

AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CAPITALIZATION

(In thousands of dollars, except per share amounts)

December 31, 2015 and 2014

	2015	2014
Aqua America stockholders' equity:		
Common stock, \$.50 par value	\$ 89,682	\$ 89,296
Capital in excess of par value	773,585	758,145
Retained earnings	930,061	849,952
Treasury stock, at cost	(68,085)	(42,838)
Accumulated other comprehensive income	687	788
Total Aqua America stockholders' equity	1,725,930	1,655,343
Noncontrolling interest	-	40
Total equity	1,725,930	1,655,383
Long-term debt of subsidiaries (substantially secured by utility plant):		
<u>Interest Rate Range</u>	<u>Maturity Date Range</u>	
0.00% to 0.99%	2023 to 2033	5,148
1.00% to 1.99%	2016 to 2035	20,811
2.00% to 2.99%	2024 to 2031	19,167
3.00% to 3.99%	2016 to 2047	297,275
4.00% to 4.99%	2020 to 2054	487,093
5.00% to 5.99%	2016 to 2043	221,435
6.00% to 6.99%	2017 to 2036	52,964
7.00% to 7.99%	2022 to 2027	33,762
8.00% to 8.99%	2021 to 2025	14,502
9.00% to 9.99%	2018 to 2026	27,100
10.00% to 10.99%	2018	6,000
	1,185,257	1,115,322
Notes payable to bank under revolving credit agreement, variable rate, due 2017	60,000	72,000
Unsecured notes payable:		
Bank notes at 1.921% and 1.975% due 2017 and 2018	100,000	50,000
Notes at 3.57% and 3.59% due 2027 and 2030	120,000	50,000
Notes ranging from 4.62% to 4.87%, due 2016 through 2024	144,400	144,400
Notes ranging from 5.20% to 5.95%, due 2016 through 2037	169,548	187,548
Total long-term debt	1,779,205	1,619,270
Current portion of long-term debt	35,593	58,615
Long-term debt, excluding current portion	1,743,612	1,560,655
Total capitalization	\$ 3,469,542	\$ 3,216,038

See accompanying notes to consolidated financial statements.

AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EQUITY

(In thousands of dollars)

	Common stock	Capital in excess of par value	Retained earnings	Treasury stock	Accumulated Other Comprehensive Income	Noncontrolling Interest	Total
Balance at December 31, 2012	\$ 70,472	\$ 718,482	\$ 611,303	\$ (14,668)	\$ 115	\$ 188	\$ 1,385,892
Net income	-	-	221,300	-	-	20	221,320
Other comprehensive income, net of income tax of \$125	-	-	-	-	231	-	231
Dividends	-	-	(102,889)	-	-	-	(102,889)
Stock split	17,655	(17,655)	-	-	-	-	-
Sale of stock (449,129 shares)	188	9,693	-	409	-	-	10,290
Repurchase of stock (415,233 shares)	-	-	-	(12,823)	-	-	(12,823)
Equity compensation plan (43,500 shares)	17	(17)	-	-	-	-	-
Exercise of stock options (1,566,089 shares)	632	25,066	-	-	-	-	25,698
Stock-based compensation	-	5,066	(442)	-	-	-	4,624
Employee stock plan tax benefits	-	2,700	-	-	-	-	2,700
Balance at December 31, 2013	88,964	743,335	729,272	(27,082)	346	208	1,535,043
Net income	-	-	233,239	-	-	40	233,279
Purchase of subsidiary shares from noncontrolling interest	-	-	-	-	-	(208)	(208)
Other comprehensive income, net of income tax of \$238	-	-	-	-	442	-	442
Dividends	-	-	(112,106)	-	-	-	(112,106)
Repurchase of stock (659,666 shares)	-	-	-	(15,756)	-	-	(15,756)
Equity compensation plan (212,920 shares)	107	(107)	-	-	-	-	-
Exercise of stock options (449,412 shares)	225	7,071	-	-	-	-	7,296
Stock-based compensation	-	6,811	(453)	-	-	-	6,358
Employee stock plan tax benefits	-	1,828	-	-	-	-	1,828
Other	-	(793)	-	-	-	-	(793)
Balance at December 31, 2014	89,296	758,145	849,952	(42,838)	788	40	1,655,383
Net income	-	-	201,790	-	-	-	201,790
Other comprehensive loss, net of income tax of \$53	-	-	-	-	(101)	-	(101)
Dividends	-	-	(121,248)	-	-	-	(121,248)
Sale of stock (26,295 shares)	13	664	-	-	-	-	677
Repurchase of stock (981,585 shares)	-	-	-	(25,247)	-	-	(25,247)
Equity compensation plan (321,402 shares)	161	(161)	-	-	-	-	-
Exercise of stock options (424,709 shares)	212	7,328	-	-	-	-	7,540
Stock-based compensation	-	5,860	(433)	-	-	-	5,427
Employee stock plan tax benefits	-	2,602	-	-	-	-	2,602
Other	-	(853)	-	-	-	(40)	(893)
Balance at December 31, 2015	\$ 89,682	\$ 773,585	\$ 930,061	\$ (68,085)	\$ 687	\$ -	\$ 1,725,930

See accompanying notes to consolidated financial statements.

AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of dollars)

Years ended December 31, 2015, 2014, and 2013

	2015	2014	2013
Cash flows from operating activities			
Net income attributable to common shareholders	\$ 201,790	\$ 233,239	\$ 221,300
Income from discontinued operations	-	19,355	18,429
Income from continuing operations	201,790	213,884	202,871
Adjustments to reconcile income from continuing operations to net cash flows from operating activities:			
Depreciation and amortization	128,737	126,535	123,985
Deferred income taxes	16,506	31,477	26,699
Provision for doubtful accounts	5,765	5,838	4,708
Share-based compensation	5,860	6,819	5,066
Gain on sale of utility system	-	-	(1,025)
(Gain) loss on sale of other assets	(468)	4	(148)
Gain on extinguishment of debt	(678)	-	-
Equity loss in joint venture	35,177	3,989	2,665
Net change in receivables, inventory and prepayments	(6,520)	(20,299)	4,466
Net change in payables, accrued interest, accrued taxes and other accrued liabilities	(3,469)	470	(13,425)
Change in income tax receivable	-	7,873	8,209
Other	(11,906)	(11,702)	1,338
Operating cash flows from continuing operations	370,794	364,888	365,409
Operating cash flows (used in) from discontinued operations, net	-	(1,100)	2,410
Net cash flows from operating activities	370,794	363,788	367,819
Cash flows from investing activities			
Property, plant and equipment additions, including the debt component of allowance for funds used during construction of \$1,598, \$1,494, and \$1,742	(364,689)	(328,605)	(307,908)
Acquisitions of utility systems and other, net	(28,989)	(14,616)	(14,997)
Release of funds previously restricted for construction activity	47	-	23,531
Additions to funds restricted for construction activity	-	-	(6)
Net proceeds from the sale of utility systems and other assets	648	558	5,315
Investment in joint venture	-	-	(14,700)
Other	(1,079)	279	76
Investing cash flows used in continuing operations	(394,062)	(342,384)	(308,689)
Investing cash flows from discontinued operations, net	-	49,883	87,126
Net cash flows used in investing activities	(394,062)	(292,501)	(221,563)
Cash flows from financing activities			
Customers' advances and contributions in aid of construction	5,904	6,064	5,114
Repayments of customers' advances	(3,977)	(4,028)	(4,303)
Net repayments of short-term debt	(1,677)	(18,342)	(43,643)
Proceeds from long-term debt	560,544	317,699	263,834
Repayments of long-term debt	(400,407)	(253,192)	(300,323)
Change in cash overdraft position	(739)	(322)	9,872
Proceeds from issuing common stock	677	-	10,290
Proceeds from exercised stock options	7,540	7,296	25,698
Share-based compensation windfall tax benefits	1,842	1,422	2,420
Repurchase of common stock	(25,247)	(15,756)	(12,823)
Dividends paid on common stock	(121,248)	(112,106)	(102,889)
Other	(853)	(793)	-
Financing cash flows used in continuing operations	22,359	(72,058)	(146,753)
Financing cash flows (used in) from discontinued operations, net	-	(149)	34
Net cash flows used in financing activities	22,359	(72,207)	(146,719)
Net decrease in cash and cash equivalents	(909)	(920)	(463)
Cash and cash equivalents at beginning of year	4,138	5,058	5,521
Cash and cash equivalents at end of year	\$ 3,229	\$ 4,138	\$ 5,058
Cash paid during the year for:			
Interest, net of amounts capitalized	\$ 70,103	\$ 72,441	\$ 75,452
Income taxes	6,902	4,348	6,995
Non-cash investing activities			
Property, plant and equipment additions purchased at the period end, but not yet paid	\$ 25,612	\$ 31,050	\$ 30,974
Non-cash customer advances for construction	27,992	43,642	26,188

See accompanying notes to consolidated financial statements.

See Note 10 – *Long-term Debt and Loans Payable*, and Note 14 – *Employee Stock and Incentive Plan* for a description of non-cash activities

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(In thousands of dollars, except per share amounts)

Note 1 – Summary of Significant Accounting Policies

Nature of Operations — Aqua America, Inc. (“Aqua America,” the “Company,” “we,” or “us”) is the holding company for regulated utilities providing water or wastewater services concentrated in Pennsylvania, Ohio, Texas, Illinois, North Carolina, New Jersey, Indiana, and Virginia. Our largest operating subsidiary is Aqua Pennsylvania, Inc., which accounted for approximately 52% of our operating revenues and approximately 76% of our Regulated segment’s income from continuing operations for 2015. As of December 31, 2015, Aqua Pennsylvania provided water or wastewater services to approximately one-half of the total number of people we serve. Aqua Pennsylvania’s service territory is located in the suburban areas north and west of the City of Philadelphia and in 27 other counties in Pennsylvania. The Company’s other regulated utility subsidiaries provide similar services in seven other states. In addition, the Company’s market-based activities are conducted through Aqua Resources, Inc. and Aqua Infrastructure LLC. Aqua Resources provides water and wastewater services through operating and maintenance contracts with municipal authorities and other parties in close proximity to our utility companies’ service territories; offers, through a third party, water and wastewater line repair service and protection solutions to households; inspects, cleans and repairs sanitary wastewater lines; installs and tests devices that prevent the contamination of potable water; designs and builds water and wastewater systems; and provides other market-based water and wastewater services. In addition, Aqua Resources provides liquid waste hauling and disposal services in a business unit that the Company has decided to sell, which as of December 31, 2015 is reported as assets held for sale in the Company’s Consolidated Balance Sheets. Aqua Infrastructure provides non-utility raw water supply services for firms in the natural gas drilling industry.

In December 2014, we completed the sale of our water utility system in southwest Allen County, Indiana, which served approximately 13,000 customers, to the City of Fort Wayne, Indiana. The completion of this sale settled the dispute concerning the February 2008 acquisition, by eminent domain, by the City of Fort Wayne, of the northern portion of our water and wastewater utility systems. Refer to Note 3 – *Discontinued Operations and Other Disposition* for further information on this sale.

In September 2012, we began to market for sale our water and wastewater operations in Florida, which served approximately 38,000 customers, and our non-regulated wastewater treatment facility in Georgia. In March 2014, we completed the sale of our wastewater treatment facility in Georgia, which concluded our operations in Georgia. In March, April, and December 2013, through five separate sales transactions, we completed the sale of our water and wastewater utility systems in Florida, which concluded our regulated operations in Florida.

The operating results, cash flows, and financial position of the Company’s water utility systems in Fort Wayne, Indiana, and Georgia and Florida subsidiaries have been presented in the Company’s consolidated financial statements as discontinued operations. Unless specifically noted, the financial information presented in the notes to consolidated financial statements reflects the Company’s continuing operations.

The company has identified ten operating segments and has one reportable segment named the Regulated segment. The reportable segment is comprised of eight operating segments for our water and wastewater regulated utility companies which are organized by the states where we provide these services. These operating segments are aggregated into one reportable segment since each of the Company’s operating segments has the following similarities: economic characteristics, nature of services, production processes, customers, water distribution or wastewater collection methods, and the nature of the regulatory environment. In addition, Aqua Resources and Aqua Infrastructure are not quantitatively significant to be reportable and are included as a component of “Other,” in addition to corporate costs that have not been allocated to the Regulated segment and intersegment eliminations.

Regulation — Most of the operating companies that are regulated public utilities are subject to regulation by the utility commissions of the states in which they operate. The respective utility commissions have jurisdiction with respect to rates, service, accounting procedures, issuance of securities, acquisitions and other matters. Some of the operating companies that are regulated public utilities are subject to rate regulation by county or city government. Regulated public utilities follow the Financial Accounting Standards Board’s (“FASB”) accounting guidance for regulated operations, which provides for the recognition of regulatory assets and liabilities as allowed by regulators for costs or credits that are reflected in current rates or are considered probable of being included in future rates. The regulatory assets or liabilities are then relieved as the cost or credit is reflected in rates.

AQUA AMERICA, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

Use of Estimates in Preparation of Consolidated Financial Statements — The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Presentation — The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany accounts and transactions have been eliminated. Certain prior period amounts have been reclassified to conform to the current period presentation of operating cash flows from continuing operations.

Recognition of Revenues — Revenues in our Regulated segment principally include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the latest billing to the end of the accounting period. In addition, the Company's market-based subsidiary Aqua Resources recognizes revenues when services are performed or, for construction of water and wastewater systems, based on the percentage of completion of the project and Aqua Infrastructure recognizes revenues when services are performed. The Company's market-based subsidiaries recognized revenues of \$34,909 in 2015, \$24,189 in 2014, and \$17,712 in 2013.

Property, Plant and Equipment and Depreciation — Property, plant and equipment consist primarily of utility plant. The cost of additions includes contracted cost, direct labor and fringe benefits, materials, overheads and, for additions meeting certain criteria, allowance for funds used during construction. Water systems acquired are typically recorded at estimated original cost of utility plant when first devoted to utility service and the applicable depreciation is recorded to accumulated depreciation. The difference between the estimated original cost, less applicable accumulated depreciation, and the purchase price is recorded as goodwill, or as an acquisition adjustment within utility plant as permitted by the applicable regulatory jurisdiction. At December 31, 2015, utility plant includes a net credit acquisition adjustment of \$24,428, which is generally being amortized from 2 to 53 years, except where not permitted or appropriate. Amortization of the acquisition adjustments totaled \$2,556 in 2015, \$2,648 in 2014, and \$2,480 in 2013.

Utility expenditures for maintenance and repairs, including major maintenance projects and minor renewals and betterments, are charged to operating expenses when incurred in accordance with the system of accounts prescribed by the utility commissions of the states in which the company operates. The cost of new units of property and betterments are capitalized. Utility expenditures for water main cleaning and relining of pipes are deferred and recorded in net property, plant and equipment in accordance with the FASB's accounting guidance for regulated operations. As of December 31, 2015, \$16,148 of these costs have been incurred since the last respective rate proceeding and the Company expects to recover these costs in future rates.

The cost of software upgrades and enhancements are capitalized if they result in added functionality which enable the software to perform tasks it was previously incapable of performing. Information technology costs associated with major system installations, conversions and improvements, such as software training, data conversion and business process reengineering costs, are deferred as a regulatory asset if the Company expects to recover these costs in future rates. If these costs are not deferred, then these costs are charged to operating expenses when incurred. As of December 31, 2015, \$24,509 of these costs have been deferred since the last respective rate proceeding as a regulatory asset, and the deferral is reported as a component of net property, plant and equipment.

When units of utility property are replaced, retired or abandoned, the recorded value thereof is credited to the asset account and such value, together with the net cost of removal, is charged to accumulated depreciation. To the extent the Company anticipates recovery of the cost of removal or other retirement costs through rates after the retirement costs are incurred, a regulatory asset is recorded as those costs are incurred. In some cases, the Company recovers retirement costs through rates during the life of the associated asset and before the costs are incurred. These amounts result in a regulatory liability being reported based on the amounts previously recovered through customer rates.

The straight-line remaining life method is used to compute depreciation on utility plant. Generally, the straight-line method is used with respect to transportation and mechanical equipment, office equipment and laboratory equipment.

Long-lived assets of the Company, which consist primarily of utility plant in service, regulatory assets, and investment in joint venture, are reviewed for impairment when changes in circumstances or events occur. These circumstances or events could include a decline in the market value or physical condition of a long-lived asset, an adverse change in the manner in which long-lived assets are used or planned to be used, a change in historical trends, operating cash flows

AQUA AMERICA, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(In thousands of dollars, except per share amounts)

associated with the long-lived assets, changes in macroeconomic conditions, industry and market conditions, or overall financial performance. When these circumstances or events occur, the Company determines whether it is more likely than not that the fair value of those assets is less than their carrying amount. If the Company determines that it is more likely than not (that is, the likelihood of more than 50 percent), the Company would recognize an impairment charge if it is determined that the carrying amount of an asset exceeds the sum of the undiscounted estimated cash flows. In this circumstance, the Company would recognize an impairment charge equal to the difference between the carrying amount and the fair value of the asset. Fair value is estimated to be the present value of future net cash flows associated with the asset, discounted using a discount rate commensurate with the risk and remaining life of the asset. There has been no change in circumstances or events that have occurred that require adjustments to the carrying values of the Company's long-lived assets, except for an impairment charge recognized by the joint venture on its long-lived assets in 2015.

Allowance for Funds Used During Construction — The allowance for funds used during construction ("AFUDC") represents the capitalized cost of funds used to finance the construction of utility plant. In general, AFUDC is applied to construction projects requiring more than one month to complete. No AFUDC is applied to projects funded by customer advances for construction, contributions in aid of construction, or applicable state-revolving fund loans. AFUDC includes the net cost of borrowed funds and a rate of return on other funds when used, and is recovered through water rates as the utility plant is depreciated. The amount of AFUDC related to equity funds in 2015 was \$4,621, 2014 was \$3,640, and 2013 was \$533. No interest was capitalized by our market-based businesses.

Cash and Cash Equivalents — The Company considers all highly liquid investments with an original maturity of three months or less, which are not restricted for construction activity, to be cash equivalents.

The Company had a book overdraft, which represents transactions that have not cleared the bank accounts at the end of the period, for specific disbursement cash accounts of \$20,693 and \$21,431 at December 31, 2015 and 2014, respectively. The Company transfers cash on an as-needed basis to fund these items as they clear the bank in subsequent periods. The balance of the book overdraft is reported as accounts payable and the change in the book overdraft balance is reported as cash flows from financing activities, due to our ability to fund the overdraft with the Company's credit facility.

Accounts Receivable — Accounts receivable are recorded at the invoiced amounts. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in our existing accounts receivable, and is determined based on historical write-off experience and the aging of account balances. The Company reviews the allowance for doubtful accounts quarterly. Account balances are written off against the allowance when it is probable the receivable will not be recovered. When utility customers request extended payment terms, credit is extended based on regulatory guidelines, and collateral is not required.

Regulatory Assets, Deferred Charges and Other Assets — Deferred charges and other assets consist of financing expenses, other costs and marketable securities. Deferred bond issuance expenses are amortized over the life of the related issues. Call premiums related to the early redemption of long-term debt, along with the unamortized balance of the related issuance expense, are deferred and amortized over the life of the long-term debt used to fund the redemption as the Company has received or expects to receive rate recovery of these costs. Other costs, for which the Company has received or expects to receive prospective rate recovery, are deferred as a regulatory asset and amortized over the period of rate recovery in accordance with the FASB's accounting guidance for regulated operations. See Note – 6 *Regulatory Assets and Liabilities* for further information regarding the Company's regulatory assets.

Marketable equity securities are carried on the balance sheet at fair market value, and changes in fair value are included in other comprehensive income.

Investment in Joint Venture — The Company uses the equity method of accounting to account for our 49% investment in a joint venture with a firm in the natural gas industry for the construction and operation of a private pipeline system to supply raw water to natural gas well drilling operations in the Marcellus Shale in north-central Pennsylvania, which commenced operations in 2012. Our initial investment is carried at cost. Subsequently, the carrying amount of our investment is adjusted to reflect capital contributions or distributions, and our equity in earnings or losses since the commencement of the system's operations. Our share of equity earnings or losses in the

AQUA AMERICA, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(In thousands of dollars, except per share amounts)

joint venture is reported in the consolidated statements of net income as equity losses (earnings) in joint venture. During 2015 and 2014 we received distributions of \$441 and \$1,372, respectively.

During the fourth quarter of 2015, the joint venture experienced the following events: a marked decline in natural gas prices, particularly in the fourth quarter of 2015, following a period of steady decline in 2015, a distinguishable reduction in the volume of water sales by the joint venture which led to a lowered forecast in the fourth quarter of 2015 on future water sales volumes by the joint venture, as well as changes in the natural gas industry and market conditions. These market conditions are largely associated with natural gas prices, which sharply declined in the fourth quarter and this downturn no longer appeared temporary and instead may be a long-term condition. It was then determined that the carrying amount of the joint venture's long-lived assets exceeded the sum of the joint venture's undiscounted estimated cash flows, which resulted in the recognition of a noncash impairment charge of \$32,975 (\$21,433 after-tax), representing the Company's share of the impairment charge. The impairment charge, on a pre-tax basis, is reported as equity loss in joint venture on the Company's consolidated statements of income. The amount of the impairment charge recognized by the joint venture is equal to the difference between the carrying value and the fair value of the long-lived assets. Fair value is estimated to be the present value of the future net cash flows associated with the assets, discounted using a rate commensurate with the risk and remaining life of the assets. As of December 31, 2015, the joint venture's assets are comprised of approximately one-half in long-lived assets and one-half in cash, and our share was \$7,716.

Funds Restricted for Construction Activity— The proceeds received from specific financings for construction and capital improvement of utility facilities are held in escrow until the designated expenditures are incurred. These amounts are reported as funds restricted for construction activity and are expected to be released over time as the capital projects are funded.

Goodwill— Goodwill represents the excess cost over the fair value of net tangible and identifiable intangible assets acquired through acquisitions. Goodwill is not amortized but is tested for impairment annually, or more often, if circumstances indicate a possible impairment may exist. When testing goodwill for impairment, we may assess qualitative factors for some or all of our reporting units to determine whether it's more likely than not that the fair value of a reporting unit is less than its carrying amount. Alternatively, we may bypass this qualitative assessment for some of our reporting units and perform a quantitative goodwill impairment test. If we perform a quantitative test and determine that the fair value of a reporting unit is less than its carrying amount, we would determine the reporting unit's implied fair value of its goodwill and compare it with the carrying amount of its goodwill to measure such impairment. The Company tested the goodwill attributable for each of our reporting units for impairment as of July 31, 2015, in conjunction with the timing of our annual strategic business plan, and concluded that the estimated fair value of each reporting unit, which has goodwill recorded, exceeded the reporting unit's carrying amount, indicating that none of the Company's goodwill was impaired. The following table summarizes the changes in the Company's goodwill:

	Regulated Segment	Other	Consolidated
Balance at December 31, 2013	\$ 24,102	\$ 4,121	\$ 28,223
Goodwill acquired during year	182	2,515	2,697
Reclassifications to utility plant acquisition adjustment	(302)	-	(302)
Other	582	(16)	566
Balance at December 31, 2014	24,564	6,620	31,184
Goodwill acquired during year	-	12	12
Reclassifications from (to) utility plant acquisition adjustment, net	2,682	-	2,682
Other	-	(12)	(12)
Balance at December 31, 2015	\$ 27,246	\$ 6,620	\$ 33,866

The reclassification of goodwill to utility plant acquisition adjustment results from a mechanism approved by the applicable utility commission. The mechanism provides for the transfer over time, and the recovery through

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(In thousands of dollars, except per share amounts)

customer rates, of goodwill associated with some acquisitions upon achieving specific objectives. The reclassification from utility plant acquisition adjustment to goodwill represents the purchase price in excess of the fair market value of the net assets acquired, from a prior acquisition, which was originally accounted for as utility plant acquisition adjustment.

Income Taxes — The Company accounts for some income and expense items in different time periods for financial and tax reporting purposes. Deferred income taxes are provided on specific temporary differences between the tax basis of the assets and liabilities, and the amounts at which they are carried in the consolidated financial statements. The income tax effect of temporary differences not currently recovered in rates is recorded as deferred taxes with an offsetting regulatory asset or liability. These deferred income taxes are based on the enacted tax rates expected to be in effect when such temporary differences are projected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amount more likely than not to be realized. Investment tax credits are deferred and amortized over the estimated useful lives of the related properties. Judgment is required in evaluating the Company's Federal and state tax positions. Despite management's belief that the Company's tax return positions are fully supportable, the Company establishes reserves when it believes that its tax positions are likely to be challenged and it may not fully prevail in these challenges. The Company's provision for income taxes includes interest, penalties and reserves for uncertain tax positions.

In 2012, the Company changed its tax method of accounting for qualifying utility asset improvement costs in Aqua Pennsylvania effective with the tax year ended December 31, 2012 and for prior tax years. The tax accounting method was changed to permit the expensing of qualifying utility asset improvement costs that were previously being capitalized and depreciated for book and tax purposes. This change was implemented in response to a June 2012 rate order issued by the Pennsylvania Public Utility Commission to Aqua Pennsylvania, which provides for a reduction in current income tax expense as a result of the recognition of income tax benefits for qualifying utility asset improvements. This change results in a significant reduction in the effective income tax rate, a reduction in current income tax expense, and reduces the amount of taxes currently payable. For qualifying capital expenditures made prior to 2012, the resulting tax benefits have been deferred as of December 31, 2012 and, in accordance with the rate order, a ten year amortization of the income tax benefits, which reduces future income tax expense, commenced in 2013. During 2013, our Ohio and North Carolina operating divisions implemented this change. These divisions currently do not employ a method of accounting that provides for a reduction in current income taxes as a result of the recognition of income tax benefits, and as such the change in the Company's tax method of accounting in these operating divisions had no impact on the Company's effective income tax rate.

Customers' Advances for Construction and Contributions in Aid of Construction — Water mains, other utility property or, in some instances, cash advances to reimburse the Company for its costs to construct water mains or other utility property, are contributed to the Company by customers, real estate developers and builders in order to extend utility service to their properties. The value of these contributions is recorded as customers' advances for construction. Over time, the amount of non-cash contributed property will vary based on the timing of the contribution of the non-cash property and the volume of non-cash contributed property received in connection with development in our service territories. The Company makes refunds on these advances over a specific period of time based on operating revenues related to the property, or as new customers are connected to and take service from the applicable water main. After all refunds are made, any remaining balance is transferred to contributions in aid of construction. Contributions in aid of construction include direct non-refundable contributions and the portion of customers' advances for construction that become non-refundable.

Based on regulatory conventions in states where the Company operates, generally our subsidiaries depreciate contributed property and amortize contributions in aid of construction at the composite rate of the related property. Contributions in aid of construction and customers' advances for construction are deducted from the Company's rate base for rate-making purposes, and therefore, no return is earned on contributed property.

Inventories, Materials and Supplies — Inventories are stated at cost. Cost is determined using the first-in, first-out method.

Stock-Based Compensation — The Company records compensation expense in the financial statements for stock-based awards based on the grant date fair value of those awards. Stock-based compensation expense includes an estimate for pre-vesting forfeitures and is recognized over the requisite service periods of the awards on a straight-line basis, which is generally commensurate with the vesting term.

AQUA AMERICA, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(In thousands of dollars, except per share amounts)

Fair Value Measurements – The Company follows the FASB’s accounting guidance for fair value measurements and disclosures, which defines fair value and establishes a framework for using fair value to measure assets and liabilities. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1: unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access;
- Level 2: inputs other than Level 1 that are observable, either directly or indirectly, such as quoted market prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in non-active markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; or
- Level 3: inputs that are unobservable and significant to the fair value measurement.

The asset’s or liability’s fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. There have been no changes in the valuation techniques used to measure fair value or asset or liability transfers between the levels of the fair value hierarchy for the years ended December 31, 2015 and 2014.

Recent Accounting Pronouncements — In November 2015, the FASB issued updated accounting guidance on the balance sheet classification of deferred tax assets and liabilities, which requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. Previously, deferred taxes were presented as a net current asset or liability and net noncurrent asset or liability, which required a jurisdiction-by-jurisdiction analysis based on the classification of the assets and liabilities to which the underlying temporary differences relate, or, in the case of tax loss carryforwards, based on the period in which the attribute is expected to be realized. The updated guidance is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with early adoption available, and the guidance may be applied either prospectively or retrospectively. The Company has elected to early adopt the updated guidance, prospectively, for its fiscal year ended December 31, 2015, and has not retrospectively adjusted the prior period consolidated balance sheet. If the Company had adopted the updated guidance retrospectively, the December 31, 2014 deferred income taxes of \$26,849 classified as current assets would have been reported as a partial reduction to the deferred income taxes and investment tax credits reported in the deferred credits and other liabilities section of the consolidated balance sheet.

In September 2015, the FASB issued updated accounting guidance on simplifying measurement-period adjustments in business combinations, which eliminates the requirement that an acquirer in a business combination account for measurement-period adjustments retrospectively. Instead, an acquirer will recognize a measurement-period adjustment during the period in which it determines the amount of the adjustment. The updated guidance is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years, with early adoption available. The Company does not expect the provisions of this accounting standard to have a material impact on its results of operations or financial position.

In April 2015, the FASB issued updated accounting guidance on simplifying the presentation of debt issuance costs, which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability. Previously, debt issuance costs were presented in the balance sheet as a deferred charge. The accounting standard is effective for reporting periods beginning after December 15, 2015, and will be applied retrospectively. The Company does not expect the provisions of this accounting standard to have a material impact on its results of operations or financial position.

In August 2014, the FASB issued an accounting standard that will require management to assess an entity’s ability to continue as a going concern for each annual and interim reporting period and to provide related footnote disclosures in circumstances in which substantial doubt exists. The accounting standard is effective in the first annual reporting period ending after December 15, 2016. The Company does not expect the provisions of this accounting standard to have an impact on its results of operations or financial position.

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In May 2014, the FASB issued updated accounting guidance on recognizing revenue from contracts with customers, which outlines a single comprehensive model that an entity will apply to determine the measurement of revenue and timing of recognition. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The updated guidance also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to fulfill a contract. In July 2015, the FASB approved a one year deferral to the original effective date of this guidance. The updated guidance is effective retrospectively for reporting periods beginning after December 15, 2017. The Company is evaluating the requirements of the updated guidance to determine the impact of adoption.

In April 2014, the FASB issued updated accounting guidance which changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. The updated guidance is effective prospectively for reporting periods beginning after December 15, 2014, with early adoption available. The Company adopted the provisions of the updated accounting guidance for its quarterly reporting period beginning January 1, 2015, and the adoption of the revised guidance did not have an impact on the Company's consolidated results of operations or consolidated financial position.

Note 2 – Acquisitions

Pursuant to the Company's growth-through-acquisition strategy, the Company completed the following acquisitions. In April 2015, the Company acquired the water and wastewater utility system assets of North Maine Utilities, located in the Village of Glenview, Illinois serving approximately 7,400 customers. The total purchase price consisted of \$23,079 in cash. The purchase price allocation for this acquisition consists primarily of acquired property, plant and equipment. Additionally, in 2015, the Company completed 14 acquisitions of water and wastewater utility systems in various states. The total purchase price of these utility systems consisted of \$5,210 in cash. The operating revenues included in the consolidated financial statements of the Company during the period owned by the Company for the utility systems acquired in 2015 are \$6,662. The pro forma effect of the businesses acquired is not material either individually or collectively to the Company's results of operations.

In 2014, the Company completed 16 acquisitions of water and wastewater utility systems in various states. The total purchase price of these utility systems consisted of \$10,530 in cash. Further, in August 2014, the Company acquired a market-based business that specializes in the inspection, cleaning and repair of storm and sanitary sewer lines. The total purchase price consisted of \$3,010, of which a total of \$810 is contingent upon satisfying certain annual performance targets over a three-year period for which \$270 has been paid for completion of the performance targets for year one. Additionally, in December 2014, the Company acquired a market-based business that specializes in providing water distribution system services to prevent the contamination of potable water, including training to waterworks operators. The total purchase price consisted of \$1,800, of which \$700 was paid in the first quarter of 2015. The operating revenues included in the consolidated financial statements of the Company during the period owned by the Company for these utility systems and market-based businesses were \$19,154 in 2015 and \$4,403 in 2014. The pro forma effect of the businesses acquired is not material either individually or collectively to the Company's results of operations.

In 2013, the Company completed 15 acquisitions of water and wastewater utility systems in various states. The total purchase price consisted of \$14,997 in cash. The operating revenues included in the consolidated financial statements of the Company during the period owned by the Company were \$3,276 in 2015, \$3,180 in 2014, and \$2,103 in 2013. The pro forma effect of the businesses acquired is not material either individually or collectively to the Company's results of operations.

In January 2016, the Company acquired Superior Water Company, Inc., which provides public water service to approximately 3,900 customers in portions of Berks, Chester, and Montgomery counties, Pennsylvania. The total purchase price for the utility system was \$16,750, which consisted of the issuance of 439,943 shares of the Company's common stock, which was valued based on the average closing price for the thirty consecutive trading days ending December 31, 2015, and \$3,905 in cash. As of the date of issuance of the financial statements, the initial accounting of the purchase price allocation for this acquisition is incomplete.

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Note 3 – Discontinued Operations and Other Disposition

Discontinued Operations – In December 2014, we completed the sale of our water utility system in southwest Allen County, Indiana to the City of Fort Wayne, Indiana (the “City”) for \$67,011, which included a payment received in December 2014 of \$50,100 in addition to \$16,911 the City already paid the Company for the northern portion of our water and wastewater utility systems, which were acquired by the City in February 2008, by eminent domain. We recognized a gain on sale of \$29,210 (\$17,611 after-tax) in the fourth quarter of 2014. As a result of this transaction, Aqua Indiana will expand its sewer customer base by accepting new wastewater flows from the City.

In September 2012, the Company began to market for sale its water and wastewater operations in Florida, which served approximately 38,000 customers, and the Company’s non-regulated wastewater treatment facility in Georgia. In March 2014, we completed the sale of our wastewater treatment facility in Georgia, which concluded our operations in this state. In March, April, and December 2013, through five separate sales transactions, we completed the sale of our water and wastewater utility systems in Florida, which concluded our regulated operations in Florida. The Company received total net proceeds from these sales of \$88,934 and recognized a gain on sale of \$21,178 (\$13,766 after-tax).

The operating results, cash flows, and financial position of the Company’s subsidiaries named above have been presented in the Company’s consolidated statements of net income, consolidated statements of cash flow, and consolidated balance sheets as discontinued operations.

A summary of discontinued operations presented in the consolidated statements of net income includes the following:

	Years Ended December 31,	
	2014	2013
Operating revenues	\$ 6,324	\$ 19,014
Total operating expenses	3,262	11,880
Operating income	3,062	7,134
Other (income) expense:		
Gain on sale	(29,093)	(21,178)
Other, net	-	1
Income from discontinued operations before income taxes	32,155	28,311
Provision for income taxes	12,800	9,882
Income from discontinued operations	<u>\$ 19,355</u>	<u>\$ 18,429</u>

As of December 31, 2015 and 2014 the Company does not have any assets or liabilities of discontinued operations held for sale.

Other Disposition – The following disposition has not been presented as discontinued operations in the Company’s consolidated financial statements as the Company does not believe that disclosure of the following disposed water and wastewater utility system as discontinued operations is meaningful to the reader of the financial statements for making investment decisions. The gains disclosed below are reported in the consolidated statements of net income as a reduction to operations and maintenance expense.

In June 2013, the Company sold a water and wastewater utility system in Texas for net proceeds of \$3,400. The sale resulted in the recognition of a gain on sale of these assets, net of expenses, of \$1,025 (\$615 after-tax), and is reported in the consolidated statement of net income as a reduction to operations and maintenance expense. The utility system represented approximately 0.04% of the Company’s total assets.

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Note 4 – Property, Plant and Equipment

	December 31,		Approximate Range	Weighted Average
	2015	2014	of Useful Lives	Useful Life
Utility plant and equipment:				
Mains and accessories	\$ 2,696,194	\$ 2,516,895	30 - 93 years	77 years
Services, hydrants, treatment plants and reservoirs	1,531,052	1,426,701	5 - 85 years	49 years
Operations structures and water tanks	263,722	252,908	14 - 70 years	47 years
Miscellaneous pumping and purification equipment	687,472	654,316	5 - 90 years	40 years
Meters, data processing, transportation and operating equipment	684,335	650,253	4 - 63 years	25 years
Land and other non-depreciable assets	98,575	100,009	-	-
Utility plant and equipment	5,961,350	5,601,082		
Utility construction work in progress	144,448	116,644	-	-
Net utility plant acquisition adjustment	(24,428)	(20,164)	2 - 53 years (1)	28 years
Non-utility plant and equipment	6,641	9,455	3 - 25 years	7 years
Total property, plant and equipment	<u>\$ 6,088,011</u>	<u>\$ 5,707,017</u>		

(1) Net utility plant acquisition adjustment is generally being amortized from 2 to 53 years, except where not permitted.

Note 5 – Accounts Receivable

	December 31,	
	2015	2014
Billed utility revenue	\$ 56,876	\$ 55,537
Unbilled revenue	37,276	35,566
Other	10,867	11,261
	105,019	102,364
Less allowance for doubtful accounts	5,873	5,365
Net accounts receivable	<u>\$ 99,146</u>	<u>\$ 96,999</u>

The Company's utility customers are located principally in the following states: 47% in Pennsylvania, 16% in Ohio, 10% in North Carolina, 8% in Texas, and 8% in Illinois. No single customer accounted for more than one percent of the Company's regulated operating revenues during the years ended December 31, 2015, 2014, and 2013. The following table summarizes the changes in the Company's allowance for doubtful accounts:

	2015	2014	2013
Balance at January 1,	\$ 5,365	\$ 4,413	\$ 4,299
Amounts charged to expense	5,762	5,838	4,708
Accounts written off	(6,513)	(6,120)	(5,884)
Recoveries of accounts written off	1,259	1,234	1,290
Balance at December 31,	<u>\$ 5,873</u>	<u>\$ 5,365</u>	<u>\$ 4,413</u>

AQUA AMERICA, INC. AND SUBSIDIARIES
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Note 6 – Regulatory Assets and Liabilities

The regulatory assets represent costs that are expected to be fully recovered from customers in future rates while regulatory liabilities represent amounts that are expected to be refunded to customers in future rates or amounts recovered from customers in advance of incurring the costs. Except for income taxes, regulatory assets and regulatory liabilities are excluded from the Company's rate base and do not earn a return. The components of regulatory assets and regulatory liabilities are as follows:

	December 31, 2015		December 31, 2014	
	Regulatory Assets	Regulatory Liabilities	Regulatory Assets	Regulatory Liabilities
Income taxes	\$ 699,247	\$ 181,067	\$ 596,459	\$ 206,940
Utility plant retirement costs	6,052	27,604	7,687	25,236
Post-retirement benefits	112,626	50,775	108,586	46,074
Accrued vacation	1,744	-	1,605	-
Water tank painting	303	-	1,533	-
Fair value adjustment of long-term debt assumed in acquisition	3,636	-	4,004	-
Rate case filing expenses and other	6,510	61	5,717	67
	<u>\$ 830,118</u>	<u>\$ 259,507</u>	<u>\$ 725,591</u>	<u>\$ 278,317</u>

Items giving rise to deferred state income taxes, as well as a portion of deferred Federal income taxes related to specific differences between tax and book depreciation expense, are recognized in the rate setting process on a cash basis or as a reduction in current income tax expense and will be recovered as they reverse. Amounts include differences that arise between specific utility asset improvement costs capitalized for book and deducted as an expense for tax purposes.

A portion of the regulatory liability for income taxes is related to Aqua Pennsylvania's income tax accounting change for the tax benefits realized on the Company's 2012 tax return, which have not yet reduced current income tax expense due to the ten year amortization period which began in 2013. This amortization was stipulated in a June 2012 rate order issued to Aqua Pennsylvania and is subject to specific parameters being met each year. Beginning in 2013, the Company amortized \$38,000, annually, of its deferred income tax benefits, which reduced current income tax expense and increased the Company's net income by \$16,734.

The regulatory asset for utility plant retirement costs, including cost of removal, represents costs already incurred that are expected to be recovered in future rates over a five year recovery period. The regulatory liability for utility plant retirement costs represents amounts recovered through rates during the life of the associated asset and before the costs are incurred.

The regulatory asset for accrued vacation represents costs that would otherwise be charged to operations and maintenance expense for vacation that is earned by employees, which is recovered as a cost of service.

The regulatory asset for Post-retirement benefits, which includes pension and other post-retirement benefits, primarily reflects a regulatory asset that has been recorded for the costs that would otherwise be charged to stockholders' equity for the underfunded status of the Company's pension and other post-retirement benefit plans. The Company also has a regulatory asset related to post-retirement benefits costs that represents costs already incurred which are now being recovered in rates over 10 years. The regulatory liability for post-retirement benefits represents costs recovered in rates in excess of post-retirement benefits expense.

Expenses associated with water tank painting are deferred and amortized over a period of time as approved in the regulatory process. Water tank painting costs are generally being amortized over a period ranging from 1 to 15 years.

The Company recorded a fair value adjustment for fixed rate, long-term debt assumed in acquisitions that matures in various years ranging from 2022 to 2029. The regulatory asset or liability results from the rate setting process continuing to recognize the historical interest cost of the assumed debt.

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The regulatory asset related to rate case filing expenses and other represents the costs associated with filing for rate increases that are deferred and amortized over periods that generally range from one to five years, and costs incurred by the Company for which it has received or expects to receive rate recovery.

The regulatory asset related to the costs incurred for information technology software projects and water main cleaning and relining projects are described in Note 1 – *Summary of Significant Accounting Policies – Property, Plant and Equipment and Depreciation*.

Note 7 – Income Taxes

The provision for income taxes for the Company's continuing operations consists of:

	Years Ended December 31,		
	2015	2014	2013
Current:			
Federal	\$ 2,624	\$ (11,296)	\$ (11,153)
State	(4,168)	5,038	5,687
	(1,544)	(6,258)	(5,466)
Deferred:			
Federal	12,649	37,500	30,327
State	3,857	(6,023)	(3,628)
	16,506	31,477	26,699
Total tax expense	\$ 14,962	\$ 25,219	\$ 21,233

The statutory Federal tax rate is 35% and for states with a corporate net income tax, the state corporate net income tax rates range from 5% to 9.99% for all years presented.

The reasons for the differences between amounts computed by applying the statutory Federal income tax rate to income before income tax expense for the Company's continuing operations are as follows:

	Years Ended December 31,		
	2015	2014	2013
Computed Federal tax expense at statutory rate	\$ 75,863	\$ 83,686	\$ 78,436
Decrease in Federal tax expense related to an income tax accounting change for qualifying utility asset improvement costs	(59,488)	(57,015)	(57,467)
State income taxes, net of Federal tax benefit	(202)	(640)	1,338
Increase in tax expense for depreciation expense to be recovered in future rates	199	317	295
Stock-based compensation	(174)	(168)	(421)
Deduction for Aqua America common dividends paid under employee benefit plan	(456)	(350)	(414)
Amortization of deferred investment tax credits	(421)	(416)	(420)
Other, net	(359)	(195)	(114)
Actual income tax expense	\$ 14,962	\$ 25,219	\$ 21,233

In December 2012, the Company changed its tax method of accounting for qualifying utility system repairs in Aqua Pennsylvania effective with the tax year ended December 31, 2012 and for prior tax years. The tax accounting method was changed to permit the expensing of qualifying utility asset improvement costs that were previously being capitalized and depreciated for book and tax purposes. This change was implemented in response to a June 2012 rate order issued by the Pennsylvania Public Utility Commission to Aqua Pennsylvania which provides for a reduction in current income tax expense as a result of the recognition of some income tax benefits resulting from the income tax accounting change. In 2013, the Company recorded \$60,555 of income tax benefits, which includes \$14,908 of income tax benefits recognized based on final filing positions used in the 2012 tax return. In 2014, the Company

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recorded \$69,048 of income tax benefits. In 2015, the Company recorded \$72,944 of income tax benefits. The Company recognized a tax deduction on its 2012 Federal tax return of \$380,000 for qualifying capital expenditures made prior to 2012, and based on the rate order, in 2013, the Company began to amortize 1/10th of these expenditures. In accordance with the rate order, the amortization is expected to reduce current income tax expense during periods when qualifying parameters are met. Beginning in 2013, the Company amortized the qualifying capital expenditures made prior to 2012 and recognized \$38,000, annually, of deferred income tax benefits, which reduced current income tax expense and increased the Company's net income by \$16,734. The Company's effective income tax rate for 2015, 2014, and 2013, for its continuing operations, was 6.9%, 10.5%, and 9.5%, respectively.

In September 2013, the Department of Treasury and the Internal Revenue Service issued "Guidance Regarding Deduction and Capitalization of Expenditures Related to Tangible Property" which contains standards for determining whether and when a taxpayer must capitalize costs incurred in acquiring, maintaining or improving tangible property. These regulations were effective for the Company's 2014 fiscal year, and the adoption of these regulations did not have a material impact on the Company's consolidated results of operations or consolidated financial position.

The Company establishes reserves for uncertain tax positions based upon management's judgment as to the sustainability of these positions. These accounting estimates related to the uncertain tax position reserve require judgments to be made as to the sustainability of each uncertain tax position based on its technical merits. The Company believes its tax positions comply with applicable law and that it has adequately recorded reserves as required. However, to the extent the final tax outcome of these matters is different than the estimates recorded, the Company would then adjust its tax reserves or unrecognized tax benefits in the period that this information becomes known. The Company has elected to recognize accrued interest and penalties related to uncertain tax positions as income tax expense.

The following table provides the changes in the Company's unrecognized tax benefits:

	2015	2014
Balance at January 1,	\$ 25,292	\$ 28,690
Additions based on tax position related to the current year	2,724	1,077
Reductions based on tax position related to prior years	-	(4,475)
Balance at December 31,	<u>\$ 28,016</u>	<u>\$ 25,292</u>

The unrecognized tax benefits relate to the income tax accounting change, and the tax position is attributable to a temporary difference. The Company does not anticipate material changes to its unrecognized tax benefits within the next year. As a result of the regulatory treatment afforded by the income tax accounting change in Pennsylvania and despite this position being a temporary difference, as of December 31, 2015 and 2014, \$17,777 and \$12,567, respectively, of these tax benefits would have an impact on the Company's effective income tax rate in the event the Company does sustain all, or a portion, of its tax position.

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The following table provides the components of the net deferred tax liability from continuing operations:

	December 31,	
	2015	2014
Deferred tax assets:		
Customers' advances for construction	\$ 27,675	\$ 27,130
Costs expensed for book not deducted for tax, principally accrued expenses	15,612	14,279
Utility plant acquisition adjustment basis differences	3,489	12,314
Post-retirement benefits	36,362	34,653
Tax loss carryforward	93,263	112,719
Other	1,102	1,528
	<u>177,503</u>	<u>202,623</u>
Less valuation allowance	<u>10,982</u>	<u>6,578</u>
	<u>166,521</u>	<u>196,045</u>
Deferred tax liabilities:		
Utility plant, principally due to depreciation and differences in the basis of fixed assets due to variation in tax and book accounting	1,027,406	966,596
Deferred taxes associated with the gross-up of revenues necessary to recover, in rates, the effect of temporary differences	214,861	161,479
Tax effect of regulatory asset for post-retirement benefits	36,362	34,653
Deferred investment tax credit	6,815	7,259
	<u>1,285,444</u>	<u>1,169,987</u>
Net deferred tax liability	<u>\$ 1,118,923</u>	<u>\$ 973,942</u>

At December 31, 2015, the Company has a cumulative Federal net operating loss ("NOL") of \$158,276. The Company believes the Federal NOLs are more likely than not to be recovered and require no valuation allowance. The Company's Federal NOLs do not begin to expire until 2031.

In 2012 and 2011, as a result of the Company's Federal cumulative NOLs the Company ceased recognizing the windfall tax benefit associated with stock-based compensation, because the deduction did not reduce income taxes payable. As of December 31, 2015, the Company utilized all of the 2011 NOL and recognized a windfall tax benefit of \$1,680. Upon realization of the Company's 2012 Federal NOLs, the Company will recognize a windfall tax benefit of \$2,805.

At December 31, 2015 the Company has a cumulative state NOL of \$548,671, a portion of which is offset by a valuation allowance because the Company does not believe these NOLs are more likely than not to be realized. The state NOLs do not begin to expire until 2023.

The Company has unrecognized tax positions that result in the associated tax benefit being unrecognized. The Company's Federal and state NOL carryforwards are reduced by an unrecognized tax position, on a gross basis, of \$62,975 and \$88,904, respectively, which results from the Company's adoption in 2013 of the FASB's accounting guidance on the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amounts of the Company's Federal and state NOL carryforwards prior to being reduced by the unrecognized tax positions are \$221,070 and \$637,575, respectively. The Company records its unrecognized tax benefit as a reduction to its deferred income tax liability.

As of December 31, 2015, the Company's Federal income tax returns for all years through 2011 have been closed. Tax years 2012 through 2015 remain open to Federal examination. The statute remains open for the Company's state income tax returns for tax years 2012 through 2015 in the various states in which the Company's conducts business.

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Note 8 – Taxes Other than Income Taxes

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

	Years Ended December 31,		
	2015	2014	2013
Property	\$ 26,545	\$ 24,133	\$ 25,341
Capital Stock	1,644	1,315	2,127
Gross receipts, excise and franchise	10,362	10,945	11,775
Payroll	9,539	7,583	7,395
Regulatory assessments	2,689	2,538	2,462
Other	4,278	3,939	3,585
Total taxes other than income	\$ 55,057	\$ 50,453	\$ 52,685

Note 9 – Commitments and Contingencies

The following disclosures reflect commitments and contingencies for the Company's continuing operations.

Commitments – The Company leases motor vehicles, buildings and other equipment under operating leases that are noncancelable. The future annual minimum lease payments due are as follows:

2016	2017	2018	2019	2020	Thereafter
\$ 1,138	\$ 714	\$ 493	\$ 404	\$ 315	\$ 301

The Company leases parcels of land on which treatment plants and other facilities are situated and adjacent parcels that are used for watershed protection. The operating leases are noncancelable, expire between 2016 and 2052 and contain renewal provisions. Some leases are subject to an adjustment every five years based on changes in the Consumer Price Index. Subject to the aforesaid adjustment, during each of the next five years, an average of \$587 of annual lease payments for land is due, and the aggregate of the years remaining approximates \$13,663.

The Company maintains agreements with other water purveyors for the purchase of water to supplement its water supply, particularly during periods of peak demand. The agreements stipulate purchases of minimum quantities of water to the year 2026. The estimated annual commitments related to such purchases through 2020 are expected to average \$7,352 and the aggregate of the years remaining approximates \$19,138.

The Company has entered into purchase obligations, in the ordinary course of business, that include agreements for water treatment processes at some of its wells in a small number of its divisions. The 20 year term agreement provides for the use of treatment equipment and media used in the treatment process and are subject to adjustment based on changes in the Consumer Price Index. The future contractual cash obligation related to these agreements are as follows:

2016	2017	2018	2019	2020	Thereafter
\$ 1,100	\$ 1,100	\$ 1,100	\$ 1,100	\$ 1,100	\$ 8,410

Rent expense under operating leases, purchased water expense, and water treatment expenses under these agreements were as follows:

	Years Ended December 31,		
	2015	2014	2013
Operating lease expense	\$ 2,440	\$ 2,820	\$ 3,375
Purchased water under long-term agreements	13,718	13,139	12,923
Water treatment expense under contractual agreement	972	892	926

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Contingencies – The Company is routinely involved in various disputes, claims, lawsuits and other regulatory and legal matters, including both asserted and unasserted legal claims, in the ordinary course of business. The status of each such matter, referred to herein as a loss contingency, is reviewed and assessed in accordance with applicable accounting rules regarding the nature of the matter, the likelihood that a loss will be incurred, and the amounts involved. As of December 31, 2015, the aggregate amount of \$13,570 is accrued for loss contingencies and is reported in the Company's consolidated balance sheet as other accrued liabilities and other liabilities. These accruals represent management's best estimate of probable loss (as defined in the accounting guidance) for loss contingencies or the low end of a range of losses if no single probable loss can be estimated. For some loss contingencies, the Company is unable to estimate the amount of the probable loss or range of probable losses. While the final outcome of these loss contingencies cannot be predicted with certainty, and unfavorable outcomes could negatively impact the Company, at this time in the opinion of management, the final resolution of these matters are not expected to have a material adverse effect on the Company's financial position, results of operations or cash flows. Further, Aqua America has insurance coverage for a number of these loss contingencies, and as of December 31, 2015, estimates that approximately \$1,013 of the amount accrued for these matters are probable of recovery through insurance, which amount is also reported in the Company's consolidated balance sheet as deferred charges and other assets, net.

Although the results of legal proceedings cannot be predicted with certainty, there are no pending legal proceedings to which the Company or any of its subsidiaries is a party or to which any of its properties is the subject that are material or are expected to have a material effect on the Company's financial position, results of operations or cash flows.

Additionally, the Company self-insures its employee medical benefit program, and maintains stop-loss coverage to limit the exposure arising from these claims. The Company's reserve for these claims totaled \$1,496 and \$1,468 at December 31, 2015 and 2014 and represents a reserve for unpaid claim costs, including an estimate for the cost of incurred but not reported claims.

Note 10 – Long-term Debt and Loans Payable

Long-term Debt – The consolidated statements of capitalization provide a summary of long-term debt as of December 31, 2015 and 2014. The supplemental indentures with respect to specific issues of the first mortgage bonds restrict the ability of Aqua Pennsylvania and other operating subsidiaries of the Company to declare dividends, in cash or property, or repurchase or otherwise acquire the stock of these companies. Loan agreements for Aqua Pennsylvania and other operating subsidiaries of the Company have restrictions on minimum net assets. As of December 31, 2015, restrictions on the net assets of the Company were \$1,240,826 of the total \$1,725,930 in net assets. Included in this amount were restrictions on Aqua Pennsylvania's net assets of \$929,319 of their total net assets of \$1,308,793. As of December 31, 2015, approximately \$1,121,206 of Aqua Pennsylvania's retained earnings of approximately \$1,141,206 and approximately \$103,800 of the retained earnings of approximately \$155,000 of other subsidiaries were free of these restrictions. Some supplemental indentures also prohibit Aqua Pennsylvania and some other subsidiaries of the Company from making loans to, or purchasing the stock of, the Company.

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Notes to Consolidated Financial Statements (continued)

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Sinking fund payments are required by the terms of specific issues of long-term debt. Excluding amounts due under the Company's revolving credit agreement, the future sinking fund payments and debt maturities of the Company's long-term debt are as follows:

Interest Rate Range	2016	2017	2018	2019	2020	Thereafter
0.00% to 0.99%	\$ 491	\$ 60,489	\$ 488	\$ 491	\$ 487	\$ 2,702
1.00% to 1.99%	1,736	51,584	51,611	1,506	1,457	12,917
2.00% to 2.99%	1,492	1,529	1,571	1,614	1,658	11,303
3.00% to 3.99%	2,500	2,584	2,674	2,621	2,413	404,483
4.00% to 4.99%	11,091	11,100	11,110	50,325	16,536	531,331
5.00% to 5.99%	16,818	25,055	10,716	31,250	23,245	283,899
6.00% to 6.99%	-	9,000	12,964	-	-	31,000
7.00% to 7.99%	408	484	523	566	613	31,168
8.00% to 8.99%	357	482	521	563	610	11,969
9.00% to 9.99%	700	700	5,700	700	2,400	16,900
10.00% to 10.99%	-	-	6,000	-	-	-
Total	\$ 35,593	\$ 163,007	\$ 103,878	\$ 89,636	\$ 49,419	\$ 1,337,672

In December 2015, Aqua Pennsylvania issued \$210,000 of first mortgage bonds, of which \$65,000 is due in 2036, \$20,000 is due in 2037, \$25,000 is due in 2038, \$60,000 is due in 2046, \$20,000 is due in 2047, and \$20,000 is due in 2048 with interest rates of 3.77%, 3.82%, 3.85%, 4.16%, 4.18%, and 4.20%, respectively. The proceeds from these bonds were used to repay existing indebtedness and for general corporate purposes.

In October 2015, Aqua Pennsylvania provided notice for the early redemption of \$4,000 of first mortgage bonds at 8.14% that were originally maturing in 2025 and \$95,985 of tax-exempt bonds at 5.00% that were originally maturing between 2035 and 2038. Upon early redemption in December 2015 of the tax-exempt bonds, a gain of \$678 was recognized resulting from the recognition of the unamortized issuance premium.

In May 2015, the Company issued \$70,000 of senior unsecured notes due in 2030 with an interest rate of 3.59%. The proceeds were used to repay existing indebtedness and for general corporate purposes.

In May 2015, Aqua Pennsylvania entered into a \$50,000 three-year unsecured loan at an interest rate of 1.975%. The proceeds from this loan were used for refinancing existing indebtedness and general working capital purposes.

In December 2014, Aqua Pennsylvania issued \$65,000 of first mortgage bonds, of which \$25,000 is due in 2035, \$15,000 is due in 2040, \$13,000 is due in 2045, and \$12,000 is due in 2054 with interest rates of 3.64%, 4.01%, 4.06%, and 4.11%, respectively. The proceeds from these bonds were used to repay existing indebtedness and for general corporate purposes.

In September 2014, Aqua Pennsylvania entered into a \$50,000 three year unsecured loan at an interest rate of 1.92%. The proceeds from this loan were used for refinancing existing indebtedness and general working capital purposes including financing acquisitions.

As of December 31, 2015, the Company did not have any funds restricted for construction activity.

The weighted average cost of long-term debt at December 31, 2015 and 2014 was 4.44% and 4.65%, respectively. The weighted average cost of fixed rate long-term debt at December 31, 2015 and 2014 was 4.57% and 4.85%, respectively.

The Company has a five-year \$200,000 unsecured revolving credit facility with three banks that expires in March 2017. Included within this facility is a \$15,000 sublimit for daily demand loans. Funds borrowed under this facility are classified as long-term debt and are used to provide working capital as well as support for letters of credit for insurance policies and other financing arrangements. As of December 31, 2015, the Company has the following sublimits and available capacity under the credit facility: \$50,000 letter of credit sublimit, \$26,640 of letters of credit available capacity, \$0 borrowed under the swing-line commitment, and \$60,000 of funds borrowed under the agreement. Interest under this facility is based at the Company's option, on the prime rate, an adjusted Euro-Rate, an adjusted federal funds rate or at rates offered by the banks. A facility fee is charged on the total commitment amount

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of the agreement. Under this facility the average cost of borrowings was 0.87% and 0.78%, and the average borrowing was \$82,880 and \$67,916, during 2015 and 2014, respectively. On February 24, 2016, the Company amended its unsecured revolving credit facility to extend the expiration from March 2017 to February 2021, to increase the facility from \$200,000 to \$250,000, and added a fourth bank to the lending group.

The Company is obligated to comply with covenants under some of its loan and debt agreements. These covenants contain a number of restrictive financial covenants, which among other things limit, subject to specific exceptions, the Company's ratio of consolidated total indebtedness to consolidated total capitalization, and require a minimum level of earnings coverage over interest expense. During 2015, the Company was in compliance with its debt covenants under its credit facilities. Failure to comply with the Company's debt covenants could result in an event of default, which could result in the Company being required to repay or finance its borrowings before their due date, possibly limiting the Company's future borrowings, and increasing its borrowing costs.

Loans Payable – In November 2015, Aqua Pennsylvania renewed its \$100,000 364-day unsecured revolving credit facility with four banks. The funds borrowed under this agreement are classified as loans payable and used to provide working capital. As of December 31, 2015 and 2014, funds borrowed under the agreement were \$7,281 and \$13,658, respectively. Interest under this facility is based, at the borrower's option, on the prime rate, an adjusted federal funds rate, an adjusted London Interbank Offered Rate corresponding to the interest period selected, an adjusted Euro-Rate corresponding to the interest period selected or at rates offered by the banks. This agreement restricts short-term borrowings of Aqua Pennsylvania. A commitment fee of 0.05% is charged on the total commitment amount of Aqua Pennsylvania's revolving credit agreement. The average cost of borrowing under the facility was 0.86% and 0.81%, and the average borrowing was \$25,486 and \$24,072, during 2015 and 2014, respectively. The maximum amount outstanding at the end of any one month was \$40,000 and \$36,943 in 2015 and 2014, respectively.

At December 31, 2015 and 2014, the Company had other combined short-term lines of credit of \$35,500 and \$60,500, respectively. Funds borrowed under these lines are classified as loans payable and are used to provide working capital. As of December 31, 2015 and 2014, funds borrowed under the short-term lines of credit were \$9,440 and \$4,740, respectively. The average borrowing under the lines was \$5,132 and \$5,657 during 2015 and 2014, respectively. The maximum amount outstanding at the end of any one month was \$9,440 and \$13,740 in 2015 and 2014, respectively. Interest under the lines is based at the Company's option, depending on the line, on the prime rate, an adjusted Euro-Rate, an adjusted federal funds rate or at rates offered by the banks. The average cost of borrowings under all lines during 2015 and 2014 was 0.99% and 1.00%, respectively.

Interest Income and Expense – Interest income of \$272, \$316, and \$438 was netted against interest expense on the consolidated statement of net income for the years ended December 31, 2015, 2014, and 2013, respectively. The total interest cost was \$76,808, \$76,713, and \$77,754 in 2015, 2014, and 2013, including amounts capitalized of \$6,219, \$5,134, and \$2,275, respectively.

Note 11 – Fair Value of Financial Instruments

Financial instruments are recorded at carrying value in the financial statements and approximate fair value as of the dates presented. The fair value of these instruments is disclosed below in accordance with current accounting guidance related to financial instruments.

The fair value of funds restricted for construction activity and loans payable are determined based on their carrying amount and utilizing level 1 methods and assumptions. As of December 31, 2015, the Company did not have any funds restricted for construction activity and as of December 31, 2014, the carrying amount of the Company's funds restricted for construction activity was \$47, which equates to its estimated fair value. As of December 31, 2015 and 2014, the carrying amount of the Company's loans payable was \$16,721 and \$18,398, respectively, which equates to their estimated fair value. The fair value of cash and cash equivalents, which is comprised of a money market fund, is determined based on the net asset value per unit utilizing level 2 methods and assumptions. As of December 31, 2015 and 2014, the carrying amounts of the Company's cash and cash equivalents were \$3,229 and \$4,138, which equates to their fair value.

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The carrying amounts and estimated fair values of the Company's long-term debt is as follows:

	December 31,	
	2015	2014
Carrying amount	\$ 1,779,205	\$ 1,619,270
Estimated fair value	1,905,393	1,694,424

The fair value of long-term debt has been determined by discounting the future cash flows using current market interest rates for similar financial instruments of the same duration utilizing level 2 methods and assumptions. The Company's customers' advances for construction have a carrying value of \$86,934 and \$78,301 at December 31, 2015 and 2014, respectively. Their relative fair values cannot be accurately estimated because future refund payments depend on several variables, including new customer connections, customer consumption levels and future rate increases. Portions of these non-interest bearing instruments are payable annually through 2025 and amounts not paid by the contract expiration dates become non-refundable. The fair value of these amounts would, however, be less than their carrying value due to the non-interest bearing feature.

Note 12 – Stockholders' Equity

At December 31, 2015, the Company had 300,000,000 shares of common stock authorized; par value \$0.50. Shares outstanding and treasury shares held were as follows:

	December 31,		
	2015	2014	2013
Shares outstanding	176,544,091	176,753,270	176,750,599
Treasury shares	2,819,569	1,837,984	1,178,323

At December 31, 2015, the Company had 1,770,819 shares of authorized but unissued Series Preferred Stock, \$1.00 par value.

In February 2015, the Company filed a universal shelf registration statement with the Securities and Exchange Commission ("SEC") to allow for the potential future sale by the Company, from time to time, in one or more public offerings, of an indeterminate amount of our common stock, preferred stock, debt securities and other securities specified therein at indeterminate prices.

In February 2015, the Company filed a registration statement with the SEC which permits the offering, from time to time, of an aggregate of \$500,000 in shares of common stock and shares of preferred stock in connection with acquisitions. The form and terms of any securities issued under these universal shelf registration statement and the acquisition shelf registration statement will be determined at the time of issuance.

The Company has a Dividend Reinvestment and Direct Stock Purchase Plan ("Plan") that allows reinvested dividends to be used to purchase shares of common stock at a five percent discount from the current market value. Under the direct stock purchase program, shares are purchased by investors at market price. The shares issued under the Plan are either shares purchased by the Company's transfer agent in the open-market or original issue shares. In 2015, 2014, and 2013, 535,439, 558,317, and 154,900 shares of the Company were purchased under the dividend reinvestment portion of the Plan by the Company's transfer agent in the open-market for \$14,380, \$14,148, and \$3,693, respectively. During 2015 and 2013, under the dividend reinvestment portion of the Plan, 26,295 and 432,894 original issue shares of common stock were sold, providing the Company with proceeds of \$677 and \$10,107, respectively. During 2014, to minimize share dilution, the Company did not sell original issue shares of common stock under the Plan.

In October 2013, the Company's Board of Directors approved a resolution authorizing the Company to purchase, from time to time, up to 685,348 shares of its common stock in the open market or through privately negotiated transactions. This authorization renewed the number of shares that had remained, when affected for stock splits, from an existing share buy-back authorization from 1997. The specific timing, amount and other terms of

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repurchases will depend on market conditions, regulatory requirements and other factors. In 2014, we repurchased 560,000 shares of our common stock in the open market for \$13,280. In December 2014, the Company's Board of Directors authorized a share buyback program, commencing in 2015, of up to 1,000,000 shares to minimize share dilution through timely and orderly share repurchases. In December 2015, the Company's Board of Directors added 400,000 shares to this program. In 2015, we repurchased 805,000 shares of the Company's common stock in the open market for \$20,502. As of December 31, 2015, an aggregate of 720,348 shares remain available for repurchase.

The Company's accumulated other comprehensive income is reported in the stockholders' equity section of the consolidated balance sheets, the consolidated statements of equity, and the related components of other comprehensive income are reported in the consolidated statements of comprehensive income. The Company reports its unrealized gains or losses on investments as other comprehensive income and accumulated other comprehensive income. The Company recorded a regulatory asset for its underfunded status of its pension and other post-retirement benefit plans that would otherwise be charged to other comprehensive income, as it anticipates recovery of its costs through customer rates.

Note 13 – Net Income per Common Share and Equity per Common Share

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

	Years ended December 31,		
	2015	2014	2013
Average common shares outstanding during the period for basic computation	176,788	176,864	176,140
Effect of dilutive securities:			
Employee stock-based compensation	729	899	674
Average common shares outstanding during the period for diluted computation	177,517	177,763	176,814

For the years ended December 31, 2015, 2014 and 2013, all of the Company's employee stock options were included in the calculation of diluted net income per share as the calculated cost to exercise the stock options was less than the average market price of the Company's common stock during these periods.

Equity per common share was \$9.78 and \$9.37 at December 31, 2015 and 2014, respectively. These amounts were computed by dividing Aqua America stockholders' equity by the number of shares of common stock outstanding at the end of each year.

Note 14 – Employee Stock and Incentive Plan

Under the Company's 2009 Omnibus Equity Compensation Plan, as amended as of February 27, 2014 (the "2009 Plan"), as approved by the Company's shareholders to replace the 2004 Equity Compensation Plan (the "2004 Plan"), stock options, stock units, stock awards, stock appreciation rights, dividend equivalents, and other stock-based awards may be granted to employees, non-employee directors, and consultants and advisors. The 2009 Plan authorizes 6,250,000 shares for issuance under the plan. A maximum of 3,125,000 shares under the 2009 Plan may be issued pursuant to stock award, stock units and other stock-based awards, subject to adjustment as provided in the 2009 Plan. During any calendar year, no individual may be granted (i) stock options and stock appreciation rights under the 2009 Plan for more than 500,000 shares of common stock in the aggregate or (ii) stock awards, stock units or other stock-based awards under the 2009 Plan for more than 500,000 shares of Company stock in the aggregate, subject to adjustment as provided in the 2009 Plan. Awards to employees and consultants under the 2009 Plan are made by a committee of the Board of Directors, except that with respect to awards to the Chief Executive Officer, the committee recommends those awards for approval by the non-employee directors of the Board of Directors. In the case of awards to non-employee directors, the Board of Directors makes such awards. At December 31, 2015,

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4,212,079 shares underlying stock-based compensation awards were still available for grant under the 2009 Plan. No further grants may be made under the 2004 plan.

The recording of compensation expense for share-based compensation has no impact on net cash flows and results in the reclassification on the consolidated cash flow statements of related tax benefits from cash flows from operating activities to cash flows from financing activities to the extent these tax benefits exceed the associated compensation cost.

Performance Share Units – During 2015, 2014, and 2013, the Company granted performance share units. A performance share unit (“PSU”) represents the right to receive a share of the Company’s common stock if specified performance goals are met over the three year performance period specified in the grant, subject to exceptions through the respective vesting periods, generally three years. Each grantee is granted a target award of PSUs, and may earn between 0% and 200% of the target amount depending on the Company’s performance against the performance goals, which consist of the following metrics for the 2015, 2014, and 2013 grants: 30% of the PSUs will be earned based on the Company’s TSR compared to the TSR for a specific peer group of investor-owned water companies (a market-based condition), 30% of the PSUs will be earned based on the Company’s TSR compared to the TSR for the companies listed in the Standard and Poor’s Midcap Utilities Index (a market-based condition), 20% of the PSUs will be earned based on maintaining an average ratio of operations and maintenance expenses as a percentage of revenues at Aqua Pennsylvania compared to a target average ratio for the three year performance period (a performance-based condition), and 20% of the PSUs will be earned based on earning a cumulative total earnings before taxes for the Company operations other than Aqua Pennsylvania for the three year performance period compared to a target (a performance-based condition).

The following table provides compensation costs for PSUs:

	Years ended December 31,		
	2015	2014	2013
Stock-based compensation within operations and maintenance expense	\$ 4,419	\$ 4,996	\$ 3,437
Income tax benefit	1,796	2,044	1,400

The following table summarizes nonvested PSU transactions for the year ended December 31, 2015:

	Number of Share Units	Weighted Average Fair Value
Nonvested share units at beginning of period	582,644	\$ 22.98
Granted	142,212	26.46
Performance criteria adjustment	17,717	25.59
Forfeited	(14,276)	25.92
Share units vested	(86,425)	26.25
Share units issued	(217,014)	18.49
Nonvested share units at end of period	424,858	\$ 25.78

A portion of the fair value of PSUs was estimated at the grant date based on the probability of satisfying the market-based conditions associated with the PSUs using the Monte Carlo valuation method, which assesses the probabilities of various outcomes of market conditions. The other portion of the fair value of the PSUs associated with performance-based conditions was based on the fair market value of the Company’s stock at the grant date, regardless of whether the market-based condition is satisfied. The fair value of each PSU grant is amortized into compensation expense on a straight-line basis over their respective vesting periods, generally 36 months. The accrual of compensation costs is based on an estimate of the final expected value of the award, and is adjusted as required for

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the portion based on the performance-based condition. The Company assumes that forfeitures will be minimal, and recognizes forfeitures as they occur, which results in a reduction in compensation expense. As the payout of the PSUs includes dividend equivalents, no separate dividend yield assumption is required in calculating the fair value of the PSUs. The recording of compensation expense for PSUs has no impact on net cash flows. The following table provides the assumptions used in the pricing model for the grant, the resulting grant date fair value of PSUs, and the intrinsic value and fair value of PSUs that vested during the year:

	Years ended December 31,		
	2015	2014	2013
Expected term (years)	3.0	3.0	3.0
Risk-free interest rate	1.03%	0.68%	0.36%
Expected volatility	16.9%	19.8%	20.0%
Weighted average fair value of PSUs granted	\$ 26.46	\$ 25.31	\$ 26.88
Intrinsic value of vested PSUs	\$ 7,964	\$ 4,327	\$ 415
Fair value of vested PSUs	\$ 6,416	\$ 3,297	\$ 351

As of December 31, 2015, \$4,098 of unrecognized compensation costs related to PSUs is expected to be recognized over a weighted average period of approximately 1.7 years. The aggregate intrinsic value of PSUs as of December 31, 2015 was \$15,236. The aggregate intrinsic value of PSUs is based on the number of nonvested share units and the market value of the Company's common stock as of the period end date.

Restricted Stock Units – A restricted stock unit (“RSU”) represents the right to receive a share of the Company's common stock and is valued based on the fair market value of the Company's stock on the date of grant. RSUs are eligible to be earned at the end of a specified restricted period, generally three years, beginning on the date of grant. In some cases, the right to receive the shares is subject to specific performance goals established at the time the grant is made. The Company assumes that forfeitures will be minimal, and recognizes forfeitures as they occur, which results in a reduction in compensation expense. As the payout of the RSUs includes dividend equivalents, no separate dividend yield assumption is required in calculating the fair value of the RSUs. The following table provides compensation costs for RSUs:

	Years ended December 31,		
	2015	2014	2013
Stock-based compensation within operations and maintenance expense	\$ 1,076	\$ 1,122	\$ 813
Income tax benefit	444	464	336

The following table summarizes nonvested RSU transactions for the year ended December 31, 2015:

	Number of Stock Units	Weighted Average Fair Value
Nonvested stock units at beginning of period	122,565	\$ 22.29
Granted	47,285	26.00
Stock units vested in prior period and issued in current period	11,500	17.99
Stock units vested and issued	(90,588)	21.02
Forfeited	(2,409)	24.94
Nonvested stock units at end of period	88,353	\$ 24.94

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The following table summarizes the value of RSUs:

	Years ended December 31,		
	2015	2014	2013
Weighted average fair value of RSUs granted	\$ 26.00	\$ 24.80	\$ 23.28
Intrinsic value of vested RSUs	2,327	759	449
Fair value of vested RSUs	1,904	544	348

As of December 31, 2015, \$1,046 of unrecognized compensation costs related to RSUs is expected to be recognized over a weighted average period of approximately 1.9 years. The aggregate intrinsic value of RSUs as of December 31, 2015 was \$2,633. The aggregate intrinsic value of RSUs is based on the number of nonvested stock units and the market value of the Company's common stock as of the period end date.

Stock Options – The following table provides compensation costs for stock options:

	Years ended December 31,		
	2015	2014	2013
Stock-based compensation within operations and maintenance expense	\$ -	\$ -	\$ 30
Income tax benefit	193	189	461

There were no stock options granted during the years ended December 31, 2015, 2014, and 2013.

Options under the plans were issued at the closing market price of the stock on the day of the grant. Options are exercisable in installments of 33% annually, starting one year from the date of the grant and expire 10 years from the date of the grant. The fair value of options was estimated at the grant date using the Black-Scholes option-pricing model, which relies on assumptions that require management's judgment.

The following table summarizes stock option transactions for the year ended December 31, 2015:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Life (years)	Aggregate Intrinsic Value
Outstanding, beginning of year	1,084,992	\$ 17.06		
Forfeited	-	-		
Expired / Cancelled	(750)	13.72		
Exercised	(424,709)	17.75		
Outstanding and exercisable at end of year	659,533	\$ 16.62	2.5	\$ 8,692

The intrinsic value of stock options is the amount by which the market price of the stock on a given date, such as at the end of the period or on the day of exercise, exceeded the closing market price of stock on the date of grant. The following table summarizes the aggregate intrinsic value of stock options exercised and the fair value of stock options which became vested:

	Years ended December 31,		
	2015	2014	2013
Intrinsic value of options exercised	\$ 4,154	\$ 4,054	\$ 12,658
Fair value of options vested	-	-	500

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The following table summarizes information about the options outstanding and options exercisable as of December 31, 2015:

Options Outstanding and Exercisable			
	Shares	Weighted Average Remaining Life (years)	Weighted Average Exercise Price
Range of prices:			
\$13.00 - 14.99	160,722	4.1	\$ 13.72
\$15.00 - 15.99	165,615	3.2	15.30
\$16.00 - 16.99	144,654	2.2	16.15
\$17.00 - 19.99	112,297	1.2	18.61
\$20.00 - 23.99	76,245	0.2	23.57
	659,533	2.5	\$ 16.62

As of December 31, 2015, there were no unrecognized compensation costs related to nonvested stock options granted under the plans.

Restricted Stock – Restricted stock awards provide the grantee with the rights of a shareholder, including the right to receive dividends and to vote such shares, but not the right to sell or otherwise transfer the shares during the restriction period. Restricted stock awards result in compensation expense which is equal to the fair market value of the stock on the date of the grant and is amortized ratably over the restriction period. The Company expects forfeitures of restricted stock to be de minimis.

The following table provides compensation costs for restricted stock:

	Years ended December 31,		
	2015	2014	2013
Stock-based compensation within operations and maintenance expense	\$ -	\$ 691	\$ 770
Income tax benefit	-	287	320

The following table summarizes the value of restricted stock awards:

	Years ended December 31,		
	2015	2014	2013
Intrinsic value of restricted stock awards vested	\$ 860	\$ 1,097	\$ 2,236
Fair value of restricted stock awards vested	553	906	1,560
Weighted average fair value of restricted stock awards granted	-	25.19	25.09

As of December 31, 2015, there were no unrecognized compensation costs related to nonvested restricted stock as restricted stock was fully amortized in 2014. Additionally, there was no restricted stock granted during the year ended December 31, 2015.

Stock Awards – On June 3, 2015, the Company granted an aggregate of 13,800 shares of common stock to the non-employee members of the Board of Directors continuing in office. The fair market value of the shares is \$26.44 per share. The shares granted are not subject to any restrictions. In 2015, the Company recognized \$365 of compensation expense and an income tax benefit of \$151 associated with these grants.

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Note 15 – Pension Plans and Other Post-retirement Benefits

The Company maintains a qualified, defined benefit pension plan that covers its full-time employees who were hired prior to April 1, 2003. Retirement benefits under the plan are generally based on the employee's total years of service and compensation during the last five years of employment. The Company's policy is to fund the plan annually at a level which is deductible for income tax purposes and which provides assets sufficient to meet its pension obligations over time. To offset some limitations imposed by the Internal Revenue Code with respect to payments under qualified plans, the Company has a non-qualified Supplemental Pension Benefit Plan for Salaried Employees in order to prevent some employees from being penalized by these limitations, and to provide certain retirement benefits based on employee's years of service and compensation. The Company also has non-qualified Supplemental Executive Retirement Plans for some current and retired employees. The net pension costs and obligations of the qualified and non-qualified plans are included in the tables which follow. Employees hired after April 1, 2003 may participate in a defined contribution plan that provides a Company matching contribution on amounts contributed by participants and an annual profit-sharing contribution based upon a percentage of the eligible participants' compensation.

In August 2014, the Company announced changes to the way it will provide future retirement benefits to employees acquired through a prior acquisition. Effective January 1, 2015, the Company began providing future retirement benefits for these employees through its defined contribution plan. As a result, no further service will be considered in future accruals in the qualified defined benefit pension plan after December 31, 2014, and as a result of this change, the Company recognized a curtailment loss of \$84 in 2014.

In the first quarter of 2014, the Company offered a one-time voluntary lump sum window to certain eligible terminated vested participants in an effort to reduce its long-term obligations and plan volatility for its qualified defined benefit pension plan. In May 2014, the plan paid \$11,471 to participants who elected to receive a lump sum distribution, which was funded from existing plan assets. These payments are reported as a portion of benefits paid for 2014 in the table presenting the change in benefit obligation for pension benefits. Effective July 1, 2015, the Company added a permanent lump sum option to the form of benefit payments offered to participants of the qualified defined benefit pension plan upon retirement or termination. The plan paid \$5,329 during the second half of 2015 to participants who elected this option.

In addition to providing pension benefits, the Company offers post-retirement benefits other than pensions to employees hired before April 1, 2003 and retiring with a minimum level of service. These benefits include continuation of medical and prescription drug benefits, or a cash contribution toward such benefits, for eligible retirees and life insurance benefits for eligible retirees. The Company funds these benefits through various trust accounts. The benefits of retired officers and other eligible retirees are paid by the Company and not from plan assets due to limitations imposed by the Internal Revenue Code.

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(In thousands of dollars, except per share amounts)

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid in the years indicated:

	Pension Benefits		Other Post-retirement Benefits
Years:			
2016	\$ 27,402	\$	1,889
2017	20,034		2,200
2018	20,079		2,518
2019	19,937		2,783
2020	20,823		2,995
2021-2025	102,607		17,413

The changes in the benefit obligation and fair value of plan assets, the funded status of the plans and the assumptions used in the measurement of the company's benefit obligation are as follows:

	Pension Benefits		Other Post-retirement Benefits	
	2015	2014	2015	2014
Change in benefit obligation:				
Benefit obligation at January 1,	\$ 311,609	\$ 281,161	\$ 71,958	\$ 57,174
Service cost	3,349	4,295	1,224	1,161
Interest cost	12,955	14,153	2,802	2,903
Actuarial (gain) loss	(7,778)	43,250	(6,527)	11,769
Plan participants' contributions	-	-	204	217
Benefits paid	(17,118)	(22,600)	(1,270)	(1,311)
Plan amendments	3,220	-	(3,254)	45
Curtailment	-	(8,650)	-	-
Special termination benefits	302	-	-	-
Benefit obligation at December 31,	306,539	311,609	65,137	71,958
Change in plan assets:				
Fair value of plan assets at January 1,	244,897	232,347	43,326	40,840
Actual return on plan assets	(3,058)	17,148	(998)	3,175
Employer contributions	13,884	18,002	2,428	300
Benefits paid	(17,118)	(22,600)	(1,052)	(989)
Fair value of plan assets at December 31,	238,605	244,897	43,704	43,326
Funded status of plan:				
Net amount recognized at December 31,	\$ 67,934	\$ 66,712	\$ 21,433	\$ 28,632

The Company's pension plans had an accumulated benefit obligation of \$291,132 and \$293,364 at December 31, 2015 and 2014, respectively. The following table provides the net liability recognized on the consolidated balance sheets at December 31,:

	Pension Benefits		Other Post-retirement Benefits	
	2015	2014	2015	2014
Current liability	\$ 8,370	\$ 4,930	\$ -	\$ -
Noncurrent liability	59,564	61,782	21,433	28,632
Net liability recognized	\$ 67,934	\$ 66,712	\$ 21,433	\$ 28,632

AQUA AMERICA, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(In thousands of dollars, except per share amounts)

At December 31, 2015 and 2014, the Company's pension plans had benefit obligations in excess of its plan assets. The following tables provide the projected benefit obligation, the accumulated benefit obligation and fair market value of the plan assets as of December 31,:

Projected Benefit Obligation Exceeds the Fair Value of Plan Assets			
	2015		2014
Projected benefit obligation	\$ 306,539	\$	311,609
Fair value of plan assets	238,605		244,897

Accumulated Benefit Obligation Exceeds the Fair Value of Plan Assets			
	2015		2014
Accumulated benefit obligation	\$ 291,132	\$	293,364
Fair value of plan assets	238,605		244,897

The following table provides the components of net periodic benefit costs for the years ended December 31,:

	Pension Benefits			Other Post-retirement Benefits		
	2015	2014	2013	2015	2014	2013
Service cost	\$ 3,349	\$ 4,295	\$ 5,313	\$ 1,224	\$ 1,161	\$ 1,525
Interest cost	12,955	14,153	12,660	2,802	2,903	2,579
Expected return on plan assets	(18,702)	(17,601)	(14,770)	(2,923)	(2,742)	(2,268)
Amortization of prior service cost (credit)	174	277	228	(687)	(278)	(295)
Amortization of actuarial loss	5,993	2,256	8,169	1,282	260	1,479
Curtailment loss	-	84	-	-	-	-
Net periodic benefit cost	\$ 3,769	\$ 3,464	\$ 11,600	\$ 1,698	\$ 1,304	\$ 3,020

The Company records the underfunded status of its pension and other post-retirement benefit plans on its consolidated balance sheets and records a regulatory asset for these costs that would otherwise be charged to stockholders' equity, as the Company anticipates recoverability of the costs through customer rates. The Company's pension and other post-retirement benefit plans were underfunded at December 31, 2015 and 2014. Changes in the plans' funded status will affect the assets and liabilities recorded on the balance sheet. Due to the Company's regulatory treatment, the recognition of the funded status is recorded as a regulatory asset pursuant to the FASB's accounting guidance for regulated operations.

The following table provides the amounts recognized in regulatory assets that have not been recognized as components of net periodic benefit cost as of December 31,:

	Pension Benefits		Other Post-retirement Benefits	
	2015	2014	2015	2014
Net actuarial loss	\$ 87,930	\$ 79,639	\$ 14,469	\$ 18,356
Prior service cost (credit)	4,419	1,374	(2,926)	(359)
Total recognized in regulatory assets	\$ 92,349	\$ 81,013	\$ 11,543	\$ 17,997

The estimated net actuarial loss and prior service cost for the Company's pension plans that will be amortized in 2016 from the regulatory assets into net periodic benefit cost are \$6,917 and \$578, respectively. The estimated net actuarial

AQUA AMERICA, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(In thousands of dollars, except per share amounts)

loss and prior service credit for the Company's other post-retirement benefit plans that will be amortized in 2016 from regulatory assets into net periodic benefit cost are \$1,068 and \$549, respectively.

Accounting for pensions and other post-retirement benefits requires an extensive use of assumptions about the discount rate, expected return on plan assets, the rate of future compensation increases received by the Company's employees, mortality, turnover and medical costs. Each assumption is reviewed annually with assistance from the Company's actuarial consultant who provides guidance in establishing the assumptions. The assumptions are selected to represent the average expected experience over time and may differ in any one year from actual experience due to changes in capital markets and the overall economy. These differences will impact the amount of pension and other post-retirement benefit expense that the Company recognizes.

The significant assumptions related to the Company's benefit obligations are as follows:

	Pension Benefits		Other Post-retirement Benefits	
	2015	2014	2015	2014
Weighted Average Assumptions Used to Determine Benefit Obligations as of December 31,				
Discount rate	4.48%	4.20%	4.60%	4.17%
Rate of compensation increase	3.0-4.0%	3.0-4.0%	n/a	n/a

Assumed Health Care Cost Trend Rates Used to Determine Benefit Obligations as of December 31,

Health care cost trend rate	n/a	n/a	7.0%	7.0%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	n/a	n/a	5.0%	5.0%
Year that the rate reaches the ultimate trend rate	n/a	n/a	2021	2019

n/a - Assumption is not applicable.

The significant assumptions related to the Company's net periodic benefit costs are as follows:

	Pension Benefits			Other Post-retirement Benefits		
	2015	2014	2013	2015	2014	2013
Weighted Average Assumptions Used to Determine Net Periodic Benefit Costs for Years Ended December 31,						
Discount rate	4.20%	5.12%	4.17%	4.17%	5.12%	4.17%
Expected return on plan assets	7.50%	7.50%	7.50%	5.00-7.50%	5.00-7.50%	5.00-7.50%
Rate of compensation increase	3.0-4.0%	4.0-4.5%	4.0-4.5%	n/a	n/a	n/a

Assumed Health Care Cost Trend Rates Used to Determine Net Periodic Benefit Costs for Years Ended December 31,

Health care cost trend rate	n/a	n/a	n/a	7.0%	7.5%	8.0%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	n/a	n/a	n/a	5.0%	5.0%	5.0%
Year that the rate reaches the ultimate trend rate	n/a	n/a	n/a	2019	2019	2019

n/a - Assumption is not applicable.

AQUA AMERICA, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(In thousands of dollars, except per share amounts)

Assumed health-care trend rates have a significant effect on the expense and liabilities for other post-retirement benefit plans. The health care trend rate is based on historical rates and expected market conditions. A one-percentage point change in the assumed health-care cost trend rates would have the following effects:

	1-Percentage- Point Increase	1-Percentage- Point Decrease
Effect on the health-care component of the accrued other post-retirement benefit obligation	\$ 3,691	\$ (3,319)
Effect on aggregate service and interest cost components of net periodic post-retirement health-care benefit cost	\$ 254	\$ (233)

The Company's discount rate assumption, which is utilized to calculate the present value of the projected benefit payments of our post-retirement benefits, was determined by selecting a hypothetical portfolio of high quality corporate bonds appropriate to match the projected benefit payments of the plans. The selected bond portfolio was derived from a universe of Aa-graded corporate bonds, all of which were noncallable (or callable with make-whole provisions), and have at least \$50,000 in outstanding value. The discount rate was then developed as the rate that equates the market value of the bonds purchased to the discounted value of the plan's benefit payments. The Company's pension expense and liability (benefit obligations) increases as the discount rate is reduced.

The Company's expected return on plan assets is determined by evaluating the asset class return expectations with its advisors as well as actual, long-term, historical results of our asset returns. The Company's market related value of plan assets is equal to the fair value of the plan's assets as of the last day of its fiscal year, and is a determinant for the expected return on plan assets which is a component of post-retirement benefits expense. The Company's pension expense increases as the expected return on plan assets decreases. For 2015, the Company used a 7.50% expected return on plan assets assumption which will decrease to 7.25% for 2016. The Company believes its actual long-term asset allocation on average will approximate the targeted allocation. The Company's investment strategy is to earn a reasonable rate of return while maintaining risk at acceptable levels through the diversification of investments across and within various asset categories. Investment returns are compared to benchmarks that include the S&P 500 Index, the Barclays Capital Intermediate Government/Credit Index, and a combination of the two indices. The Pension Committee meets semi-annually to review plan investments and management monitors investment performance quarterly through a performance report prepared by an external consulting firm.

The Company's pension plan asset allocation and the target allocation by asset class are as follows:

	Target Allocation	Percentage of Plan Assets at December 31,	
		2015	2014
Domestic equities	25 to 75%	63%	64%
International equities	0 to 10%	6%	6%
Fixed income	25 to 50%	24%	25%
Alternative investments	0 to 5%	3%	3%
Cash and cash equivalents	0 to 20%	4%	2%
Total	100%	100%	100%

AQUA AMERICA, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

The fair value of the Company's pension plans' assets at December 31, 2015 by asset class are as follows:

	Total	Level 1	Level 2	Level 3
Domestic equities: (1)				
Common stocks	\$ 146,970	\$ 146,970	\$ -	\$ -
Mutual funds	3,605	3,605	-	-
International equities (2)	14,180	14,180	-	-
Fixed income: (3)				
U.S. Treasury and government agency bonds	22,953	-	22,953	-
Corporate and foreign bonds	13,579	-	13,579	-
Mutual funds	21,523	21,523	-	-
Alternative investments: (4)				
Real estate	5,981	5,981	-	-
Commodity funds	1,169	1,169	-	-
Cash and cash equivalents (5)	8,645	50	8,595	-
Total pension assets	<u>\$ 238,605</u>	<u>\$ 193,478</u>	<u>\$ 45,127</u>	<u>\$ -</u>

The fair value of the Company's pension plans' assets at December 31, 2014 by asset class are as follows:

	Total	Level 1	Level 2	Level 3
Domestic equities: (1)				
Common stocks	\$ 151,402	\$ 151,402	\$ -	\$ -
Mutual funds	4,168	4,168	-	-
International equities (2)	14,584	14,584	-	-
Fixed income: (3)				
U.S. Treasury and government agency bonds	25,150	-	25,150	-
Corporate and foreign bonds	13,716	-	13,716	-
Mutual funds	21,405	21,405	-	-
Alternative investments: (4)				
Real estate	6,215	6,215	-	-
Commodity funds	1,203	1,203	-	-
Cash and cash equivalents (5)	7,054	19	7,035	-
Total pension assets	<u>\$ 244,897</u>	<u>\$ 198,996</u>	<u>\$ 45,901</u>	<u>\$ -</u>

- (1) Investments in common stocks are valued using unadjusted quoted prices obtained from active markets. Investments in equity mutual funds, which invest in stocks, are valued using the net asset value per unit as obtained from quoted market prices from active markets.
- (2) Investments in international equities are valued using unadjusted quoted prices obtained from active markets.
- (3) Investments in U.S. Treasury and government agency bonds and corporate and foreign bonds are valued by a pricing service which utilizes pricing models that incorporate available trade, bid, and other market information to value the fixed income securities. Investments in fixed income mutual funds, which invest in bonds, are valued using the net asset value per unit as obtained from quoted market prices in active markets.
- (4) Alternative investments are comprised of real estate funds, real estate investment trusts, and commodity funds, and are valued using unadjusted quoted prices obtained from active markets.

AQUA AMERICA, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(In thousands of dollars, except per share amounts)

- (5) Cash and cash equivalents are comprised of both uninvested cash and money market funds. The uninvested cash is valued based on its carrying value, and the money market funds are valued utilizing the net asset value per unit based on the fair value of the underlying assets as determined by the fund's investment managers.

Equity securities include Aqua America, Inc. common stock in the amounts of \$19,958 or 8.4% and \$17,409 or 7.1% of total pension plans' assets as of December 31, 2015 and 2014, respectively.

The asset allocation for the Company's other post-retirement benefit plans and the target allocation by asset class are as follows:

	Target Allocation	Percentage of Plan Assets at December 31,	
		2015	2014
Domestic equities	25 to 75%	54%	57%
International equities	0 to 10%	2%	3%
Fixed income	25 to 50%	26%	25%
Alternative investments	0 to 5%	0%	1%
Cash and cash equivalents	0 to 20%	18%	14%
Total	100%	100%	100%

The fair value of the Company's other post-retirement benefit plans' assets at December 31, 2015 by asset class are as follows:

	Total	Level 1	Level 2	Level 3
Domestic equities: (1)				
Common stocks	\$ 11,772	\$ 11,772	\$ -	\$ -
Mutual funds	12,030	12,030	-	-
International equities (2)	1,078	1,078	-	-
Fixed income: (3)				
U.S. Treasury and government agency bonds	4,551	-	4,551	-
Corporate and foreign bonds	4,476	-	4,476	-
Mutual funds	2,177	2,177	-	-
Cash and cash equivalents (5)	7,620	-	7,620	-
Total other post-retirement assets	<u>\$ 43,704</u>	<u>\$ 27,057</u>	<u>\$ 16,647</u>	<u>\$ -</u>

AQUA AMERICA, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

The fair value of the Company's other post-retirement benefit plans' assets at December 31, 2014 by asset class are as follows:

	Total	Level 1	Level 2	Level 3
Domestic equities: (1)				
Common stocks	\$ 12,265	\$ 12,265	\$ -	\$ -
Mutual funds	12,582	12,582	-	-
International equities (2)	1,482	1,482	-	-
Fixed income: (3)				
U.S. Treasury and government agency bonds	5,678	-	5,678	-
Corporate and foreign bonds	3,822	-	3,822	-
Mutual funds	1,409	1,409	-	-
Alternative investments (4)	204	204	-	-
Cash and cash equivalents (5)	5,884	-	5,884	-
Total other post-retirement assets	<u>\$ 43,326</u>	<u>\$ 27,942</u>	<u>\$ 15,384</u>	<u>\$ -</u>

- (1) Investments in common stocks are valued using unadjusted quoted prices obtained from active markets. Investments in equity mutual funds, which invest in stocks, are valued using the net asset value per unit as obtained from quoted market prices from active markets.
- (2) Investments in international equities are valued using unadjusted quoted prices obtained from active markets.
- (3) Investments in U.S. Treasury and government agency bonds and corporate and foreign bonds are valued by a pricing service which utilizes pricing models that incorporate available trade, bid, and other market information to value the fixed income securities. Investments in fixed income mutual funds, which invest in bonds, are valued using the net asset value per unit as obtained from quoted market prices in active markets.
- (4) Investments in alternative investments are comprised of investments in real estate funds and real estate investment trusts and are valued using unadjusted quoted prices obtained from active markets.
- (5) Cash and cash equivalents is comprised of money market funds, which are valued utilizing the net asset value per unit based on the fair value of the underlying assets as determined by the fund's investment managers.

Funding requirements for qualified defined benefit pension plans are determined by government regulations and not by accounting pronouncements. In accordance with funding rules and the Company's funding policy, during 2016 our pension contribution is expected to be \$8,145.

The Company has a 401(k) savings plan, which is a defined contribution plan and covers substantially all employees. The Company makes matching contributions that are initially invested in our common stock based on a percentage of an employee's contribution, subject to specific limitations. Participants may diversify their Company matching account balances into other investments offered under the 401(k) savings plan. The Company's contributions, which are recorded as compensation expense, were \$5,001, \$3,051, and \$2,790, for the years ended December 31, 2015, 2014, and 2013, respectively.

Note 16 – Water and Wastewater Rates

On June 7, 2012, Aqua Pennsylvania reached a settlement agreement in its rate filing with the Pennsylvania Public Utility Commission, which in addition to a water rate increase, provided for a reduction in current income tax expense as a result of the recognition of qualifying income tax benefits upon Aqua Pennsylvania changing its tax accounting method to permit the expensing of qualifying utility asset improvement costs that historically have been capitalized and depreciated for book and tax purposes. In December 2012, Aqua Pennsylvania implemented this change which resulted in a substantial reduction in income tax expense and greater net income and cash flow, and as a result allowed Aqua Pennsylvania to suspend its water Distribution System Improvement Charges in 2013 and lengthen the amount of time until the next Aqua Pennsylvania rate case is filed.

AQUA AMERICA, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(In thousands of dollars, except per share amounts)

The Company's operating subsidiaries were allowed rate increases totaling \$3,347 in 2015, \$9,886 in 2014, and \$9,431 in 2013, represented by four, twelve, and six rate decisions, respectively. Revenues from these increases realized in the year of grant were approximately \$2,887, \$5,375, and \$8,169 in 2015, 2014, and 2013, respectively.

Six states in which the Company operates permit water utilities, and in five states wastewater utilities, to add a surcharge to their water or wastewater bills to offset the additional depreciation and capital costs related to infrastructure system replacement and rehabilitation projects completed and placed into service between base rate filings. Currently, Pennsylvania, Illinois, Ohio, Indiana, New Jersey, and North Carolina allow for the use of this surcharge. On December 22, 2014, the North Carolina Utilities Commission granted the first infrastructure surcharge for Aqua North Carolina. The Attorney General filed an appeal to the State Supreme Court challenging the approval and on August 21, 2015, the State Supreme Court upheld the Commission's decision granting this surcharge. The surcharge for infrastructure system replacements and rehabilitations is typically adjusted periodically based on additional qualified capital expenditures completed or anticipated in a future period, is capped as a percentage of base rates, generally at 5% to 12.75%, and is reset to zero when new base rates that reflect the costs of those additions become effective or when a utility's earnings exceed a regulatory benchmark. The surcharge for infrastructure system replacements and rehabilitations provided revenues in 2015, 2014, and 2013 of \$3,261, \$4,598, and \$3,205, respectively.

Note 17 – Segment Information

The Company has ten operating segments and one reportable segment. The Regulated segment, the Company's single reportable segment, is comprised of eight operating segments representing our water and wastewater regulated utility companies which are organized by the states where we provide water and wastewater services. These operating segments are aggregated into one reportable segment since each of these operating segments has the following similarities: economic characteristics, nature of services, production processes, customers, water distribution or wastewater collection methods, and the nature of the regulatory environment.

Two operating segments are included within the Other category below. These segments are not quantitatively significant and are comprised of Aqua Resources and Aqua Infrastructure. In addition to these segments, Other is comprised of other business activities not included in the reportable segment, including corporate costs that have not been allocated to the Regulated segment and intersegment eliminations. Corporate costs include general and administrative expenses, and interest expense.

AQUA AMERICA, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)

(In thousands of dollars, except per share amounts)

The following table presents information about the Company's reportable segment:

	2015			2014		
	Regulated	Other and Eliminations	Consolidated	Regulated	Other and Eliminations	Consolidated
Operating revenues	\$ 779,613	\$ 34,591	\$ 814,204	\$ 756,057	\$ 23,846	\$ 779,903
Operations and maintenance expense	282,866	26,444	309,310	274,754	13,802	288,556
Depreciation	125,146	144	125,290	122,728	326	123,054
Operating income	315,876	5,224	321,100	305,333	9,026	314,359
Interest expense, net	72,703	3,833	76,536	72,106	4,291	76,397
Allowance for funds used during construction	(6,219)	-	(6,219)	(5,134)	-	(5,134)
Equity loss in joint venture	-	35,177	35,177	-	3,989	3,989
Income tax (benefit)	26,379	(11,417)	14,962	24,792	427	25,219
Income (loss) from continuing operations	224,122	(22,332)	201,790	213,890	(6)	213,884
Capital expenditures	363,594	1,095	364,689	325,943	2,662	328,605
Total assets	5,564,089	176,949	5,741,038	5,195,191	211,561	5,406,752
Goodwill	27,246	6,620	33,866	24,564	6,620	31,184

	2013		
	Regulated	Other and Eliminations	Consolidated
Operating revenues	\$ 744,527	\$ 17,366	\$ 761,893
Operations and maintenance expense	269,804	13,757	283,561
Depreciation	118,592	(178)	118,414
Operating income	300,779	883	301,662
Interest expense, net	70,835	6,481	77,316
Allowance for funds used during construction	(2,275)	-	(2,275)
Equity loss in joint venture	-	2,665	2,665
Income tax (benefit)	24,911	(3,678)	21,233
Income (loss) from continuing operations	207,509	(4,638)	202,871
Capital expenditures	307,032	876	307,908
Total assets	4,893,573	158,244	5,051,817
Goodwill	24,102	4,121	28,223

Selected Quarterly Financial Data (Unaudited)

Aqua America, Inc. and Subsidiaries

(In thousands of dollars, except per share amounts)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
2015					
Operating revenues	\$ 190,326	\$ 205,760	\$ 221,051	\$ 197,067	\$ 814,204
Operations and maintenance expense	73,189	79,746	78,519	77,856	309,310
Operating income	71,167	80,246	95,072	74,615	321,100
Net income attributable to common shareholders	48,545	57,382	67,429	28,434	201,790
Basic net income per common share	0.27	0.32	0.38	0.16	1.14
Diluted net income per common share	0.27	0.32	0.38	0.16	1.14
Dividend paid per common share	0.165	0.165	0.178	0.178	0.686
Dividend declared per common share	0.165	0.165	0.178	0.178	0.686
Price range of common stock:					
- high	28.13	27.53	27.10	31.09	31.09
- low	25.42	24.40	24.45	26.20	24.40
2014					
Operating revenues	\$ 182,672	\$ 195,307	\$ 210,535	\$ 191,389	\$ 779,903
Operations and maintenance expense	71,686	70,375	72,374	74,121	288,556
Operating income	66,770	79,934	95,058	72,597	314,359
Income from continuing operations	42,401	54,818	67,711	48,954	213,884
Income from discontinued operations	458	751	285	17,861	19,355
Net income attributable to common shareholders	42,859	55,569	67,996	66,815	233,239
Basic income from continuing operations per common share	0.24	0.31	0.38	0.28	1.21
Diluted income from continuing operations per common share	0.24	0.31	0.38	0.28	1.20
Basic income from discontinued operations per common share	0.00	0.00	0.00	0.10	0.11
Diluted income from discontinued operations per common share	0.00	0.00	0.00	0.10	0.11
Basic net income per common share	0.24	0.31	0.38	0.38	1.32
Diluted net income per common share	0.24	0.31	0.38	0.38	1.31
Dividend paid per common share	0.152	0.152	0.165	0.165	0.634
Dividend declared per common share	0.152	0.152	0.165	0.165	0.634
Price range of common stock:					
- high	25.56	26.27	26.29	28.22	28.22
- low	22.40	24.25	23.12	23.26	22.40

Fourth quarter of 2015 net income attributable to common shareholders includes the Company's share of a joint venture impairment charge of \$21,433 (\$32,975 pre-tax).

High and low prices of the Company's common stock are as reported on the New York Stock Exchange.

Summary of Selected Financial Data (Unaudited)

Aqua America, Inc. and Subsidiaries

(In thousands of dollars, except per share amounts)

Years ended December 31,	2015	2014	2013	2012	2011
PER COMMON SHARE:					
Income from continuing operations:					
Basic	\$ 1.14	\$ 1.21	\$ 1.15	\$ 1.04	\$ 0.81
Diluted	1.14	1.20	1.15	1.04	0.81
Income from discontinued operations:					
Basic	0.00	0.11	0.10	0.08	0.02
Diluted	0.00	0.11	0.10	0.08	0.02
Net income:					
Basic	1.14	1.32	1.26	1.13	0.83
Diluted	1.14	1.31	1.25	1.12	0.83
Cash dividends declared and paid	0.69	0.63	0.58	0.54	0.50
Return on Aqua America stockholders' equity	11.7%	14.1%	14.4%	14.2%	11.4%
Book value at year end	\$ 9.78	\$ 9.37	\$ 8.68	\$ 7.91	\$ 7.21
Market value at year end	29.80	26.70	23.59	20.34	17.64
INCOME STATEMENT HIGHLIGHTS:					
Operating revenues	\$ 814,204	\$ 779,903	\$ 761,893	\$ 750,685	\$ 680,677
Depreciation and amortization	128,737	126,535	123,985	116,180	107,463
Interest expense, net	76,536	76,397	77,316	77,757	77,804
Income from continuing operations before income taxes (1)	216,752	239,103	224,104	247,057	207,265
Provision for income taxes	14,962	25,219	21,233	65,220	67,590
Income from continuing operations (1)	201,790	213,884	202,871	181,837	139,675
Income from discontinued operations	-	19,355	18,429	14,726	3,394
Net income attributable to common shareholders (1)	201,790	233,239	221,300	196,563	143,069
BALANCE SHEET HIGHLIGHTS:					
Total assets	\$ 5,741,038	\$ 5,406,752	\$ 5,051,817	\$ 4,858,517	\$ 4,348,420
Property, plant and equipment, net	4,688,925	4,401,990	4,138,568	3,907,552	3,502,968
Aqua America stockholders' equity	1,725,930	1,655,343	1,534,835	1,385,704	1,251,313
Long-term debt, including current portion	1,779,205	1,619,270	1,554,871	1,588,992	1,475,886
Total debt	1,795,926	1,637,668	1,591,611	1,669,375	1,583,657
ADDITIONAL INFORMATION:					
Operating cash flows from continuing operations	\$ 370,794	\$ 364,888	\$ 365,409	\$ 375,823	\$ 349,927
Capital additions	364,689	328,605	307,908	347,098	324,360
Net cash expended for acquisitions of utility systems and other	28,989	14,616	14,997	121,248	8,515
Dividends on common stock	121,248	112,106	102,889	93,423	87,133
Number of utility customers served (2)	957,866	940,119	928,200	917,986	848,336
Number of shareholders of common stock	25,269	25,780	25,833	26,216	26,744
Common shares outstanding (000)	176,544	176,753	176,751	175,209	173,519
Employees (full-time) (2)	1,617	1,617	1,542	1,556	1,464

(1) 2015 results includes Aqua America's share of a joint venture impairment charge of \$21,433 (\$32,975 pre-tax).

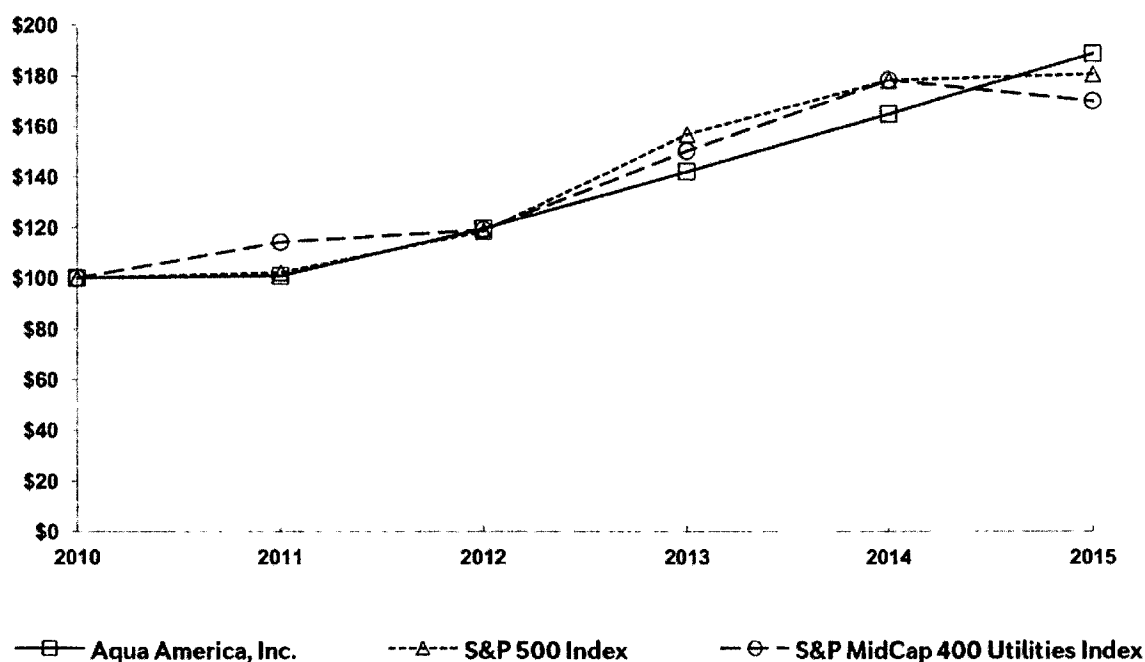
(2) Reflects continuing operations.

Stock Price Performance

The graph below matches the cumulative 5-Year total return of holders of Aqua America, Inc.'s common stock with the cumulative total returns of the S&P 500 index and a customized peer group of eighteen companies that includes: Alliant Energy Corp., Aqua America Inc., Atmos Energy Corp., Black Hills Corp., Cleco Corp., Great Plains Energy Inc., Hawaiian Electric Industries Inc., Idacorp Inc., MDU Resources Group Inc., National Fuel Gas Company, OGE Energy Corp., One Gas Inc., PNM Resources Inc., Questar Corp., UGI Corp., Vectren Corp., Westar Energy Inc. and WGL Holdings Inc. The graph assumes that the value of the investment in our common stock, in each index, and in the peer group (including reinvestment of dividends) was \$100 on 12/31/2010 and tracks it through 12/31/2015.

Comparison of Five Year Cumulative Total Shareholder Return*

Among Aqua America, Inc., The S&P 500 Index, And S&P Midcap 400 Utilities Index



*\$100 invested on 12/31/10 in stock or index, including reinvestment of dividends. Fiscal year ending December 31.

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Years as of December 31

	2010	2011	2012	2013	2014	2015
Aqua America, Inc.	100.00	100.86	119.62	142.06	164.93	188.84
S&P 500 Index	100.00	102.11	118.45	156.82	178.29	180.75
S&P MidCap 400 Utilities Index	100.00	114.25	119.07	150.31	178.36	169.98

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

Financial Reports and Investor Relations

Copies of the company's public financial reports, including annual reports and Forms 10-K and 10-Q, are available online and can be downloaded from the investor relations section of our website at AquaAmerica.com. You may also obtain these reports by writing to us at:

Investor Relations Department
Aqua America, Inc.
762 W. Lancaster Avenue
Bryn Mawr, PA 19010-3489

Corporate Governance

We are committed to maintaining high standards of corporate governance and are in compliance with the corporate governance rules of the Securities and Exchange Commission (SEC) and the New York Stock Exchange. Copies of our key corporate governance documents, including our Corporate Governance Guidelines, Code of Ethical Business Conduct, and the charters of each committee of our Board of Directors can be obtained from the corporate governance portion of the investor relations section of our website, AquaAmerica.com. Amendments to the code, and in the event of any grant of waiver from a provision of the code requiring disclosure under applicable SEC rules will be disclosed on our Website.

Annual Meeting

8:30 a.m. Eastern Daylight Time
Friday, May 6, 2016
Drexelbrook Banquet Facility and Corporate Center
4700 Drexelbrook Drive
Drexel Hill, PA 19026

Transfer Agent and Registrar

Computershare
P.O. BOX 30170
College Station, TX 77842
800.205.8314 or
www.computershare.com/investor

Independent Registered Public Accounting Firm

PricewaterhouseCoopers LLP
Two Commerce Square
Suite 1700
2001 Market Street
Philadelphia, PA 19103-7042

Stock Exchange

The Common Stock of the company is listed on the New York Stock Exchange and under the ticker symbol **WTR**.

Dividend Reinvestment and Direct Stock Purchase Plan

The company's Dividend Reinvestment and Direct Stock Purchase Plan ("Plan") enables shareholders to reinvest all, or a designated portion of, dividends paid on up to 100,000 shares of Common Stock in additional shares of Common Stock at a discretionary discount from a price based on the market value of the stock. The discount between 0 and 5.0 percent on the shares purchased or issued to meet the dividend reinvestment requirement will be designated by us in our sole discretion prior to the purchase or issuance of such shares. We reserve the right to change, reduce or discontinue any discount at any time without notice. In addition, shareholders may purchase additional shares of Aqua America Common Stock at any time with a minimum investment of \$50, up to a maximum of \$250,000 annually. Individuals may become shareholders by making an initial investment of at least \$500. A Plan prospectus may be obtained by calling Computershare at 800.205.8314 or by visiting www.computershare.com/investor. Please read the prospectus carefully before you invest.

IRA, Roth IRA, Education IRA

An IRA, Roth IRA or Coverdell Education Savings Account may be opened through the Plan to hold shares of Common Stock of the company and to make contributions to the IRA to purchase shares of Common Stock. Participants in the Plan may roll over an existing IRA or other qualified plan distribution in cash into an IRA under the Plan to purchase the company's Common Stock. Participants may also transfer the company's Common Stock from an existing IRA into an IRA under the Plan. A prospectus, IRA forms and a disclosure statement may be obtained by calling Computershare at 800.597.7736. Please read the prospectus carefully before you invest.

Direct Deposit

With direct deposit, Aqua America cash dividends are deposited automatically on the dividend payment date of each quarter. Shareholders will receive confirmation of their deposit in the mail. Shareholders interested in direct deposit should call the company's transfer agent at 800.205.8314.

Delivery of voting materials to shareholders sharing an address

The SEC's rules permit the Company to deliver a Notice of Internet Availability of Proxy Materials or a single set of proxy materials to one address shared by two or more of the Company's shareholders. This is intended to reduce the printing and postage expense of delivering duplicate voting materials to our shareholders who have more than one Aqua America stock account. A separate Notice of Internet Availability or proxy card is included for each of these shareholders. If you received a Notice of Internet Availability you will not receive a printed copy of the proxy materials unless you request it by following the instructions in the notice for requesting printed proxy materials.

How to obtain a separate set of voting materials

If you are a registered shareholder who shares an address with another registered shareholder and have received only one Notice of Internet Availability of Proxy Materials or set of proxy material and wish to receive a separate copy for each shareholder in your household for the 2016 annual meeting, you may call us to request a separate copy of this material at no cost to you at 610.645.1196 or write to us at:

Attn: Investor Relations
Aqua America, Inc.
762 W. Lancaster Avenue
Bryn Mawr, PA, 19010

For future annual meetings, you may request separate voting material by calling Broadridge at 800.542.1061, or by writing to Broadridge Financial Solutions, Inc., Householding Department, 51 Mercedes Way, Edgewood, New York 11717.

Account Access

Aqua America shareholders may access their account by visiting www.computershare.com/investor. Shareholders may view their account, purchase additional shares, and make changes to their account. To learn more, visit www.computershare.com/investor or call 800.205.8314.

Dividends

Aqua America has paid dividends for 71 consecutive years. The normal Common Stock dividend dates for 2016 and the first six months of 2017 are:

Declaration Date	Ex-Dividend Date	Record Date	Payment Date
February 1, 2016	February 10, 2016	February 12, 2016	March 1, 2016
May 2, 2016	May 11, 2016	May 13, 2016	June 1, 2016
August 8, 2016	August 16, 2016	August 18, 2016	September 1, 2016
November 4, 2016	November 14, 2016	November 16, 2016	December 1, 2016
February 3, 2017	February 13, 2017	February 15, 2017	March 1, 2017
May 5, 2017	May 15, 2017	May 17, 2017	June 1, 2017

To be an owner of record, and therefore eligible to receive the quarterly dividend, shares must have been purchased before the ex-dividend date. Owners of any share(s) on or after the ex-dividend date will not receive the dividend for that quarter. The previous owner — the owner of record — will receive the dividend.

Only the Board of Directors may declare dividends and set record dates. Therefore, the payment of dividends and these dates may change at the discretion of the Board.

Dividends paid on the company's Common Stock are subject to Federal and State income tax.

Lost Dividend Checks, Stock Certificates and Escheatment

Dividend checks lost by shareholders, or those that might be lost in the mail, will be replaced upon notification of the lost or missing check. All inquiries concerning lost or missing dividend checks should be made to the company's transfer agent at 800.205.8314. Shareholders should call or write the company's transfer agent to report a lost certificate. Appropriate documentation will be prepared and sent to the shareholder with instructions.

Escheatment is the act of reporting and transferring property to a state when the rightful owner has an invalid address or has not made contact or initiated a transaction during the state's designated dormancy period. Escheated assets are transferred to the state for safekeeping (and often liquidated) until the rightful owner makes a claim on the asset. To keep your shares of stock and uncashed dividends from being escheated, you must maintain contact (recommended at least once a year) with the company's transfer agent, especially if you recently changed your address, changed your marital status or are managing an estate following a death. Unclaimed property laws vary widely from state to state.

Safekeeping of Stock Certificates

Under the Direct Stock Purchase Plan, shareholders may have their stock certificates deposited with the transfer agent for safekeeping free of charge. Stock certificates and written instructions should be forwarded to:

Computershare, N.A.
P.O. Box 30170
College Station, TX 77842.

Notes

Corporate Information

Board Of Directors

Nicholas DeBenedictis

*Non-executive Chairman and former
Chief Executive Officer
Aqua America, Inc.
Director since 1992*

Christopher H. Franklin

*President and Chief Executive Officer
Aqua America, Inc.
Director since 2015*

Michael Browne

*Retired President and Chief Operating Officer
Harleysville Insurance
Director since 2013*

Richard H. Glanton

*Founder, Chairman and Chief Executive Officer
ElectedFace, Inc.
Director since 1995*

Lon R. Greenberg

*Chairman Emeritus of the Board and
Retired Chief Executive Officer
UGI Corporation
Director since 2005*

William P. Hankowsky

*Chairman, President and Chief Executive Officer
Liberty Property Trust
Director since 2004*

Wendell F. Holland, Esq.

*Partner
CFSD Group, LLC
Director since 2011*

Ellen T. Ruff

*Partner
McGuireWoods, LLP.
Director since 2006*

Officers

Christopher H. Franklin

President and Chief Executive Officer

Richard S. Fox

*Executive Vice President and
Chief Operating Officer, Regulated Operations*

Karen M. Heisler

*Senior Vice President and
Chief Human Resources Officer*

Christopher P. Luning

*Senior Vice President, General Counsel and
Secretary*

William C. Ross

*Senior Vice President
Engineering and Environmental Affairs*

Robert A. Rubin

*Senior Vice President
Controller and Chief Accounting Officer*

Daniel J. Schuller, PhD.

*Executive Vice President
Corporate Development and Strategy*

David P. Smeltzer

*Executive Vice President
Chief Financial Officer*

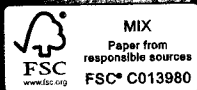




762 W. Lancaster Avenue
Bryn Mawr, Pennsylvania 19010

610.525.1400 • AquaAmerica.com
NYSE: WTR

AQUASM



SERVICE COMPANY AGREEMENT

AGREEMENT

This Agreement (Agreement) dated as of _____, 2014 between Aqua Services, Inc., a corporation organized and existing under the laws of the Commonwealth of Pennsylvania, with its principal place of business located at 762 W. Lancaster Avenue, Bryn Mawr, PA 19010 (hereinafter "Service Company"), and the following companies:

Aqua Texas, Inc. 1106 Clayton Lane, Suite 400W Austin, TX 78723	Aqua Development, Inc. 1106 Clayton Lane, Suite 400W Austin, TX 78723
Aqua Utilities, Inc. 1106 Clayton Lane, Suite 400W Austin, TX 78723	Kerrville South Water Company, Inc. 1106 Clayton Lane, Suite 400W Austin, TX 78723
Harper Water Company, Inc. 1106 Clayton Lane, Suite 400W Austin, TX 78723	

(hereinafter referred to individually as the "Texas Water Company" and collectively as the "Texas Water Companies") and collectively hereinafter referred to jointly as the "Parties" or individually as a "Party."

RECITALS

1. WHEREAS, both Service Company and the Texas Water Companies are direct or indirect subsidiaries of Aqua America, Inc., a Pennsylvania corporation (hereinafter "Aqua America"); and
2. WHEREAS, the Texas Water Companies have been organized for and are presently engaged in the business of providing water and/or wastewater services as a public utility in the State of Texas (hereinafter the Texas Water Companies and any of its affiliates that are also engaged in the business of providing water and/or wastewater services as a public

utility in the same state are collectively referred to in this Agreement as the Texas Water Companies); and

3. WHEREAS, Service Company maintains an organization whose officers and employees are familiar with the water and wastewater utility business, including the business and operations of the Texas Water Companies, and have experience and expertise in accounting and financial services, administration, communications, corporate secretarial, customer service and billing, engineering, financial, fleet services, human resources, information systems, operation, rates and regulatory, risk management, water quality, legal, and purchasing, contracts and sales of real estate of water and wastewater utilities. The officers and employees of Service Company are qualified to aid, assist and advise the Texas Water Companies in their business operations through the services to be performed under this Agreement; and
4. WHEREAS, the Texas Water Companies are entering into this Agreement with Service Company to specifically define the types of services available to it as set forth in Exhibit A attached hereto and made a part hereof; and
5. WHEREAS, Service Company has entered or proposes to enter into agreements similar to this agreement with other affiliated companies that are direct or indirect subsidiaries of Aqua America (hereinafter individually a "Subsidiary" or collectively the "Subsidiaries"), including those Subsidiaries that are regulated public utilities (hereinafter individually a "Utility Company" or collectively the "Utility Companies") and those Subsidiaries that are other non-regulated businesses (hereinafter individually a "Non-Regulated Company" or collectively the "Non-Regulated Companies"); and

6. WHEREAS, Service Company may engage or subcontract with other companies or persons, including other affiliated companies, to provide portions of the services hereunder; and
7. WHEREAS, the services to be rendered under this Agreement are to be rendered by Service Company to the Texas Water Companies at the lower of their cost or market to Service Company, as hereinafter provided; and

NOW, THEREFORE, in consideration of the premises and mutual agreements herein contained, Service Company and the Texas Water Companies agree as follows:

ARTICLE I. PERSONNEL AND SERVICES TO BE PROVIDED

1.1 During the term of this Agreement as set forth in Article V and upon the terms and conditions hereinafter set forth, Service Company may provide to the Texas Water Companies the Accounting and Financial Services, Administration, Communication, Corporate Secretarial, Customer Service and Billing, Engineering, Financial, Fleet Services, Human Resources, Information Systems, Operation, Rates and Regulatory, Risk Management, Water Quality, Legal, and Purchasing as set forth on Exhibit A attached hereto, provided, however, that the Texas Water Companies may perform any such services with its own personnel or engage another company or person to provide those services on its behalf. Service Company may engage or subcontract with another company or person to provide such services on its behalf. If Service Company engages other affiliates of Aqua America to provide any of the services hereunder, such services shall be charged to the Texas Water Companies on the same basis as the services provided by the Service Company.

1.2 Service Company shall employ qualified officers and employees to provide the services hereunder and those persons shall be available to serve as officers of the Texas Water Companies.

ARTICLE II. PAYMENT FOR SERVICES

2.1 In consideration for the services to be rendered by Service Company as herein provided, the Texas Water Companies agree to pay to Service Company the cost of the services provided to it as determined as provided in this Article II and in Article III.

2.2 The costs for service rendered by Service Company personnel directly for the Texas Water Companies shall be charged to the Texas Water Companies based on such personnel's time sheets.

2.3 For services that are made available by Service Company in common to other Aqua America Subsidiaries, including the Texas Water Companies, which cannot be identified and related exclusively to a particular Subsidiary, the cost for such services will be first allocated between the Utility Companies and the Non-Regulated Companies based on the relative proportion of the total Utility Companies assets and the Non-Regulated Companies assets at the most recent fiscal year end to the total assets of all the Utility and Non-Regulated Companies assets combined.

2.4 The portion of the costs for such common services allocated to the Utility Companies or a group of Utility Companies will be further allocated to each Utility Company or group of Utility Companies, including the Texas Water Companies, based on the ratio of the number of customers served by each Utility Company or the group of Utility Companies at the most recent fiscal year end to the number of customers served by all Utility Companies, subject to adjustment during any year for a substantial change in the number of customers at any Utility Company or among the Utility Companies since the previous year-end in accordance with the Service Company's accounting policies.