |
| November 3, 2010<br>(Date) | /s/ Ellen C. Wolf<br>Ellen C. Wolf<br>Senior Vice President and Chief Financial Officer<br>(Principal Financial and Accounting Officer) |

**Table of Contents**

**EXHIBIT INDEX**

**Exhibit**

| <b>Number</b> | <b>Exhibit Description</b>   |
|---------------|--|
| *10.1         | American Water Works Company, Inc. Executive Severance Policy, dated as of December 16, 2008   |
| *10.2         | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan September 2010 Form of Stock Unit Grant Agreement for Non-Employee Directors  |
| *31.1         | Certification of Jeffrey Sterba, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act  |
| *31.2         | Certification of Ellen C. Wolf, Senior Vice President and Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act   |
| *32.1         | Certification of Jeffrey Sterba, President and Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act  |
| *32.2         | Certification of Ellen C. Wolf, Senior Vice President and Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act   |
| 101           | The following financial statements from American Water Works Company, Inc. s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2010, filed with the Securities and Exchange Commission on November 3, 2010, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations; (iii) the Consolidated Statements of Cash Flows; (iv) the Consolidated Statement of Changes in Stockholders Equity; (v) the Consolidated Statements of Comprehensive Income and (vi) the Notes to Consolidated Financial Statements. |

\* filed herewith.