

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 or 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

Commission File
number 1-6659

AQUA AMERICA, INC. (formerly Philadelphia Suburban Corporation)

(Exact name of registrant as specified in its charter)

Pennsylvania

23-1702594

(State or other jurisdiction of
incorporation or organization)

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

762 W. Lancaster Avenue, Bryn Mawr, Pennsylvania

19010-3489

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including
area code:

(610)-527-8000

Securities registered pursuant to Section
12(b) of the Act:

Title of each class

Name of each exchange on
which registered

Common stock, par value \$.50 per share

New York Stock Exchange, Inc.
Philadelphia Stock Exchange Inc.

Securities registered pursuant to Section
12(g) of the Act: None

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

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. []

Indicate by check mark whether the registrant is an accelerated filer (as defined in Section 12(b)-2 of the Securities Exchange Act of 1934). Yes X No .

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2003. \$1,687,501,659

For purposes of determining this amount only, registrant has defined affiliates as including (a) the executive officers named in Part I of this 10-K report, (b) all directors of registrant, and (c) each shareholder that has informed registrant by June 30, 2003, that it has sole or shared voting power of 5% or more of the outstanding common stock of registrant.

The number of shares outstanding of each of the registrant's classes of common stock as of February 17, 2004.

92,674,480

Documents incorporated by reference

(1) Portions of registrant's 2003 Annual Report to Shareholders have been incorporated by reference into Parts I and II of this Form 10-K Report.

(2) Portions of the Proxy Statement, relative to the May 20, 2004 annual meeting of shareholders of registrant, to be filed within 120 days after the end of the fiscal year covered by this Form 10-K Report, have been incorporated by reference into Part III of this Form 10-K Report.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Annual Report on Form 10-K ("10-K"), or incorporated by reference in this 10-K, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 made based upon, among other things, our current assumptions, expectations and beliefs concerning future developments and their potential effect on us. These forward-looking statements involve risks, uncertainties and other factors, many of which are outside our control, that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. In some cases you can identify forward-looking statements where statements are preceded by, followed by or include the words "believes," "expects," "anticipates," "plans," "future," "potential" or the negative of such terms or similar expressions. Forward-looking statements in this 10-K, or incorporated by reference in this 10-K, include, but are not limited to, statements regarding:

- o projected capital expenditures and related funding requirements;
- o developments and trends in the water and wastewater utility industries;
- o dividend payment projections;
- o opportunities for future acquisitions and success of pending acquisitions;
- o the capacity of our water supplies and facilities;
- o the development of new services and technologies by us or our competitors;
- o the availability of qualified personnel;
- o general economic conditions;
- o acquisition-related costs and synergies; and
- o the forward-looking statements contained under the heading "Forward-Looking Statements" in the section entitled "Management's Discussion and Analysis" from the portion of our 2003 Annual Report to Shareholders incorporated by reference herein and made a part hereof.

Because forward-looking statements involve risks and uncertainties, there are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements, including but not limited to:

- o changes in general economic, business and financial market conditions;
- o changes in government regulations and policies, including environmental and public utility regulations and policies;
- o changes in environmental conditions, including those that result in water use restrictions;
- o abnormal weather conditions;
- o changes in capital requirements;
- o changes in our credit rating;
- o our ability to integrate businesses, technologies or services which we may acquire;

- o our ability to manage the expansion of our business;
- o the extent to which we are able to develop and market new and improved services;

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- o the effect of the loss of major customers;
- o our ability to retain the services of key personnel and to hire qualified personnel as we expand;
- o unanticipated capital requirements;
- o increasing difficulties in obtaining insurance and increased cost of insurance;
- o cost overruns relating to improvements or the expansion of our operations; and
- o civil disturbance or terroristic threats or acts.

Given these uncertainties, you should not place undue reliance on these forward-looking statements. You should read this 10-K and the documents that we incorporate by reference in this 10-K completely and with the understanding that our actual future results may be materially different from what we expect. These forward-looking statements represent our estimates and assumptions only as of the date of this 10-K. Except for our ongoing obligations to disclose material information under the federal securities laws, we are not obligated to update these forward-looking statements, even though our situation may change in the future. We qualify all of our forward-looking statements by these cautionary statements.

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PART I

Item 1. Business

Name Change

On January 16, 2004, Philadelphia Suburban Corporation changed its corporate name to Aqua America, Inc. to reflect our position as the largest U.S.-based publicly-traded water utility. In addition, we have changed our ticker symbol from PSC to WTR on the New York Stock Exchange and Philadelphia Stock Exchange effective as of the opening of trading on January 20, 2004.

The Company

Aqua America, Inc. (referred to as "Aqua America", "we" or "us") is the holding company for regulated utilities providing water or wastewater services to approximately 2.5 million people in Pennsylvania, Ohio, Illinois, Texas, New Jersey, Indiana, Virginia, Florida, North Carolina, Maine, Missouri, New York, South Carolina and Kentucky. Our largest operating subsidiary, Aqua Pennsylvania, Inc. - formerly Pennsylvania Suburban Water Company, accounts for approximately 60% of our operating revenues and provides water or wastewater services to approximately 1.3 million residents in the suburban areas north and west of the City of Philadelphia and in 19 other counties in Pennsylvania. Our other subsidiaries provide similar services in 13 other states. In addition, we provide water and wastewater service through operating and maintenance contracts with municipal authorities and other parties close to our operating companies' service territories. We are the largest U.S.-based publicly-traded water utility based on number of people served.

On July 31, 2003, we completed the acquisition of four operating water

and wastewater subsidiaries of AquaSource, Inc. (a subsidiary of DQE, Inc.), including selected, integrated operating and maintenance contracts and related assets, for approximately \$190.7 million in cash, as adjusted pursuant to the purchase agreement for the completion of a closing balance sheet and the finalization of working capital (\$195.5 million was paid at closing and refunds were subsequently received totaling \$4.8 million). There remains approximately \$12 million of the above purchase price in dispute, which is subject to an arbitration process under the terms of the purchase agreement. Accordingly, the final purchase price is expected to be within the range of \$178.7 to \$190.7 million. We expect the arbitration process to conclude by mid-year 2004. The acquired operations of AquaSource serve over 130,000 water and wastewater customer accounts in 11 states (including the Connecticut operations which we sold in October 2003).

Item 1, Continued

The following table reports our operating revenues, in thousands of dollars, by principal state for the year ended December 31, 2003:

	Results as Reported	Supplemental Pro forma Information for Full Fiscal Year
	-----	-----
Pennsylvania	\$ 240,628	\$ 240,628
Ohio	36,584	36,584
Illinois	30,007	30,007
Texas	12,289 *	26,237
New Jersey	18,078 *	18,954
Maine	9,279	9,279
Indiana	6,292 *	15,524
Florida	4,282 *	10,584
North Carolina	3,769 *	4,777
Virginia	3,096 *	7,853
Other states	2,929 *	7,201
	-----	-----
	\$ 367,233	\$ 407,628
	=====	=====

*Operating revenues of AquaSource have been included in our consolidated financial statements beginning August 1, 2003.

Note: Supplemental Pro forma information is presented to illustrate the effects of the AquaSource acquisition, which was completed on July 31, 2003, on the operating revenues for 2003 as if the acquisition had occurred on January 1, 2003. The supplemental information is not necessarily representative of the actual results that may have occurred for these periods or of the results that may occur in the future. This information is based upon the historical operating results of AquaSource for periods prior to the acquisition date of July 31, 2003 as provided to us by AquaSource, Inc. and DQE, Inc. management. In October 2003, we sold the Connecticut operations that we acquired with the AquaSource acquisition and the annual operating revenues of this unit approximated \$4,000. Supplemental Pro forma information does not reflect adjustment for this transaction.

The following table indicates by customer class our operating revenues, in thousands of dollars, for the year ended December 31, 2003:

Customer class	Operating Revenues	Percent
-----	-----	-----
Residential water	\$ 218,487	59%
Commercial water	61,343	17%
Fire protection	20,294	6%
Industrial water	17,675	5%
Other water	19,754	5%

Wastewater	17,874	5%
Operating contracts and other	11,806	3%
	-----	-----
	\$ 367,233	100%
	=====	=====

Our customer base is diversified among residential, commercial, industrial, other and wastewater customers. Residential customers make up the largest component of our customer base, with these

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Item 1, Continued

customers representing 59% of our total water revenues. Substantially all of our water customers are metered, which allows us to measure and bill for our customers' water consumption. Water consumption per customer is affected by local weather conditions during the year, especially during the late spring and early summer in our northern U.S. service territories. In general, during these seasons, an extended period of dry weather increases consumption, while above average rainfall decreases water consumption. Also, an increase in the average temperature generally causes an increase in water consumption. On occasion, abnormally dry weather in our service areas can result in governmental authorities declaring drought warnings and water use restrictions in the affected areas, which could reduce water consumption. See "Water Supplies and Water Facilities" for a discussion of water use restrictions that may impact water consumption during abnormally dry weather. The geographic diversity of our customer base reduces our exposure to extreme or unusual weather conditions in any one area of our service territory.

The growth in revenues over the past three years is a result of increases in the customer base and in water rates. The majority of the increase in customer base is due to customers added through acquisitions. During the three year period of 2000 through 2002, our customer base increased at an annual compound rate of 9.9%. The customer growth rate in 2003 was 23.8%, and reflects the additional customers obtained in the AquaSource acquisition on July 31, 2003.

Available Information

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission ("SEC"). You may read and copy any document we file at the SEC's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. You may also obtain our SEC filings from the SEC's website at <http://www.sec.gov>.

Our internet website address is <http://www.aquaamerica.com>. We make available free of charge through our internet website's Investor Relations page all of our filings with the SEC, including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and other information. These reports and information are available as soon as reasonably practicable after such material is electronically filed or furnished to the SEC.

Our Board of Directors has various committees including an audit committee, an executive compensation and employee benefits committee and a corporate governance committee. Each of the three committees named above has a formal charter. We also have Corporate Governance Guidelines and a Code of Ethical Business Conduct. Copies of these charters, guidelines and codes, and any waivers or amendments to such codes which are applicable to our executive officers, senior financial officers or directors, can be obtained free of charge from our website, www.aquaamerica.com.

In addition, you may request a copy of the foregoing filings (excluding exhibits), charters, guidelines and codes, and any waivers or amendments to such codes which are applicable to our executive officers, senior financial officers or directors, at no cost by writing or telephoning us at the following address or telephone number:

Shareholder Relations Department
Aqua America, Inc.
762 W. Lancaster Avenue
Bryn Mawr, PA 19010-3489
Telephone: 610-527-8000

Item 1, Continued

Acquisitions and Water Sale Agreements

With more than 50,000 community water systems in the U.S. (84% of which serve less than 3,300 customers), the water industry is the most fragmented of the major utility industries (telephone, natural gas, electric, water and wastewater). The nation's water systems range in size from large municipally-owned systems, such as the New York City water system that serves approximately 9 million people, to small systems, where a few customers share a common well. In the states where we operate, we believe there are over 22,000 public water systems of widely varying size, with the majority of the population being served by government-owned water systems.

Although not as fragmented as the water industry, the wastewater industry in the U.S. also presents opportunities for consolidation. According to the U.S Environmental Protection Agency's ("EPA") most recent survey of publicly-owned wastewater treatment facilities in 2000, there are approximately 16,000 such facilities in the nation serving approximately 72% of the U.S. population. The remaining population represents individual homeowners with their own treatment facilities; for example, community on-lot disposal systems and septic tank systems. The vast majority of wastewater facilities are government-owned rather than privately-owned. The EPA survey also indicated that there are approximately 6,800 wastewater facilities in operation or planned in the 14 states where we operate.

Because of the fragmented nature of the water and wastewater utility industries, we believe that there are many potential water and wastewater system acquisition candidates throughout the United States. We believe the factors driving consolidation of these systems are:

- o the benefits of economies of scale;
- o increasingly stringent environmental regulations;
- o the need for capital investment; and
- o the need for technological and managerial expertise.

We are actively exploring other opportunities to expand our utility operations through acquisitions or otherwise. As of December 31, 2003, exclusive of the Consumers Water Company merger in 1999 and the AquaSource acquisition in 2003, we had completed 97 acquisitions or other growth ventures during the past five years.

We believe that acquisitions will continue to be an important source of growth for us. We intend to continue to pursue acquisitions of municipally-owned and investor-owned water and wastewater systems of all sizes that provide services in areas adjacent to our existing service territories or in new service areas. We engage in continuing activities with respect to potential acquisitions, including calling on perspective sellers, performing analyses and investigations of acquisition candidates, making preliminary acquisition proposals and negotiating the terms of potential acquisitions.

Item 1, Continued

Water Supplies and Water Facilities

Our water utility operations obtain their water supplies from surface water sources such as reservoirs, lakes, ponds, rivers and streams, in addition to obtaining water from wells and purchasing water from other water suppliers. Less than 10% of our water sales are purchased from other suppliers. It is our policy to obtain and maintain the permits necessary to obtain the water we distribute. Our supplies are sufficient for anticipated daily demand and normal peak demand under normal weather conditions. Our supplies by principal service area are as follows:

- o Suburban Philadelphia - The principal supply of water is surface water from eight rural streams, two rivers (Schuylkill River and Delaware River), and the Upper Merion Reservoir, a former quarry now impounding groundwater. Wells and interconnections with adjacent municipal authorities supplement these surface supplies.
- o Pennsylvania (other than suburban Philadelphia) - The Roaring Creek Division draws its water from a man-made lake within a 12,000 acre watershed and two wells also located in the watershed. The Susquehanna Division obtains its water supply from wells. The Shenango Division draws its water from the Shenango River. The Waymart and Whitehaven Divisions' water supply is obtained from wells.
- o Ohio - Water supply is obtained for customers in Lake County from Lake Erie. Customers in Mahoning County obtain their water from man-made lakes and the Ashtabula division is supplied by purchased water. Water supply is obtained for customers in Stark and Summit Counties from wells. In Trumbull County, customers are served through an interconnection from our Pennsylvania division.
- o Illinois - Water supply is obtained for customers in Kankakee County from the Kankakee River and satellite wells, while customers in Vermilion County are supplied from Lake Vermilion. In Will, Lee, Boone, Lake and Knox counties, our customers are served from wells.
- o Texas - Water supply in 272 non-contiguous water systems is obtained principally from wells, supplemented in some cases by purchased water from adjacent surface water systems.
- o New Jersey - Water supply in our three non-contiguous divisions is obtained principally from wells and is supplemented with purchased water in two divisions.
- o Indiana - Water supply in three water systems is obtained principally from wells.
- o Virginia - Water supply in 124 non-contiguous divisions is obtained from wells, one division's supply is from surface water, and one division supplements its supply with purchased water from a nearby water system.
- o Florida - Water supply in 46 water systems is obtained principally from wells, supplemented in some cases by purchased water from adjacent surface water systems.
- o North Carolina - Water supply in 183 non-contiguous divisions is obtained principally from wells, with six divisions purchasing water from neighboring municipalities.
- o Maine - Eleven non-contiguous water systems obtain their water supply as follows: five systems use groundwater, five systems use surface water and one system purchases water from a neighboring municipal district.

We believe that the capacities of our sources of supply, and our water treatment, pumping and distribution facilities are generally sufficient to meet the present requirements of our customers. We make system improvements and additions to capacity in response to changing regulatory standards, changing patterns of consumption and increased demand from a growing number of customers. The various state public utility commissions have generally recognized the operating and capital costs associated with these improvements in setting water rates.

Item 1, Continued

On occasion, drought warnings and water use restrictions are issued by governmental authorities for portions of our service territories in response to extended periods of dry weather conditions. The timing and duration of the warnings and restrictions can have an impact on our water revenues and net income. In general, water consumption in the summer months is affected by drought warnings and restrictions to a higher degree because nonessential and recreational use of water is at its highest during the summer months. At other times of the year, warnings and restrictions generally have less of an effect on water consumption.

In November 2001, a drought warning was declared in nine counties in Pennsylvania, including one of the five counties we serve in southeastern Pennsylvania. A drought warning calls for a 10 to 15 percent voluntary reduction of water use, particularly non-essential uses of water. In February 2002, a drought emergency was declared in 24 counties in Pennsylvania, including all five of the counties we serve in southeastern Pennsylvania. A drought emergency

imposes a ban on nonessential water use. In June and July 2002, drought restrictions were relaxed in three of the five counties we serve in southeastern Pennsylvania where approximately 275,000 of our customers are located, moving from drought emergency mandatory restrictions to a drought warning voluntary restrictions. However, by early September 2002, the Commonwealth of Pennsylvania had reinstated the drought emergency in the three counties where restrictions had been relaxed because of hot, dry weather in August. In November and December 2002, the Commonwealth of Pennsylvania removed the drought restrictions in the counties we serve in Pennsylvania. Water use restrictions were also imposed and relaxed at various times during 2002 in our service territories in New Jersey.

Economic Regulation

Most of our water and wastewater utility operations are subject to regulation by their respective state regulatory commissions, which have broad administrative power and authority to regulate rates and charges, determine franchise areas and conditions of service and authorize the issuance of securities. The regulatory commissions also establish uniform systems of accounts and approve the terms of contracts with affiliates and customers, business combinations with other utility systems, loans and the sales of property. Some of our operations are subject to rate regulation by county or city government. The profitability of our utility operations is influenced a great extent by the timeliness and adequacy of rate allowances in the various states in which we operate. Accordingly, we maintain a rate case management capability to provide that the tariffs of our utility operations reflect, to the extent practicable, the timely recovery of increases in costs of operations, capital, taxes, energy, materials and compliance with environmental regulations. In the states in which we operate, we are subject to regulation by the following state regulatory commissions:

State	Regulatory Commission
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Pennsylvania	Pennsylvania Public Utility Commission
Ohio	The Public Utilities Commission of Ohio
Illinois	Illinois Commerce Commission
Texas	Texas Commission on Environmental Quality
New Jersey	New Jersey Board of Public Utilities
Indiana	Indiana Utility Regulatory Commission
Virginia	Virginia State Corporation Commission
Florida	Florida Public Service Commission
North Carolina	North Carolina Utilities Commission
Maine	Maine Public Utilities Commission
Missouri	Missouri Public Service Commission
New York	New York Public Service Commission
South Carolina	South Carolina Public Service Commission
Kentucky	Kentucky Public Service Commission

Item 1, Continued

Four states in which we operate permit water utilities, and in some states wastewater utilities, to add a surcharge to their water or wastewater bills to offset the additional depreciation and capital costs associated with certain capital expenditures related to replacing and rehabilitating infrastructure systems. Prior to these mechanisms being approved, water and wastewater utilities absorbed all of the depreciation and capital costs of these projects between base rate increases without the benefit of additional revenues. The gap between the time that a capital project is completed and the recovery of its costs in rates is known as regulatory lag. The infrastructure rehabilitation surcharge mechanism is intended to substantially reduce regulatory lag which often acted as a disincentive to water and wastewater utilities to rehabilitate their infrastructure. In addition, our subsidiaries in certain states use a surcharge or credit on their bill to reflect certain changes in costs until such time as the costs are incorporated in base rates.

Currently, Pennsylvania, Illinois, Ohio and Indiana allow for the use of infrastructure rehabilitation surcharges. These mechanisms typically adjust periodically based on additional qualified capital expenditures completed or anticipated in a future period. The infrastructure rehabilitation surcharge is capped as a percentage of base rates, generally 5% of base rates, 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.

Infrastructure rehabilitation surcharges provided revenues of \$8,147,000 in 2003, \$5,518,000 in 2002 and \$6,672,000 in 2001. We are currently working to establish similar mechanisms in the other states in which we operate.

In general, we believe that Aqua America, Inc. and its subsidiaries have valid authority, free from unduly burdensome restrictions, to enable us to carry on our business as presently conducted in the franchised or contracted areas we now serve. The rights to provide water or wastewater service to a particular franchised service territory are generally non-exclusive, although the applicable regulatory commissions usually allow only one utility to provide service to a given area. In some instances, another water utility provides service to a separate area within the same political subdivision served by one of our subsidiaries. In the states where our subsidiaries operate, it is possible that portions of our subsidiaries' operations could be acquired by municipal governments by one or more of the following methods:

- o eminent domain;
- o the right of purchase given or reserved by a municipality or political subdivision when the original franchise was granted; and
- o the right of purchase given or reserved under the law of the state in which the subsidiary was incorporated or from which it received its permit.

The price to be paid upon such an acquisition by the municipal government is usually determined in accordance with applicable law governing the taking of lands and other property under eminent domain. In other instances, the price may be negotiated, fixed by appraisers selected by the parties or computed in accordance with a formula prescribed in the law of the state or in the particular franchise or charter.

In December 2002, as a result of the settlement of a condemnation action, our Ohio operating subsidiary sold its water utility assets in the unincorporated areas of Ashtabula County and the area within the Village of Geneva on the Lake to Ashtabula County, Ohio for approximately \$12,118,000, which was in excess of the book value for these assets. The sale resulted in the recognition in the fourth quarter of 2002 of a gain on the sale of these assets, net of expenses, of \$5,676,000 or an after-tax gain of \$3,690,000 (or \$.04 per share). We continue to operate this water system for Ashtabula County under a

Item 1, Continued

multi-year operating contract, that was recently renewed, that began upon the closing of the sale and is expected to provide us with over \$300,000 in operating revenues annually. The water utility assets sold represent less than 1% of our total assets, and the total number of customers included in the water system sold represents less than 1% of our total customer base. The interest savings associated with paying off debt with the sale's proceeds and the operating income generated by the operating contract will offset the loss of this water system's normal contribution to income.

As part of the Ashtabula County condemnation, the adjacent City of Geneva in Ashtabula County, Ohio, passed an ordinance seeking authorization to condemn the assets of our Ohio operating subsidiary that are located in Geneva. The issue was submitted to a referendum in 2000, whereby voters affirmed the ordinance by a margin of 16 votes. The City engaged a consulting firm to assist it in valuing the assets that may be condemned. In December 2002, the City of Geneva filed a condemnation action. The number of customers included in the Geneva system represents approximately 0.3% of our total customer base.

The City of Fort Wayne, Indiana has authorized the acquisition, by eminent domain or otherwise, of a portion of the utility assets of one of the operating subsidiaries that we acquired in connection with the AquaSource acquisition in July 2003. The portion of the system under consideration represents approximately 1% of our total customer base. While we continue to discuss this matter with officials from the City of Fort Wayne, we continue to protect our interests in this proceeding.

We believe that our operating subsidiaries will be entitled to fair market value for any assets that are condemned, and we believe the fair market value will be in excess of the book value for such assets and may approximate the multiple to book value of other recent industry business combinations. Despite these events, our strategy continues to be to acquire additional water

and wastewater systems, maintain our existing systems, and actively oppose efforts by municipal governments to acquire any of our operations, particularly for less than the fair market value of our operations or where the municipal government seeks to acquire more than it is entitled to under the applicable law or agreement.

Environmental Regulation

Provision of water and wastewater services is subject to regulation under the federal Safe Drinking Water Act, the Clean Water Act and related state laws, and under federal and state regulations issued under these laws. These laws and regulations establish criteria and standards for drinking water and for wastewater discharges. In addition, we are subject to federal and state laws and other regulations relating to solid waste disposal, dam safety and other operations. Capital expenditures and operating costs required as a result of water quality standards and environmental requirements have been traditionally recognized by state public utility commissions as appropriate for inclusion in establishing rates.

There are some environmental compliance issues at various water and wastewater facilities associated with the AquaSource acquisition that was completed on July 31, 2003. We estimate that the capital expenditures required to address these AquaSource compliance issues will be approximately \$65,000,000 over the next five years. As a comparison, during the next five years, our future utility construction is estimated to require aggregate expenditures of \$779,000,000 (representing all of our on-going construction programs). Various operating subsidiaries that were acquired in the AquaSource acquisition are parties to agreements with regulatory agencies regarding environmental compliance. These agreements are intended to provide the regulators with assurance that problems will be addressed, and they generally provide some protection to us from fines, penalties and other actions while corrective measures are being implemented. For the most part, the agreements were negotiated by AquaSource

Item 1, Continued

prior to the acquisition being completed, and we have willingly assumed the obligations under these agreements. In several cases, we have re-negotiated a compliance agreement to address conditions that developed prior to completion of the AquaSource acquisition. We are actively working directly with state environmental officials to implement or amend these agreements as necessary. The regulatory agencies may impose some fines and penalties, with respect to existing compliance issues at the operations acquired from AquaSource, which are not expected to be material. To the extent such fines and penalties arise from incidents that occurred prior to our purchase of the AquaSource operations, we may make an indemnity claim for such amounts against AquaSource, Inc. and its parent company DQE, Inc. under the purchase agreement.

Safe Drinking Water Act - The Safe Drinking Water Act establishes criteria and procedures for the U.S. Environmental Protection Agency to develop national quality standards for drinking water. Regulations issued pursuant to the Safe Drinking Water Act and its amendments set standards on the amount of certain microbial and chemical contaminants and radionuclides allowable in drinking water. Current requirements under the Safe Drinking Water Act are not expected to have a material impact on our operations or financial condition as we have already made investments to meet existing water quality standards. We may, in the future, be required to change our method of treating drinking water at certain sources of supply if additional regulations become effective.

EPA's issuance of a rule regulating radon in tap water has been postponed repeatedly since 1991. Limits for radon would probably become effective 4 or 5 years after issuance of any such rule. We anticipate this rule may establish a radon level that would require treatment at a few of our wells. If the states in which we operate elect not to implement general radon reduction programs (Multi-Media Mitigation), then a more stringent limit for radon may apply and a larger number of wells would be affected. We anticipate that states will adopt Multi-Media Mitigation programs. The capital costs to comply with the anticipated limit are expected to total approximately \$2,000,000 or less than 2% of our typical annual capital expenditures.

The Safe Drinking Water Act provides for the regulation of radionuclides other than radon, such as radium and uranium. In December 2000, the EPA issued a final rule regulating certain radionuclides other than radon. The rule became effective in December 2003, and requires additional testing. It may require additional treatment at some of our groundwater facilities. The cost of compliance is expected to be less than \$1,000,000. The impact of the new rulemaking is not expected to have a material impact on our results from operations or financial condition.

In order to eliminate or inactivate microbial organisms, the Surface Water Treatment Rule and the Interim Enhanced Surface Water Treatment Rule were issued by the EPA to improve disinfection or filtration of potable water. The EPA developed the Stage 1 Disinfectants-Disinfection By-Products Rule to reduce consumers' exposure to disinfectants and by-products of the disinfection process. Beginning January 1, 2004, groundwater and smaller surface water systems had to comply with the Stage 1 Disinfectants-Disinfection By-Products Rule. In the future, we may be required to install filtration or other treatment for one surface water supply. The cost of this treatment, should it be required, is not expected to exceed \$5,000,000. Certain small groundwater systems could be reclassified as being influenced by surface water. This may require additional treatment or the development of replacement sources of supply over time, the cost for which is not expected to exceed \$3,000,000.

In January 2001, the EPA issued a final rule for arsenic that lowers the limit on arsenic in potable water to a more stringent level effective in 2006, with a provision for further time extensions for small systems. Currently, several small well systems slightly exceed the new arsenic levels and may require additional treatment. The cost of compliance with this new rulemaking is not expected to exceed \$1,000,000.

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Item 1, Continued

In April 2000, the gasoline additive Methyl tert-Butyl Ether ("MtBE") was discovered in a production well in one of our operating subsidiaries at levels exceeding the state drinking water standard. The well was immediately taken out of service and alternate water supplies were obtained. We have commenced legal action against the company we believed to be responsible for the contamination and have reached a settlement in principle subject to certain conditions being satisfied, pursuant to which we expect to receive an amount sufficient to cover our estimated costs to purchase alternative water on an interim basis and to develop a permanent replacement well.

Clean Water Act - The Clean Water Act regulates discharges from drinking water and wastewater treatment facilities into lakes, rivers, streams, and groundwater. We operate approximately 200 facilities with such discharges in twelve states. It is our policy to obtain and maintain all required permits and approvals for the discharge from these water and wastewater facilities, and to comply with all conditions of those permits and other regulatory requirements. A program is in place to monitor facilities for compliance with permitting, monitoring and reporting for wastewater discharges. From time to time, violations may occur which may result in fines. As described above, various operating subsidiaries that were acquired in the AquaSource acquisition had entered into agreements, prior to the acquisition being completed, to address compliance issues. Based on AquaSource's previous experience with these agreements, penalties or fines that may be imposed under these agreements are not expected to have a material impact on our results of operations or financial condition.

Solid Waste Disposal - The handling and disposal of residuals and solid waste generated from water and wastewater treatment facilities is governed by federal and state laws and regulations. A program is in place to monitor our facilities for compliance with regulatory requirements, and we do not currently anticipate any major expenditures in connection with the handling and disposal of waste material from our water and wastewater operations.

Dam Safety - Our subsidiaries own seventeen major dams that are subject to the requirements of the Federal and state regulations related to dam safety. All major dams undergo an annual engineering inspection. We believe that all seventeen dams are structurally sound and well-maintained.

In Pennsylvania, the Department of Environmental Protection has

recently adopted the use of a new formula for determining the magnitude of the Probable Maximum Flood. We are studying our dams to determine what improvements may be needed to our dams as a result of this new calculation. As a result of the initial results of the studies, we have identified three dams that could require capital improvements of approximately \$7 million in aggregate. We believe that these capital expenditures that could be required by the new formulas would be recoverable in our rates. Similarly, in Ohio, the Department of Natural Resources has adopted the use of the new formula. We have studied our dams in Ohio and it has been determined that some of the dams will require improvements. Based on the preliminary results, we believe that capital expenditures of approximately \$4.2 million in aggregate will be required on three dams in Ohio over the next four years.

Employee Relations

As of December 31, 2003, we employed a total of 1,260 full-time employees. Our subsidiaries are parties to 10 agreements with labor unions covering 445 employees that expire at various times between May 2004 and December 2007. Based on the number of employees covered by each agreement, a substantial portion of the agreements expire in 2006.

Item 1, Continued

Risk Factors

Our business requires significant capital expenditures and the rates we charge our customers are subject to regulation. If we are unable to obtain government approval of our requests for rate increases, or if approved rate increases are untimely or inadequate to cover our investments, our profitability may suffer.

The water utility business is capital intensive. On an annual basis, we spend significant sums for additions to or replacement of property, plant and equipment. Our ability to maintain and meet our financial objectives is dependent upon the rates we charge our customers. These rates are subject to approval by the public utility commissions or similar regulatory bodies in the states in which we operate. We file rate increase requests, from time to time, to recover our investments in utility plant and expenses. Once a rate increase petition is filed with a public utility commission, the ensuing administrative and hearing process may be lengthy and costly. The timing of our rate increase requests are therefore partially dependent upon the estimated cost of the administrative process in relation to the investments and expenses that we hope to recover through the rate increase to the extent approved. We can provide no assurances that any future rate increase request will be approved by the appropriate state public utility commission; and, if approved, we cannot guarantee that these rate increases will be granted in a timely or sufficient manner to cover the investments and expenses for which we initially sought the rate increase.

Our operating costs could be significantly increased in order to comply with new or stricter regulatory standards imposed by federal and state environmental agencies.

Our water and wastewater services are governed by various federal and state environmental protection and health and safety laws and regulations, including the federal Safe Drinking Water Act, the Clean Water Act and similar state laws, and state and federal regulations issued under these laws by the United States Environmental Protection Agency and state environmental regulatory agencies. These laws and regulations establish, among other things, criteria and standards for drinking water and for discharges into the waters of the United States and states. Pursuant to these laws, we are required to obtain various environmental permits from environmental regulatory agencies for our operations. We cannot assure you that we have been or will be at all times in total compliance with these laws, regulations and permits. If we violate or fail to comply with these laws, regulations or permits, we could be fined or otherwise sanctioned by regulators. Environmental laws and regulations are complex and change frequently. These laws, and the enforcement thereof, have tended to become more stringent over time. While we have budgeted for future capital and operating expenditures to maintain compliance with these laws and our permits, it is possible that new or stricter standards could be imposed that will raise our operating costs. Although these costs may be recovered in the form of higher

rates, there can be no assurance that the various state public utility commissions or similar regulatory bodies that govern our business would approve rate increases to enable us to recover such costs. In summary, we cannot assure you that our costs of complying with, or discharging liability under, current and future environmental and health and safety laws will not adversely affect our business, results of operations or financial condition.

Our business is subject to seasonal fluctuations, which could affect demand for our water service and our revenues.

Demand for our water during the warmer months is generally greater than during cooler months due primarily to additional requirements for water in connection with irrigation systems, swimming pools, cooling systems and other outside water use. Throughout the year, and particularly during typically warmer months, demand will vary with temperature and rainfall levels. In the event that temperatures during the typically warmer months are cooler than normal, or if there is more rainfall than normal, the demand for our water may decrease and adversely affect our revenues.

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Item 1, Continued

Drought conditions may impact our ability to serve our current and future customers, and may impact our customers' use of our water, which may adversely affect our financial condition and results of operations.

We depend on an adequate water supply to meet the present and future demands of our customers. Drought conditions could interfere with our sources of water supply and could adversely affect our ability to supply water in sufficient quantities to our existing and future customers. An interruption in our water supply could have a material adverse effect on our financial condition and results of operations. Moreover, governmental restrictions on water usage during drought conditions may result in a decreased demand for our water, even if our water reserves are sufficient to serve our customers during these drought conditions, which may adversely affect our revenues and earnings.

An important element of our growth strategy is the acquisition of water and wastewater systems. Any future acquisitions we decide to undertake may involve risks.

An important element of our growth strategy is the acquisition and integration of water and wastewater systems in order to broaden our current, and move into new, service areas. We will not be able to acquire other businesses if we cannot identify suitable acquisition opportunities or reach mutually agreeable terms with acquisition candidates. It is our intent, when practical, to integrate any businesses we acquire with our existing operations. The negotiation of potential acquisitions as well as the integration of acquired businesses could require us to incur significant costs and cause diversion of our management's time and resources. Future acquisitions by us could result in:

- o dilutive issuances of our equity securities;
- o incurrence of debt and contingent liabilities;
- o fluctuations in quarterly results; and
- o other acquisition-related expenses.

Some or all of these items could have a material adverse effect on our business and our ability to finance our business. The businesses we acquire in the future may not achieve sales and profitability that justify our investment and any difficulties we encounter in the integration process could interfere with our operations and reduce our operating margins. In addition, as consolidation becomes more prevalent in the water and wastewater industries, the prices for suitable acquisition candidates may increase to unacceptable levels and limit our ability to grow through acquisitions.

Contamination to our water supply may result in disruption in our services and litigation which could adversely affect our business, operating results and financial condition.

Our water supplies are subject to contamination, including contamination from the development of naturally-occurring compounds, chemicals in groundwater systems, pollution resulting from man-made sources and possible terrorist attacks. In the event that our water supply is contaminated, we may

have to interrupt the use of that water supply until we are able to substitute the flow of water from an uncontaminated water source. In addition, we may incur significant costs in order to treat the contaminated source through expansion of our current treatment facilities, or development of new treatment methods. If we are unable to substitute water supply from an uncontaminated water source, or to adequately treat the contaminated water source in a cost-effective manner, there may be an adverse effect on our revenues, operating results and financial condition. The costs we incur to decontaminate a water source or an underground water system could be significant and could adversely affect our business,

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Item 1, Continued

operating results and financial condition and may be recoverable in rates. We could also be held liable for consequences arising out of human exposure to hazardous substances in our water supplies or other environmental damage. For example, private plaintiffs have the right to bring personal injury or other toxic tort claims arising from the presence of hazardous substances in our drinking water supplies. Our insurance policies may not be sufficient to cover the costs of these claims.

In addition to the potential pollution of our water supply as described above, in the wake of the September 11, 2001 terrorist attacks and the ensuing threats to the nation's health and security, we have taken steps to increase security measures at our facilities and heighten employee awareness of threats to our water supply. We have also tightened our security measures regarding the delivery and handling of certain chemicals used in our business. We have and will continue to bear increased costs for security precautions to protect our facilities, operations and supplies. These costs may be significant. We are currently not aware of any specific threats to our facilities, operations or supplies; however, it is possible that we would not be in a position to control the outcome of terrorist events should they occur.

We depend significantly on the services of the members of our senior management team, and the departure of any of those persons could cause our operating results to suffer.

Our success depends significantly on the continued individual and collective contributions of our senior management team. The loss of the services of any member of our senior management or the inability to hire and retain experienced management personnel could harm our operating results.

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Item 2. Properties.

Our properties consist of transmission and distribution mains and conduits, water and wastewater treatment plants, pumping facilities, wells, tanks, meters, supply lines, dams, reservoirs, buildings, vehicles, land, easements, rights and other facilities and equipment used for the operation of our systems, including the collection, treatment, storage and distribution of water. Substantially all of our properties are owned by our subsidiaries and are subject to liens of mortgage or indentures. These liens secure bonds, notes and other evidences of long-term indebtedness of our subsidiaries. For certain properties that we acquired through the exercise of the power of eminent domain and certain other properties we purchased, we hold title for water supply purposes only. We own, operate and maintain several thousand miles of transmission and distribution mains, 20 water treatment plants and many

wastewater treatment plants. Some properties are leased under long-term leases. The following table indicates our net utility plant, in thousands of dollars, as of December 31, 2003 in the principal states where we operate:

	Net Property, Plant and Equipment
Pennsylvania	\$1,138,338
Ohio	162,489
Illinois	154,752
Texas	136,407
New Jersey	97,715
Indiana	76,052
Maine	38,518
Florida	30,948
North Carolina	21,551
Virginia	20,423
Missouri	3,016
Inter-company eliminations and other states	(55,918)

	\$1,824,291
	=====

We believe that our properties are generally maintained in good condition and in accordance with current standards of good waterworks industry practice. We believe that the facilities used in the operation of our business are in good condition in terms of suitability, adequacy and utilization.

Our corporate offices are leased from Aqua Pennsylvania, Inc. and located in Bryn Mawr, Pennsylvania.

Item 3. Legal Proceedings

There are various legal proceedings in which we are involved. Although the results of legal proceedings cannot be predicted with certainty, there are no pending legal proceedings to which we or any of our subsidiaries is a party or to which any of our properties is the subject that are expected to have a material effect on our financial position, results of operations or cash flows.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of 2003.

PART II

Item 5. Market for the Registrant's Common Stock and Related Security Holder Matters

Our common stock is traded on the New York Stock Exchange and the Philadelphia Stock Exchange under the ticker symbol WTR. As of February 17, 2004, there were approximately 22,973 holders of record of our common stock.

The following table shows the high and low intraday sales prices for our common stock as reported on the New York Stock Exchange composite transactions reporting system and the cash dividends paid per share for the periods indicated (all per share data as presented has been adjusted for the 2003 5-for-4 common stock split effected in the form of a stock distribution):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
2003	-----				
Dividend paid per common share	\$ 0.112	\$ 0.112	\$ 0.112	\$ 0.120	\$ 0.456
Price range of common stock					
- high	17.83	19.85	20.07	22.40	22.40
- low	15.77	17.22	18.28	18.71	15.77

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Dividend paid per common share	\$ 0.106	\$ 0.106	\$ 0.106	\$ 0.112	\$ 0.430
Price range of common stock					
- high	19.69	20.00	16.24	17.50	20.00
- low	16.88	14.79	12.82	15.44	12.82

We have paid common dividends consecutively for 59 years. Effective December 1, 2003, our Board of Directors authorized an increase of 7.1% in the dividend rate over the amount Aqua America, Inc. paid in the previous quarter. As a result of this authorization, beginning with the dividend payment in December 2003, the annualized dividend rate increased to \$0.48 per share. We presently intend to pay quarterly cash dividends in the future, on March 1, June 1, September 1 and December 1, subject to our earnings and financial condition, regulatory requirements and such other factors as our Board of Directors may deem relevant. During the past five years, our common dividends paid have averaged 59.4% of net income.

In August 2003, our Board of Directors declared a 5-for-4 common stock split effected in the form of a 25% stock distribution for all common shares outstanding, to shareholders of record on November 14, 2003. The new shares were distributed on December 1, 2003. Aqua America's par value of \$0.50 per share remained unchanged and \$9,244,000 was transferred from Capital in Excess of Par Value to Common Stock to record the split. All share and per share data for all periods presented have been restated to give effect to the stock split.

Item 6. Selected Financial Data

The information appearing in the section captioned "Summary of Selected Financial Data" from the portions of our 2003 Annual Report to Shareholders filed as Exhibit 13.1 to this Form 10-K Report is incorporated by reference herein.

Item 7. Management's Discussion and Analysis of Financial Condition and \ Results of Operations

The information appearing in the section captioned "Management's Discussion and Analysis" from the portions of our 2003 Annual Report to Shareholders filed as Exhibit 13.1 to this Form 10-K Report is incorporated by reference herein.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are subject to market risks in the normal course of business, including changes in interest rates and equity prices. The exposure to changes in interest rates is a result of financings through the issuance of fixed-rate, long-term debt. Such exposure is typically related to financings between utility rate increases, since generally our rate increases include a revenue level to allow recovery of our current cost of capital. Interest rate risk is managed through the use of a combination of long-term debt, which is at fixed interest rates and short-term debt, which is at floating interest rates. As of December 31, 2003, the debt maturities by period, in thousands of dollars, and the weighted average interest rate for fixed-rate, long-term debt are as follows:

	2004	2005	2006	2007	2008	Thereafter	Total	Fair Value
Long-term debt (fixed rate)	\$39,386	\$40,418	\$16,088	\$14,395	\$19,438	\$606,327	\$736,052	\$781,502
Weighted average interest rate	6.39%	7.26%	7.25%	6.94%	7.38%	6.02%	6.19%	

From time to time, we make investments in marketable equity securities. As a result, we are exposed to the risk of changes in equity prices for the "available-for-sale" marketable equity securities. As of December 31, 2003, our carrying value of marketable equity securities was \$1,019,000, which reflects the market value of such securities and is in excess of our original cost. The market risks that we are exposed to are consistent with the risks that we were exposed to in the prior year.

Item 8. Financial Statements and Supplementary Data

Information appearing under the captions "Consolidated Statements of Income and Comprehensive Income", "Consolidated Balance Sheets", "Consolidated Cash Flow Statements" "Consolidated Statements of Capitalization" and "Notes to Consolidated Financial Statements" from the portions of our 2003 Annual Report to Shareholders filed as Exhibit 13.1 to this Form 10-K Report is incorporated by reference herein. Also, the information appearing in the section captioned "Reports on Financial Statements" from the portions of our 2003 Annual Report to Shareholders filed as Exhibit 13.1 to this Form 10-K Report is incorporated by reference herein.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures - Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report are functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. A controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

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

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PART III

Item 10. Directors and Executive Officers of the Registrant

We make available free of charge within the Investor Relations / Corporate Governance section of our internet website, at www.aquaamerica.com, and in print to any shareholder who requests, our Corporate Governance Guidelines, the Charters of each Committee of our Board of Directors, and our Code of Ethical Business Conduct. Requests for copies may be directed to Shareholder Relations Department, Aqua America, Inc., 762 W. Lancaster Avenue, Bryn Mawr, PA 19010-3489. Amendments to the Code, and any grant of waiver from a provision of the Code requiring disclosure under applicable SEC rules will be disclosed on the Company's website. The information contained on our Internet website is not incorporated by reference into this Form 10-K and should not be considered part of this or any other report that we file with or furnish to the SEC.

Directors of the Registrant

The information appearing in the section captioned "Information Regarding Nominees and Directors" of the Proxy Statement relating to our May 20, 2004, annual meeting of shareholders, to be filed within 120 days after the end of the fiscal year covered by this Form 10-K Report, is incorporated herein by reference.

Executive Officers of the Registrant

The following table and the notes thereto set forth information with respect to our executive officers, including their names, ages, positions with

Aqua America, Inc. and business experience during the last five years:

Name ----	Age ---	Position with Aqua America, Inc. (1) -----
Nicholas DeBenedictis	58	President and Chairman (May 1993 to present); President and Chief Executive Officer (July 1992 to May 1993); Chairman and Chief Executive Officer, Aqua Pennsylvania, Inc. (July 1992 to present); President, Philadelphia Suburban Water Company (February 1995 to January 1999) (2)
Roy H. Stahl	51	Executive Vice President and General Counsel (May 2000 to present); Secretary (June 2001 to present); Senior Vice President and General Counsel (April 1991 to May 2000) (3)
David P. Smeltzer	45	Senior Vice President - Finance and Chief Financial Officer (December 1999 to present); Vice President - Finance and Chief Financial Officer (May 1999 to December 1999); Vice President - Rates and Regulatory Relations, Philadelphia Suburban Water Company (March 1991 to May 1999) (4)
Richard R. Riegler	57	Senior Vice President - Engineering and Environmental Affairs (January 1999 to present); Senior Vice President - Operations, Philadelphia Suburban Water Company (April 1989 to January 1999) (5)
Richard D. Hugus	54	President, Southern Operations (August 2003 to present); Vice President - Corporate Development, Pennsylvania Suburban Water Company (March 1991 to August 2003) (6)

Item 10, Continued

- (1) In addition to the capacities indicated, the individuals named in the above table hold other offices or directorships with subsidiaries of the Registrant. Officers serve at the discretion of the Board of Directors.
- (2) Mr. DeBenedictis was Secretary of the Pennsylvania Department of Environmental Resources from 1983 to 1986. From December 1986 to April 1989, he was President of the Greater Philadelphia Chamber of Commerce. Mr. DeBenedictis was Senior Vice President for Corporate and Public Affairs of Philadelphia Electric Company from April 1989 to June 1992.
- (3) From January 1984 to August 1985, Mr. Stahl was Corporate Counsel, from August 1985 to May 1988 he was Vice President - Administration and Corporate Counsel of Aqua America, Inc., and from May 1988 to April 1991 he was Vice President and General Counsel of Aqua America, Inc..
- (4) Mr. Smeltzer was Vice President - Controller of Philadelphia Suburban Water Company from March, 1986 to March 1991.
- (5) Mr. Riegler was Chief Engineer of Philadelphia Suburban Water Company from 1982 to 1984. He then served as Vice President and Chief Engineer from 1984 to 1986 and Vice President of Operations from 1986 to 1989.
- (6) Mr. Hugus was Vice President and Treasurer of Philadelphia Suburban Water Company from December 1988 to March 1991.

Item 11. Executive Compensation

The information appearing in the sections captioned "Executive Compensation" of the Proxy Statement relating to our May 20, 2004, annual meeting of shareholders, to be filed within 120 days after the end of the fiscal year covered by this Form 10-K Report, is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and related Stockholder matters

Ownership of Common Stock - The information appearing in the section captioned "Ownership of Common Stock" of the Proxy Statement relating to our May 20, 2004, annual meeting of shareholders, to be filed within 120 days after the end of the fiscal year covered by this Form 10-K Report, is incorporated herein by reference.

Item 12, Continued

Securities Authorized for Issuance under Equity Compensation Plans - The following table provides information for our equity compensation plan as of December 31, 2003:

EQUITY COMPENSATION PLAN INFORMATION			
Plan Category	Number of Securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of Securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column
Equity compensation plans approved by security holders	2,993,421	\$13.31	4,984,151
Equity compensation plans not approved by security holders	0	0	0
Total	2,993,421	\$13.31	4,984,151

Item 13. Certain Relationships and Related Transactions

The information appearing in the sections captioned "Certain Relationships and Related Transactions" of the Proxy Statement relating to our May 20, 2004, annual meeting of shareholders, to be filed within 120 days after the end of the fiscal year covered by this Form 10-K Report, is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

The information appearing in the section captioned "Independent Accountants - Services and Fees" of the Proxy Statement relating to our May 20, 2004, annual meeting of shareholders, to be filed within 120 days after the end of the fiscal year covered by this Form 10-K Report, is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

Financial Statements. The following is a list of our consolidated financial statements and supplementary data incorporated by reference in Item 8 hereof:

Report of Management

Independent Auditors' Report of PricewaterhouseCoopers LLP

Consolidated Balance Sheets - December 31, 2003 and 2002

Consolidated Statements of Income and Comprehensive Income - 2003, 2002 and 2001

Consolidated Cash Flow Statements - 2003, 2002, and 2001

Consolidated Statements of Capitalization - December 31, 2003 and 2002

Notes to Consolidated Financial Statements

Financial Statement Schedules. The financial statement schedules, or supplemental schedules, filed as part of this annual report on Form 10-K are omitted because they are not applicable or not required, or because the required information is included in the consolidated financial statements or notes thereto.

Reports on Form 8-K.

Current Report on Form 8-K furnished on November 5, 2003, responding to Item 9, Regulation FD Disclosure. (Related to the Company's issuance of a press release on November 5, 2003 announcing its third quarter 2003 earnings).

Current Report on Form 8-K filed on November 26, 2003, responding to Item 5, Other Events. (Related to the Company entering into a purchase agreement with ALLETE Water Services, Inc., a subsidiary of ALLETE, Inc., to acquire the capital stock of Heater Utilities, Inc., which owns water and wastewater systems located in North Carolina).

Exhibits, Including Those Incorporated by Reference. The following is a list of exhibits filed as part of this annual report on Form 10-K. Where so indicated by footnote, exhibits which were previously filed are incorporated by reference. For exhibits incorporated by reference, the location of the exhibit in the previous filing is indicated in parentheses. The page numbers listed refer to page numbers where such exhibits are located using the sequential numbering system specified by Rules 0-3 and 403.

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EXHIBIT INDEX

Exhibit No.

- 3.1 Restated Articles of Incorporation (as of May 17, 2001) (15)
(Exhibit 3.11)
- 3.2 By-Laws, as amended (9) (Exhibit 3.2)
- 3.3 Amendment to Section 3.03 and addition of Section 3.17
to Bylaws (11) (Exhibits 1 and 2)
- 3.4 Amendment to Section 3.03 of the Bylaws (13) (Exhibit 3.8)
- 3.5 Amendments to Sections 2.01(a), 2.02 and 3.08(b) of the Bylaws
(14) (Exhibit 3.10)
- 4.1 Indenture of Mortgage dated as of January 1, 1941
between Philadelphia Suburban Water Company and The
Pennsylvania Company for Insurance on Lives and Granting
Annuities (now First Pennsylvania Bank, N.A.), as Trustee, with
supplements thereto through the Twentieth Supplemental
Indenture dated as of August 1, 1983 (2) (Exhibits 4.1 through
4.16)

- 4.2 Agreement to furnish copies of other long-term debt instruments (1) (Exhibit 4.7)
- 4.3 Twenty-fourth Supplemental Indenture dated as of June 1, 1988 (3) (Exhibit 4.5)
- 4.4 Twenty-fifth Supplemental Indenture dated as of January 1, 1990 (4) (Exhibit 4.6)
- 4.5 Twenty-sixth Supplemental Indenture dated as of November 1, 1991 (5) (Exhibit 4.12)
- 4.6 Twenty-eighth Supplemental Indenture dated as of April 1, 1993 (6) (Exhibit 4.15)
- 4.7 Twenty-ninth Supplemental Indenture dated as of March 30, 1995 (7) (Exhibit 4.17)
- 4.8 Thirtieth Supplemental Indenture dated as of August 15, 1995 (8) (Exhibit 4.18)
- 4.9 Thirty-first Supplemental Indenture dated as of July 1, 1997 (10) (Exhibit 4.22)
- 4.10 First Amended and Restated Rights Agreement, dated as of February 20, 2004 between Aqua America, Inc. and Equiserve Trust Company, N.A., as Rights Agent
- 4.11 Thirty-second Supplement Indenture, dated as of October 1, 1999 (12) (Exhibit 4.26)
- 4.12 Thirty-third Supplemental Indenture, dated as of November 15, 1999. (13) (Exhibit 4.27)
- 4.13 Revolving Credit Agreement between Philadelphia Suburban Water Company and PNC Bank National Association, First Union National Bank, N.A., Mellon Bank, N.A. dated as of December 22, 1999 (13) (Exhibit 4.27)
- 4.14 First Amendment to Revolving Credit Agreement dated as of November 28, 2000, between Philadelphia Suburban Water Company and PNC Bank, National Association, First Union National Bank, N.A., Mellon Bank, N.A. dated as of December 22, 1999 (14) (Exhibit 4.19)
- 4.15 Second Amendment to Revolving Credit Agreement dated as of December 18, 2001, between Philadelphia Suburban Water Company (and its successor Pennsylvania Suburban Water Company) and PNC Bank, National Association, Citizens Bank of Pennsylvania, First Union National Bank, N.A., Fleet National Bank dated as of December 22, 1999 (15) (4.20)

EXHIBIT INDEX

Exhibit No.

- 4.16 Thirty-fourth Supplemental Indenture, dated as of October 15, 2001. (15) (4.21)
- 4.17 Thirty-fifth Supplemental Indenture, dated as of January 1, 2002. (15) (4.22)
- 4.18 Thirty-sixth Supplemental Indenture, dated as of June 1, 2002. (17) (4.23)
- 4.19 Thirty-seventh Supplemental Indenture, dated as of December 15, 2002. (18) (4.23)
- 4.20 Credit Agreement dated as of October 25, 2002, between Philadelphia

Suburban Corporation and PNC Bank, National Association. (18)
(4.24)

- 4.21 Third Amendment to Revolving Credit Agreement dated as of December 16, 2002, between Philadelphia Suburban Water Company (and its successor Pennsylvania Suburban Water Company) and PNC Bank, National Association, Citizens Bank of Pennsylvania, Fleet National Bank dated as of December 22, 1999. (18) (4.25)
- 4.22 Fourth Amendment to Revolving Credit Agreement dated as of December 24, 2002, between Philadelphia Suburban Water Company (and its successor Pennsylvania Suburban Water Company) and PNC Bank, National Association, Citizens Bank of Pennsylvania, Fleet National Bank, National City Bank dated as of December 22, 1999. (18) (4.26)
- 4.23 Note Purchase Agreement among the note purchasers and Philadelphia Suburban Corporation, dated July 31, 2003 (19) (4.27)
- 4.24 Credit Agreement dated as of July 31, 2003, between Philadelphia Suburban Corporation and PNC Bank, National Association (19) (4.28)
- 4.25 Fifth Amendment to Revolving Credit Agreement dated as of December 14, 2003, between Philadelphia Suburban Water Company (and its successor Pennsylvania Suburban Water Company) and PNC Bank, National Association, Citizens Bank of Pennsylvania, Fleet National Bank, National City Bank dated as of December 22, 1999.
- 10.1 Excess Benefit Plan for Salaried Employees, effective December 1, 1989* (4) (Exhibit 10.4)
- 10.2 Supplemental Executive Retirement Plan, effective December 1, 1989* (4) (Exhibit 10.5)
- 10.3 Supplemental Executive Retirement Plan, effective March 15, 1992* (1) (Exhibit 10.6)
- 10.4 Employment letter agreement with Mr. Nicholas DeBenedictis* (1) (Exhibit 10.8)
- 10.5 1994 Equity Compensation Plan, as amended by Amendment effective August 5, 2003*
- 10.6 Placement Agency Agreement between Philadelphia Suburban Water Company and PaineWebber Incorporated dated as of March 30, 1995 (7) (Exhibit 10.12)
- 10.7 Bond Purchase Agreement among the Delaware County Industrial Development Authority, Philadelphia Suburban Water Company and Legg Mason Wood Walker, Incorporated dated August 24, 1995 (8) (Exhibit 10.13)
- 10.8 Construction and Financing Agreement between the Delaware County Industrial Development Authority and Philadelphia Suburban Water Company dated as of August 15, 1995 (8) (Exhibit 10.14)

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EXHIBIT INDEX

Exhibit No.

- 10.9 Philadelphia Suburban Corporation Amended and Restated Executive Deferral Plan*
- 10.10 Philadelphia Suburban Corporation Deferred Compensation Plan Master Trust Agreement with PNC Bank, National Association, dated as of December 31, 1996* (9) (Exhibit 10.24)
- 10.11 First Amendment to Supplemental Executive Retirement Plan* (9) (Exhibit 10.25)

- 10.12 Placement Agency Agreement between Philadelphia Suburban Water Company and A.G. Edwards and Sons, Inc., Janney Montgomery Scott Inc., HSBC Securities, Inc., and PaineWebber Incorporated (10) (Exhibit 10.26)
- 10.13 The Director Deferral Plan* (as amended and restated effective January 1, 2003)
- 10.14 Bond Purchase Agreement among the Delaware County Industrial Development Authority, Philadelphia Suburban Water Company and Commerce Capital Markets dated September 29, 1999 (12) (Exhibit 10.37)
- 10.15 Construction and Financing Agreement between the Delaware County Industrial Development Authority and Philadelphia Suburban Water Company dated as of October 1, 1999 (12) (Exhibit 10.38)
- 10.16 Placement Agency Agreement between Philadelphia Suburban Water Company and Merrill Lynch & Co., PaineWebber Incorporated, A.G. Edwards & Sons, Inc., First Union Securities, Inc., PNC Capital Markets, Inc. and Janney Montgomery Scott, Inc., dated as of November 15, 1999 (13) (Exhibit 10.41)
- 10.17 Bond Purchase Agreement among the Delaware County Industrial Development Authority, Philadelphia Suburban Water Company and The GMS Group, L.L.C., dated October 23, 2001 (15) (10.35)
- 10.18 Construction and Financing Agreement between the Delaware County Industrial Development Authority and Philadelphia Suburban Water Company dated as of October 15, 2001 (15) (10.36)
- 10.19 Agreement among Philadelphia Suburban Corporation, Philadelphia Suburban Water Company and Nicholas DeBenedictis, dated August 7, 2001* (15) (10.37)
- 10.20 Agreement among Philadelphia Suburban Corporation, Philadelphia Suburban Water Company and Roy H. Stahl, dated August 7, 2001* (15) (10.38)
- 10.21 Agreement among Philadelphia Suburban Corporation, Philadelphia Suburban Water Company and Richard R. Riegler, dated August 7, 2001* (15) (10.39)
- 10.22 Agreement among Philadelphia Suburban Corporation, Philadelphia Suburban Water Company and David P. Smeltzer, dated August 7, 2001* (15) (10.40)
- 10.23 Agreement among Philadelphia Suburban Corporation, Philadelphia Suburban Water Company and Richard D. Hugus, dated August 7, 2001*

EXHIBIT INDEX

Exhibit No.

- 10.24 2002 Annual Cash Incentive Compensation Plan* (16) (Exhibit 10.41)
- 10.25 Bond Purchase Agreement among the Bucks County Industrial Development Authority, Pennsylvania Suburban Water Company and Janney Montgomery Scott LLC, dated May 21, 2002 (17) (Exhibit 10.42)
- 10.26 Construction and Financing Agreement between the Bucks County Industrial Development Authority and Pennsylvania Suburban Water Company dated as of June 1, 2002 (17) (Exhibit 10.43)
- 10.27 Bond Purchase Agreement among the Delaware County Industrial Development Authority, Pennsylvania Suburban Water Company, and The GMS Group, L.L.C., dated December 19, 2002 (18) (Exhibit 10.44)

- 10.28 Construction and Financing Agreement between the Delaware County Industrial Development Authority and Pennsylvania Suburban Water Company dated as of December 15, 2002 (18) (Exhibit 10.45)
- 10.29 2003 Annual Cash Incentive Compensation Plan* (18) (Exhibit 10.46)
- 10.30 2004 Annual Cash Incentive Compensation Plan*
- 13.1 Selected portions of Annual Report to Shareholders for the year ended December 31, 2003 incorporated by reference in Annual Report on Form 10-K for the year ended December 31, 2003
- 21. Subsidiaries of Aqua America, Inc.
- 23.1 Consent of Independent Accountants - PricewaterhouseCoopers LLP
- 24. Power of Attorney (set forth as a part of this report)
- 31.1 Certification of Chief Executive Officer, pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934
- 31.2 Certification of Chief Financial Officer, pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934
- 32.1 Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350
- 32.2 Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350

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Notes -
Documents Incorporated by Reference

- (1) Filed as an Exhibit to Annual Report on Form 10-K for the year ended December 31, 1992.
- (2) Indenture of Mortgage dated as of January 1, 1941 with supplements thereto through the Twentieth Supplemental Indenture dated as of August 1, 1983 were filed as an Exhibit to Annual Report on Form 10-K for the year ended December 31, 1983.
- (3) Filed as an Exhibit to Annual Report on Form 10-K for the year ended December 31, 1988.
- (4) Filed as an Exhibit to Annual Report on Form 10-K for the year ended December 31, 1989.
- (5) Filed as an Exhibit to Annual Report on Form 10-K for the year ended December 31, 1991.
- (6) Filed as an Exhibit to Annual Report on Form 10-K for the year ended December 31, 1993.
- (7) Filed as an Exhibit to Quarterly Report on Form 10-Q for the quarter ended March 31, 1995.
- (8) Filed as an Exhibit to Quarterly Report on Form 10-Q for the quarter ended September 30, 1995.
- (9) Filed as an Exhibit to Annual Report on Form 10-K for the year ended December 31, 1996.
- (10) Filed as an Exhibit to Quarterly Report on Form 10-Q for the quarter ended June 30, 1997.
- (11) Filed as an Exhibit to Form 8-K filed August 7, 1997.
- (12) Filed as an Exhibit to Quarterly Report on Form 10-Q for the quarter ended September 30, 1999.

- (13) Filed as Exhibit to Annual Report on Form 10-K for the year ended December 31, 1999.
- (14) Filed as Exhibit to Annual Report on Form 10-K for the year ended December 31, 2000.
- (15) Filed as Exhibit to Annual Report on Form 10-K for the year ended December 31, 2001.
- (16) Filed as an Exhibit to Quarterly Report on Form 10-Q for the quarter ended March 31, 2002.
- (17) Filed as an Exhibit to Quarterly Report on Form 10-Q for the quarter ended June 30, 2002.
- (18) Filed as an Exhibit to Annual Report on Form 10-K for the year ended December 31, 2002.
- (19) Filed as an Exhibit to Quarterly Report on Form 10-Q for the quarter ended September 30, 2003

*Indicates management contract or compensatory plan or arrangement.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AQUA AMERICA, INC.

By NICHOLAS DEBENEDICTIS

Nicholas DeBenedictis
President and Chairman

Date: March 12, 2004

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Each person in so signing also makes, constitutes and appoints Nicholas DeBenedictis, President and Chairman of Aqua America, Inc., David P. Smeltzer, Senior Vice President - Finance and Chief Financial Officer of Aqua America, Inc., and each of them, his or her true and lawful attorneys-in-fact, in his or her name, place and stead to execute and cause to be filed with the Securities and Exchange Commission any and all amendments to this report.

NICHOLAS DEBENEDICTIS ----- Nicholas DeBenedictis President and Chairman	DAVID P. SMELTZER ----- David P. Smeltzer Senior Vice President - Finance and
---	--

(principal executive officer)
and Director

Chief Financial Officer

MARY C. CARROLL

G. FRED DIBONA, JR.

Mary C. Carroll
Director

G. Fred DiBona, Jr.
Director

RICHARD H. GLANTON

ALAN HIRSIG

Richard H. Glanton
Director

Alan Hirsig
Director

JOHN F. MCCAUGHAN

JOHN E. MENARIO

John F. McCaughan
Director

John E. Menario
Director

RICHARD L. SMOOT

Richard L. Smoot
Director

AQUA AMERICA, INC.

and

EQUISERVE TRUST COMPANY, N.A.

as Rights Agent

FIRST AMENDED AND RESTATED RIGHTS AGREEMENT

Dated as of February 20, 2004

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FIRST AMENDED AND RESTATED RIGHTS AGREEMENT

FIRST AMENDED AND RESTATED RIGHTS AGREEMENT, dated as of February 20, 2004 (the "Agreement"), between AQUA AMERICA, INC., a Pennsylvania corporation (the "Company"), and EQUISERVE TRUST COMPANY, N.A. (the "Rights Agent").

W I T N E S S E T H

WHEREAS, the Company and the Rights Agent entered into a Rights Agreement, dated as of March 1, 1998 (the "Original Rights Agreement");

WHEREAS, on February 3, 1998 (the "Rights Dividend Declaration Date"), the Board of Directors of the Company authorized and declared a dividend distribution of one Right for each Common Share (as hereinafter defined) of the Company outstanding at the close of business on March 1, 1998 (the "Record Date") (which for these purposes included all Common Shares then entitled to receive dividends) and authorized the issuance of one Right (as such number may hereafter be adjusted pursuant to the provisions of Section 11(i) hereof) for each Common Share of the Company issued between the Record Date (whether originally issued or delivered from the Company's treasury) and the Distribution Date (as hereinafter defined), each Right initially representing the right to purchase one one-thousandth of a Preferred Share (as hereinafter defined) of the Company having the rights, powers and preferences set forth in the form of the Resolution of the Board of Directors attached hereto as Exhibit A, upon the terms and subject to the conditions hereinafter set forth (the "Rights");

WHEREAS, on March 1, 1998, the Rights were distributed to the holders of record of shares of Common Stock on the Record Date;

WHEREAS, the Company and the Rights Agent desire to amend and restate the Original Rights Agreement to provide, among other things, that a majority of the Board of Directors of the Company can redeem the Rights hereunder and, in certain circumstances, amend this Agreement;

WHEREAS, the Rights are held by the Rights Agent as trustee for the shareholders of the Company until the Distribution Date;

WHEREAS, the Board of Directors of the Company has considered whether approval of this Agreement and the distribution of the Rights is in the best interests of the Company and all other pertinent factors; and

WHEREAS, the Board of Directors of the Company has concluded that approval of this Agreement and the distribution of the Rights is in the best interests of the Company because the existence of the Rights will help (i) reduce the risk of coercive two-tiered, front-end loaded or partial offers that may not offer fair value to all shareholders, (ii) mitigate against market accumulators who through open market and/or private purchases may achieve a position of substantial influence or control without paying to selling or remaining shareholders a fair control premium, (iii) deter market accumulators who are simply interested in putting the Company into "play," (iv) restrict self-dealing by a substantial shareholder, and (v) preserve the Board of Directors' bargaining power and flexibility to deal with third-party acquirors, to pursue the business strategies of the Company and to otherwise seek to maximize values for all shareholders.

NOW, THEREFORE, in consideration of the premises and the mutual agreements herein set forth, and intending to be legally bound hereby, the parties hereby agree as follows:

Section 1. Certain Definitions. For purposes of this Agreement, the following terms have the meanings indicated:

(a) "Acquiring Person" shall mean any Person who or which, together with all Affiliates and Associates of such Person, shall be the Beneficial Owner of 20% or more of the Common Shares then outstanding, but shall not include the Company, any Subsidiary of the Company, any employee benefit plan of the Company or of any Subsidiary of the Company, or any Person or entity organized, appointed or established by the Company for or pursuant to the terms of any such plan. Notwithstanding the foregoing, no Person shall become an "Acquiring Person" as the result of an acquisition of Common Shares by the Company which, by reducing the number of Common Shares outstanding, increases the proportionate number of Common Shares beneficially owned by such Person to 20% or more of the Common Shares then outstanding; provided, however, that if a Person shall become the Beneficial Owner of 20% or more of the then outstanding Common Shares by reason of Common Shares purchased by the Company and shall, after such share purchases by the Company, become the Beneficial Owner of any additional Common Shares, then such Person shall be deemed to be an "Acquiring Person." Notwithstanding the foregoing, if a majority of the Board of Directors of the Company determines in good faith that a Person who would otherwise be an "Acquiring Person", as defined pursuant to the foregoing provisions of this paragraph (a), has become such inadvertently, and such Person divests as promptly as practicable a sufficient number of Common Shares so that such Person would no longer be an Acquiring Person, as defined pursuant to the foregoing provisions of this paragraph (a), then such Person shall not be deemed to be an "Acquiring Person" for purposes of this Agreement.

(b) "Affiliate" and "Associate" shall have the respective meanings ascribed to such terms in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended and in effect on the date hereof (the "Exchange Act").

(c) A Person shall be deemed the "Beneficial Owner" of, and shall be deemed to "beneficially own," any securities:

(i) that such Person or any of such Person's Affiliates or Associates, directly or indirectly, has the right to acquire (whether such right is exercisable immediately or only after the passage of time) pursuant to any agreement, arrangement or understanding (whether or not in writing) or upon the exercise of conversion rights, exchange rights, rights, warrants or options, or otherwise; provided, however, that a Person shall not be deemed the "Beneficial Owner" of, or to "beneficially own," (A) securities tendered pursuant to a tender or exchange offer made by such Person or any of such Person's Affiliates

or Associates until such tendered securities are accepted for payment, purchase or exchange, or (B) securities issuable upon exercise of Rights at any time prior to the occurrence of a Triggering Event, or (C) securities issuable upon exercise of Rights from and after the occurrence of a Triggering Event which Rights were acquired by such Person or any of such Person's Affiliates or Associates prior to the Distribution Date or pursuant to Section 3(a) or Section 22 hereof (the "Original Rights") or pursuant to Section 11(i) hereof in connection with an adjustment made with respect to any Original Rights;

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(ii) that such Person or any of such Person's Affiliates or Associates, directly or indirectly, has the right to vote or dispose of or has "beneficial ownership" of (as determined pursuant to Rule 13d-3 of the General Rules and Regulations under the Exchange Act), including without limitation pursuant to any agreement, arrangement or understanding (whether or not in writing); provided, however, that a Person shall not be deemed the "Beneficial Owner" of, or to "beneficially own," any security under this subparagraph (ii) as a result of an oral or written agreement, arrangement or understanding to vote such security if such agreement, arrangement or understanding: (A) arises solely from a revocable proxy given in response to a public proxy or consent solicitation made pursuant to, and in accordance with, the applicable provisions of the General Rules and Regulations under the Exchange Act, and (B) is not also then reportable by such Person on Schedule 13D under the Exchange Act (or any comparable or successor report); or

(iii) that are beneficially owned, directly or indirectly, by any other Person (or any Affiliate or Associate thereof) with which such Person (or any of such Person's Affiliates or Associates) has any agreement, arrangement or understanding (whether or not in writing), for the purpose of acquiring, holding, voting (except pursuant to a revocable proxy as described in the proviso to subparagraph (ii) of this paragraph (c)) or disposing of any voting securities of the Company,

provided, however, that nothing in this paragraph (c) shall cause a person engaged in business as an underwriter of securities to be the "Beneficial Owner" of, or to "beneficially own," any securities acquired through such Person's participation in good faith in a firm commitment underwriting until the expiration of forty days after the date of such acquisition.

(d) "Business Day" shall mean any day other than a Saturday, Sunday or a day on which banking institutions in the State of New Jersey or the Commonwealth of Pennsylvania are authorized or obligated by law or executive order to close.

(e) "Close of Business" on any given date shall mean 5:00 P.M., Philadelphia time, on such date; provided, however, that if such date is not a Business Day it shall mean 5:00 P.M., Philadelphia time, on the next succeeding Business Day.

(f) "Common Share" shall mean, when used with reference to the Company, a share of common stock, par value \$.50 per share, of the Company and, to the extent that there are not a sufficient number of Common Shares authorized to permit the full exercise of the Rights, shares of any other class or series of the Company designated for such purpose containing terms substantially similar to the terms of the Common Shares, except that "Common Share" when used with reference to any Person other than the Company shall mean the shares of common stock of such Person with the greatest voting power, or the equity securities or other equity interest having power to control or direct the management, of such Person.

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(g) "Distribution Date" shall have the meaning set forth in Section 3 hereof.

(h) "Expiration Date" shall have the meaning set forth in Section 7(a) hereof.

(i) "Person" shall mean any individual, firm, corporation, partnership, limited liability company or other entity.

(j) "Preferred Share" shall mean a share of Series A Junior

Participating Preferred Shares, par value \$1.00 per share, of the Company and, to the extent that there are not a sufficient number of shares of Series A Junior Participating Preferred Shares authorized to permit the full exercise of the Rights, shares of any other series of Series Preferred Stock of the Company designated for such purpose containing terms substantially similar to the terms of the Series A Junior Participating Preferred Shares.

(k) "Preferred Share Fraction" shall mean one one-thousandth of a Preferred Share.

(l) "Section 11(a)(ii) Event" shall mean any event described in Section 11(a)(ii) (A), (B) or (C) hereof.

(m) "Section 13 Event" shall mean any event described in clauses (x), (y) or (z) of Section 13(a) hereof.

(n) "Stock Acquisition Date" shall mean the first date of public announcement (which, for purposes of this definition, shall include, without limitation, a report filed pursuant to Section 13(d) under the Exchange Act) by the Company or an Acquiring Person that an Acquiring Person has become such.

(o) "Subsidiary" shall have the meaning ascribed to such term in Rule 12b-2 of the General Rules and Regulations under the Exchange Act.

(p) "Trading Day" shall have the meaning set forth in Section 11(d)(i) hereof.

(q) "Triggering Event" shall mean any Section 11(a)(ii) Event or any Section 13 Event.

Unless otherwise specified, where reference is made in this Agreement to sections of, and the General Rules and Regulations under, the Exchange Act, such reference shall mean such sections and rules as amended from time to time and any successor provisions thereto.

Section 2. Appointment of Rights Agent. The Company hereby appoints the Rights Agent to act as agent for the Company in accordance with the terms and conditions hereof, and the Rights Agent hereby accepts such appointment. The Company may from time to time appoint such Co-Rights Agents as it may deem necessary or desirable, upon ten (10) days' prior written notice to the Rights Agent. The Rights Agent shall have no duty to supervise, and in no event be liable for, the acts or omissions of any such co-Rights Agent.

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Section 3. Issue of Rights Certificates.

(a) Until the earlier of (i) the Close of Business on the tenth Business Day after a Stock Acquisition Date involving an Acquiring Person that has become such in a transaction as to which the Board of Directors has not made the determination referred to in Section 11(a)(ii)(B) hereof, or (ii) within ten (10) Business Days (or such later date as may be determined by action of the Board of Directors prior to such time any Person becomes an Acquiring Person) after the date that a tender or exchange offer by any Person (other than the Company, any Subsidiary of the Company, any employee benefit plan of the Company or of any Subsidiary of the Company, or any Person or entity organized, appointed or established by the Company for or pursuant to the terms of any such plan) is first published or sent or given within the meaning of Rule 14d-2(a) of the General Rules and Regulations under the Exchange Act, if upon consummation thereof, such Person would be the Beneficial Owner of 20% or more of the Common Shares then outstanding (the earlier of (i) and (ii) being herein referred to as the "Distribution Date"), (x) beneficial interests in the Rights will be evidenced (subject to the provisions of paragraph (b) of this Section 3) by the certificates for the Common Shares registered in the names of the holders of the Common Shares (which certificates for Common Shares shall be deemed also to be certificates for beneficial interests in the Rights) and not by separate certificates, and (y) the Rights and beneficial interests therein will be transferable only in connection with the transfer of the underlying Common Shares (including a transfer to the Company). The Company must promptly notify the Rights Agent of such Distribution Date and request that its transfer agent provide the Rights Agent with a list of the record holders of the Company's Common Shares as of the close of business on the Distribution Date. As soon as practicable after the Rights Agent receives such notice and list, the Rights

Agent will send by first-class, postage prepaid mail, to each record holder of the Common Shares as of the close of business on the Distribution Date, at the address of such holder shown on the records of the Company, one or more rights certificates, in substantially the form of Exhibit B hereto (the "Rights Certificates"), evidencing one Right for each Common Share so held, subject to adjustment as provided herein. In the event that an adjustment in the number of Rights per Common Share has been made pursuant to Section 11(p) hereof, at the time of distribution of the Rights Certificates, the Company shall make the necessary and appropriate rounding adjustments (in accordance with Section 14(a) hereof) so that Rights Certificates representing only whole numbers of Rights are distributed and cash is paid in lieu of any fractional Rights. As of and after the Distribution Date, the Rights will be evidenced solely by such Rights Certificates.

(b) With respect to certificates for the Common Shares outstanding as of the Record Date, until the Distribution Date, the registered holders of the Common Shares shall also be the registered holders of the beneficial interests in the associated Rights. Until the earlier of the Distribution Date or the Expiration Date (as such term is defined in Section 7 hereof), the transfer of any certificates representing Common Shares in respect of which Rights have been issued shall also constitute the transfer of the Rights associated with such Common Shares. Certificates issued after the Record Date upon the transfer of Common Shares outstanding on the Record Date shall bear the legend set forth in subsection (c).

(c) Except as provided in Section 22 hereof, Rights shall be issued in respect of all Common Shares that are issued (whether originally issued or delivered from the Company's treasury) after the Record Date but prior to the earlier of the Distribution Date or the Expiration Date. Certificates representing such Common Shares shall also be deemed to be certificates for beneficial interests in the associated Rights, and shall bear the following legend:

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"This certificate also evidences a beneficial interest in and entitles the holder hereof to certain Rights as set forth in the First Amended and Restated Rights Agreement between Aqua America, Inc. (the "Company") and Equiserve Trust Company, N.A. (the "Rights Agent") dated as of February 20, 2004 (the "Rights Agreement"), and as the same may be amended from time to time, the terms of which are hereby incorporated herein by reference and a copy of which is on file at the principal offices of the Company. Under certain circumstances, as set forth in the Rights Agreement, such Rights will be evidenced by separate certificates and beneficial interests therein will no longer be evidenced by this certificate. The Company will mail to the holder of this certificate a copy of the Rights Agreement, as in effect on the date of mailing, without charge promptly after receipt of a written request therefor. Under certain circumstances set forth in the Rights Agreement, Rights issued to, or held by, any Person who is, was or becomes an Acquiring Person or any Affiliate or Associate thereof (as such terms are defined in the Rights Agreement), whether currently held by or on behalf of such Person or by any subsequent holder, may become null and void."

With respect to such certificates containing the foregoing legend, until the earlier of (i) the Distribution Date or (ii) the Expiration Date, beneficial interests in the Rights associated with the Common Shares represented by such certificates shall be evidenced by such certificates alone and registered holders of Common Shares shall also be the registered holders of beneficial interests in the associated Rights, and the transfer of any of such certificates shall also constitute the transfer of beneficial interests in the Rights associated with the Common Shares represented by such certificates.

Section 4. Form of Rights Certificates.

(a) The Rights Certificates (and the forms of election to purchase and of assignment to be printed on the reverse thereof) shall each be substantially in the form set forth in Exhibit B hereto and may have such marks of identification or designation and such legends, summaries or endorsements printed thereon as the Company may deem appropriate (which do not affect the

duties or responsibilities of the Rights Agent) and as are not inconsistent with the provisions of this Agreement, or as may be required to comply with any applicable law or with any rule or regulation made pursuant thereto or with any rule or regulation of any stock exchange or the Nasdaq Stock Market on which the Rights may from time to time be listed, or to conform to usage. Subject to the provisions of Section 11 and Section 22 hereof, the Rights Certificates, whenever distributed, shall entitle the holders thereof to purchase such number of Preferred Share Fractions as shall be set forth therein at the price set forth therein (such exercise price per Preferred Share Fraction, the "Purchase Price"), but the amount and type of securities purchasable upon the exercise of each Right and the Purchase Price thereof shall be subject to adjustment as provided herein.

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(b) Any Rights Certificate issued pursuant to Section 3(a) or Section 22 hereof that represents Rights that the Company knows are beneficially owned by: (i) an Acquiring Person or any Associate or Affiliate of an Acquiring Person, (ii) a transferee of an Acquiring Person (or of any such Associate or Affiliate) who becomes a transferee after the Acquiring Person becomes such, or (iii) a transferee of an Acquiring Person (or of any such Associate or Affiliate) who becomes a transferee prior to or concurrently with the Acquiring Person becoming such and receives such Rights pursuant to either (A) a transfer (whether or not for consideration) from the Acquiring Person to holders of equity interests in such Acquiring Person or to any Person with whom such Acquiring Person has any continuing oral or written plan, agreement, arrangement or understanding regarding the transferred Rights or (B) a transfer that the Board of Directors of the Company has determined is part of an oral or written plan, agreement, arrangement or understanding that has as a primary purpose or effect avoidance of Section 7(e) hereof, and provided that the Company shall have notified the Rights Agent that this Section 4(b) applies, any Rights Certificate issued pursuant to Section 6 or Section 11 hereof upon transfer, exchange, replacement or adjustment of any other Rights Certificate referred to in this sentence, shall contain (to the extent feasible) the following legend:

"The Rights represented by this Rights Certificate are or were beneficially owned by a Person who was or became an Acquiring Person or an Affiliate or Associate of an Acquiring Person (as such terms are defined in the Rights Agreement). Accordingly, this Rights Certificate and the Rights represented hereby may become null and void in the circumstances specified in Section 7(e) of such Agreement."

Section 5. Countersignature and Registration.

(a) The Rights Certificates shall be executed on behalf of the Company by its Chairman of the Board, its President or any Vice President, either manually or by facsimile signature, and shall have affixed thereto the Company's seal or a facsimile thereof which shall be attested by the Secretary or an Assistant Secretary of the Company, either manually or by facsimile signature. The Rights Certificates shall be manually countersigned by the Rights Agent and shall not be valid for any purpose unless so countersigned. In case any officer of the Company who shall have signed any of the Rights Certificates shall cease to be such officer of the Company before countersignature by the Rights Agent and issuance and delivery by the Company, such Rights Certificates, nevertheless, may be countersigned by the Rights Agent and issued and delivered by the Company with the same force and effect as though the Person who signed such Rights Certificates had not ceased to be such officer of the Company; and any Rights Certificates may be signed on behalf of the Company by any Person who, at the actual date of the execution of such Rights Certificate, shall be a proper officer of the Company to sign such Rights Certificate, although at the date of the execution of this Agreement any such Person was not such an officer.

(b) Following the Distribution Date and upon receipt by the Rights Agent of the notice and list of recordholders of the Rights referred to in Section 3(a), the Rights Agent will keep or cause to be kept, at its office or offices designated pursuant to Section 25 hereof, books for registration and transfer of the Rights Certificates issued hereunder. Such books shall show the names and addresses of the respective holders of the Rights Certificates, the number of Rights evidenced on its face by each of the Rights Certificates, the Certificate number and the date of each of the Rights Certificates.

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Section 6. Transfer, Split Up, Combination and Exchange of Rights Certificates; Mutilated, Destroyed, Lost or Stolen Rights Certificates.

(a) Subject to the provisions of Section 4(b), Section 7(e) and Section 14 hereof, at any time after the Close of Business on the Distribution Date, and at or prior to the Close of Business on the Expiration Date, any Rights Certificate or Certificates may be transferred, split up, combined or exchanged for another Rights Certificate or Certificates, entitling the registered holder to purchase a like number of Preferred Share Fractions (or, following a Triggering Event, Common Shares or other securities, cash or other assets, as the case may be), as the Rights Certificate or Certificates surrendered then entitled such holder or former holder in the case of a transfer to purchase. Any registered holder desiring to transfer, split up, combine or exchange any Rights Certificate or Certificates shall make such request in writing delivered to the Rights Agent, and shall surrender the Rights Certificate or Certificates to be transferred, split up, combined or exchanged at the office of the Rights Agent designated for such purpose. Neither the Rights Agent nor the Company shall be obligated to take any action whatsoever with respect to the transfer of any such surrendered Rights Certificate or Certificates until the registered holder shall have completed and signed the certificate contained in the form of assignment on the reverse side of such Rights Certificate and shall have provided such additional evidence of the identity of the Beneficial Owner (or former Beneficial Owner) or Affiliates or Associates thereof as the Company or the Rights Agent shall reasonably request. Thereupon the Rights Agent shall, subject to Section 4(b), Section 7(e) and Section 14 hereof, countersign and deliver to the Person entitled thereto a Rights Certificate or Rights Certificates, as the case may be, as so requested. The Rights Agent shall not be obligated to process the transaction until it has received evidence that all taxes and charges arising from the transaction have been paid. The Company may require payment of a sum sufficient to cover any tax or governmental charge that may be imposed in connection with any transfer, split up, combination or exchange of Rights Certificates.

(b) Upon receipt by the Company and the Rights Agent of evidence reasonably satisfactory to them of the loss, theft, destruction or mutilation of a Rights Certificate, and, in case of loss, theft or destruction, of indemnity or security satisfactory to them, and reimbursement to the Company and the Rights Agent of all reasonable expenses incidental thereto, and upon surrender to the Rights Agent and cancellation of the Rights Certificate if mutilated, the Company will execute and deliver a new Rights Certificate of like tenor to the Rights Agent for countersignature and delivery to the registered owner in lieu of the Rights Certificate so lost, stolen, destroyed or mutilated.

Section 7. Exercise of Rights; Purchase Price; Expiration Date of Rights.

(a) Subject to subsection (e), the registered holder of any Rights Certificate may exercise the Rights evidenced thereby (except as otherwise provided herein including, without limitation, the restrictions on exercisability set forth in Section 9(c), Section 11(a)(iii) and Section 23(a) hereof) in whole or in part at any time after the Distribution Date upon surrender of the Rights Certificate, with the form of election to purchase and the certificate on the reverse side thereof duly executed, to the Rights Agent at the office of the Rights Agent designated for such purpose, together with

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payment of the aggregate Purchase Price (except as provided in Section 11(q) hereof) with respect to the total number of Preferred Share Fractions (or Common Shares, other securities, cash or other assets, as the case may be) as to which such surrendered Rights are then exercisable (except as provided in Section 11(q) hereof), at or prior to the earliest of (i) the Close of Business on March 1, 2008 (the "Final Expiration Date"), (ii) the consummation of a transaction contemplated by Section 13(d) hereof, or (iii) the time at which the Rights are redeemed or terminated as provided in Section 23 hereof (the earliest of (i), (ii) and (iii) being herein referred to as the "Expiration Date").

(b) The "Purchase Price" for each Preferred Share Fraction pursuant to the exercise of a Right shall initially be \$46.08 (which amount represents the purchase price of \$90 set forth in the Original Rights Agreement, adjusted for stock splits occurring between the date of the Original Rights Agreement and the date hereof), and shall be subject to adjustment from time to

time as provided in Sections 11 and 13(a) hereof and shall be payable in accordance with subsection (c).

(c) Upon receipt of a Rights Certificate representing exercisable Rights, with the form of election to purchase and the certificate duly executed, accompanied by payment, with respect to each Right so exercised, of the Purchase Price per Preferred Share Fraction (or Common Shares, other securities, cash or other assets, as the case may be) to be purchased as set forth below and an amount equal to any applicable tax or governmental charge, the Rights Agent shall, subject to Section 20(k) and Section 14(b) hereof, thereupon promptly (i) (A) requisition from any transfer agent of the Preferred Shares (or make available, if the Rights Agent is the transfer agent for the Common Shares) certificates for the total number of Preferred Shares to be purchased and the Company hereby irrevocably authorizes its transfer agent to comply with all such requests, or (B) if the Company shall have elected to deposit some or all of the total number of Preferred Shares issuable upon exercise of the Rights hereunder with a depositary agent, requisition from the depositary agent depositary receipts representing such number of Preferred Share Fractions as are to be purchased (in which case certificates for the Preferred Shares represented by such receipts shall be deposited by the transfer agent with the depositary agent) and the Company will direct the depositary agent to comply with such request, (ii) requisition from the Company the amount of cash, if any, to be paid in lieu of fractional shares in accordance with Section 14 hereof, (iii) after receipt of such certificates or depositary receipts, cause the same to be delivered to or upon the order of the registered holder of such Rights Certificate, registered in such name or names as may be designated by such holder, and (iv) after receipt thereof, deliver such cash, if any, to or upon the order of the registered holder of such Rights Certificate. The payment of the Purchase Price (as such amount may be reduced pursuant to Section 11(a)(iii) hereof) may be made, at the election of the holder of the Rights Certificate, (x) in cash or by certified bank check or money order payable to the order of the Company or (y) by delivery of Rights if and to the extent authorized by Section 11(q) hereof. In the event that the Company is obligated to issue other securities of the Company (including Common Shares) pay cash and/or distribute other property pursuant to Section 11(a) hereof, the Company will make all arrangements necessary so that such other securities, cash and/or other property are available for distribution by the Rights Agent, if and when necessary to comply with this agreement.

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(d) In case the registered holder of any Rights Certificate shall exercise less than all the Rights evidenced thereby, a new Rights Certificate evidencing Rights equivalent to the Rights remaining unexercised shall be issued by the Rights Agent and delivered to, or upon the order of, the registered holder of such Rights Certificate, registered in such name or names as may be designated by such holder, subject to the provisions of Section 6 and Section 14 hereof.

(e) Notwithstanding anything in this Agreement to the contrary, from and after the first occurrence of a Section 11(a)(ii) Event, any Rights beneficially owned by (i) an Acquiring Person or an Associate or Affiliate of an Acquiring Person, (ii) a transferee of an Acquiring Person (or of any such Associate or Affiliate) who becomes a transferee after the Acquiring Person becomes such, or (iii) a transferee of an Acquiring Person (or of any such Associate or Affiliate) who becomes a transferee prior to or concurrently with the Acquiring Person becoming such and receives such Rights pursuant to either (A) a transfer (whether or not for consideration) from the Acquiring Person to holders of equity interests in such Acquiring Person or to any Person with whom the Acquiring Person has any continuing oral or written plan, agreement, arrangement or understanding regarding the transferred Rights or (B) a transfer which the Board of Directors of the Company has determined is part of an oral or written plan, agreement, arrangement or understanding which has as a primary purpose or effect the avoidance of this Section 7(e), shall become null and void without any further action and no holder of such Rights shall have any rights whatsoever with respect to such Rights, whether under any provision of this Agreement or otherwise; provided, however, that the Rights held by an Acquiring Person, an Affiliate or Associate of an Acquiring Person or the transferees of such persons referred to above shall not be voided unless the Acquiring Person in question or an Affiliate or Associate of such Acquiring Person shall be involved in the transaction giving rise to the Section 11(a)(ii) Event. The Company shall notify the Rights Agent when this Section 7(e) applies and shall use all reasonable efforts to insure that the provisions of this

Section 7(e) and Section 4(b) hereof are complied with, but neither the Company nor the Rights Agent shall have any liability to any holder of Rights Certificates or other Person as a result of the Company's failure to make any determinations with respect to an Acquiring Person or its Affiliates, Associates or transferees hereunder.

(f) Notwithstanding anything in this Agreement to the contrary, neither the Rights Agent nor the Company shall be obligated to undertake any action with respect to a registered holder upon the occurrence of any purported exercise as set forth in this Section 7 unless such registered holder shall have (i) properly completed and signed the certificate contained in the form of election to purchase set forth on the reverse side of the Rights Certificate surrendered for such exercise, and (ii) provided such additional evidence of the identity of the Beneficial Owner (or former Beneficial Owner) or Affiliates or Associates thereof as the Company shall or the Rights Agent reasonably request.

Section 8. Cancellation and Destruction of Rights Certificates. All Rights Certificates surrendered for the purpose of exercise, transfer, split up, combination or exchange shall, if surrendered to the Company or any of its agents, be delivered to the Rights Agent for cancellation or in canceled form, or, if surrendered to the Rights Agent, shall be canceled by it, and no Rights Certificates shall be issued in lieu thereof except as expressly permitted by any of the provisions of this Agreement. The Company shall deliver to the Rights Agent for cancellation and retirement, and the Rights Agent shall so cancel and retire, any other Rights Certificate purchased or acquired by the Company otherwise than upon the exercise thereof. The Rights Agent shall deliver all canceled Rights Certificates to the Company, or shall, at the written request of the Company, destroy such canceled Rights Certificates, and in such case shall deliver a certificate of destruction thereof to the Company.

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Section 9. Reservation and Availability of Capital Stock; Registration of Securities.

(a) The Company covenants and agrees that it will cause to be reserved and kept available for issuance upon the exercise of outstanding Rights as many of its authorized and unissued Preferred Shares (and, following the occurrence of a Triggering Event, out of its authorized and unissued or treasury Common Shares and/or other securities) or out of its authorized and issued shares held in its treasury, which together, shall at all times after the Distribution Date be sufficient to permit the exercise in full of all outstanding Rights.

(b) So long as the Preferred Shares (and, following the occurrence of a Triggering Event, Common Shares or other securities) issuable and deliverable upon the exercise of the Rights may be listed on any stock exchange, or quoted on the Nasdaq Stock Market, the Company shall use its best efforts to cause, from and after such time as the Rights become exercisable, all shares and other securities reserved for such issuance to be listed on such exchange upon official notice of issuance upon such exercise.

(c) The Company shall use its best efforts to (i) file, as soon as practicable following the earliest date after the first occurrence of a Section 11(a)(ii) Event on which the consideration to be delivered by the Company upon exercise of the Rights has been determined in accordance with Section 11(a)(iii) hereof, or as soon as is required by law following the Distribution Date, as the case may be, a registration statement or statements under the Securities Act of 1933, as amended (the "Act"), with respect to the securities purchasable upon exercise of the Rights on an appropriate form or forms, (ii) cause such registration statement or statements to become effective as soon as practicable after such filing, and (iii) cause such registration statement or statements to remain effective (with a prospectus at all times meeting the requirements of the Act) until the earlier of (A) the date as of which the Rights are no longer exercisable for such securities, and (B) the Expiration Date. The Company will also take such action as may be appropriate under, or to ensure compliance with, the securities or "blue sky" laws of the various states in connection with the exercisability of the Rights. The Company may temporarily suspend, for a period of time not to exceed ninety (90) days after the date set forth in clause (i) of the first sentence of this subsection (c), the exercisability of the Rights in order to prepare and file such registration statement and permit it to become effective. Upon any such suspension, the Company shall issue a public announcement stating that the

exercisability of the Rights has been temporarily suspended, as well as a public announcement at such time as the suspension is no longer in effect. In addition, if the Company shall determine that a registration statement is required following the Distribution Date, the Company may, by issuing a public announcement, temporarily suspend the exercisability of the Rights until such time as a registration statement has been declared effective. The Company shall notify the Rights Agent whenever it makes a public announcement pursuant to this subsection (c) and give the Rights Agent a copy of the announcement. Notwithstanding any provision of this Agreement to the contrary, the Rights shall not be exercisable in any jurisdiction unless the requisite qualification in such jurisdiction shall have been obtained, nor shall the Rights be exercisable if the exercise thereof shall not be permitted under applicable law or a registration statement shall not have been declared effective.

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(d) The Company covenants and agrees that it will take all such action as may be necessary to ensure that all Preferred Shares (and, following a Triggering Event, Common Shares or other securities) delivered upon exercise of Rights shall, at the time of delivery of the certificates for such shares or other securities (subject to payment of the Purchase Price), be duly and validly authorized and issued and, with respect to Preferred Shares, Common Shares or other shares of capital stock, fully paid and nonassessable.

(e) The Company further covenants and agrees that it will pay when due and payable any and all taxes and governmental charges that may be payable in respect of the issuance or delivery of the Rights Certificates and of any certificates for a number of Preferred Share Fractions (or Common Shares or other securities, as the case may be) upon the exercise of Rights. The Company shall not, however, be required to pay any transfer tax that may be payable in respect of any transfer or delivery of Rights Certificates to a Person other than, or the issuance or delivery of a number of Preferred Share Fractions (or Common Shares or other securities, as the case may be) in respect of a name other than that of the registered holder of the Rights Certificates evidencing Rights surrendered for exercise or to issue or deliver any certificates for a number of Preferred Share Fractions (or Common Shares or other securities, as the case may be) in a name other than that of the registered holder upon the exercise of any Rights until such tax shall have been paid (any such tax being payable by the holder of such Rights Certificate at the time of surrender) or until it has been established to the Company's satisfaction that no such tax is due.

Section 10. Capital Stock Record Date. Each Person in whose name any certificate for a number of Preferred Share Fractions (or Common Shares or other securities, as the case may be) is issued upon the exercise of Rights shall for all purposes be deemed to have become the holder of record of such Preferred Share Fractions (or Common Shares or other securities, as the case may be) represented thereby on, and such certificate shall be dated, the date upon which the Rights Certificate evidencing such Rights was duly surrendered and payment of the Purchase Price (and all applicable taxes and governmental charges) was made; provided, however, that if the date of such surrender and payment is a date upon which the applicable transfer books of the Company are closed, such Person shall be deemed to have become the record holder of such shares (fractional or otherwise) on, and such certificate shall be dated, the next succeeding Business Day on which the applicable transfer books of the Company are open. Prior to the exercise of the Rights evidenced thereby, the holder of a Rights Certificate shall not be entitled to any rights of a shareholder of the Company with respect to shares for which the Rights shall be exercisable, including, without limitation, the right to vote, to receive dividends or other distributions or to exercise any preemptive rights, and shall not be entitled to receive any notice of any proceedings of the Company, except as provided herein.

Section 11. Adjustment of Purchase Price, Number and Kind of Shares or Number of Rights. The Purchase Price, the number and kind of shares and other securities covered by each Right and the number of Rights outstanding are subject to adjustment from time to time as provided in this Section 11.

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(a) (i) In the event the Company shall at any time after the date of

this Agreement (A) declare a dividend on any security of the Company payable in Preferred Shares, (B) subdivide the outstanding Preferred Shares, (C) combine the outstanding Preferred Shares into a smaller number of shares, or (D) issue any shares of its capital stock in a reclassification of the Preferred Shares (including any such reclassification in connection with a consolidation or merger in which the Company is the continuing or surviving corporation), except as otherwise provided in this Section 11(a) and Section 7(e) hereof, the Purchase Price in effect at the time of the record date for such dividend or of the effective date of such subdivision, combination or reclassification, and the number and kind of Preferred Shares or capital stock, as the case may be, issuable on such date, shall be proportionately adjusted so that the holder of any Right exercised after such time shall be entitled to receive, upon payment of the adjusted Purchase Price, the aggregate number and kind of Preferred Shares or capital stock, as the case may be, that, if such Right had been exercised immediately prior to such date and at a time when the Preferred Share transfer books were open, such holder would have owned upon such exercise and been entitled to receive by virtue of such dividend, subdivision, combination or reclassification. If an event occurs which would require an adjustment under both this Section 11(a) (i) and Section 11(a) (ii) hereof, the adjustment provided for in this Section 11(a) (i) shall be in addition to, and shall be made prior to, any adjustment required pursuant to Section 11(a) (ii) hereof.

(ii) In the event:

(A) any Acquiring Person or any Associate or Affiliate of any Acquiring Person, at any time after the Stock Acquisition Date, directly or indirectly, (1) shall merge into the Company or otherwise combine with the Company and the Company shall be the continuing or surviving corporation of such merger or combination and the Common Shares of the Company or other equity securities of the Company shall remain outstanding, (2) shall, in one transaction or a series of transactions, transfer any assets to the Company or to any of its Subsidiaries in exchange (in whole or in part) for Common Shares, for shares of other equity securities of the Company, or for securities exercisable for or convertible into shares of equity securities of the Company (Common Shares or otherwise) or otherwise obtain from the Company, with or without consideration, any additional shares of such equity securities or securities exercisable for or convertible into shares of such equity securities (other than pursuant to a pro rata distribution to all holders of Common Shares), (3) shall sell, purchase, lease, exchange, mortgage, pledge, transfer or otherwise acquire or dispose of assets in one transaction or a series of transactions, to, from or with (as the case may be) the Company or any of its Subsidiaries, on terms and conditions less favorable to the Company than the Company would be able to obtain in arm's-length negotiation with an unaffiliated third party, other than pursuant to a Section 13 Event, (4) shall sell, purchase, lease, exchange, mortgage, pledge, transfer or otherwise dispose of assets having an aggregate fair market value of more than \$5,000,000 in one transaction or a series of transactions, to, from or with (as the case may be) the Company or any of the Company's Subsidiaries (other than incidental to the lines of business, if any, engaged in as of the date hereof between the Company and such Acquiring Person or Associate or Affiliate), other than pursuant to a Section 13 Event, (5) shall receive any compensation from the Company or any of the Company's Subsidiaries other than compensation for full-time employment as a regular employee at rates in accordance with the Company's (or its Subsidiaries') past practices, or (6) shall receive the benefit, directly or indirectly (except proportionately as a shareholder and except if resulting from a requirement of law or governmental regulation), of any loans, advances, guarantees, pledges or other financial assistance or any tax credits or other tax advantages provided by the Company or any of its Subsidiaries; or

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(B) any Person (other than the Company, any Subsidiary of the Company, any employee benefit plan of the Company or of any Subsidiary of the Company, or any Person or entity organized, appointed or established by the Company for or pursuant to the terms of any such plan), alone or together with its Affiliates and Associates, shall, at any time after the Rights Dividend Declaration Date, become the Beneficial Owner of 20% or more of the Common Shares then outstanding, unless the event causing the 20% threshold to be crossed is a Section 13 Event, or is an acquisition of Common Shares pursuant to a tender offer or an exchange offer for all outstanding Common Shares at a price and on terms determined by at least a majority of the Board of Directors of the Company, after receiving advice from one or more nationally recognized investment banking firms, to be in the best interests of the Company and its shareholders (a "Qualifying Offer"), after taking into consideration all factors

that such members of the Board of Directors deem relevant, including, without limitation, the long-term prospects and value of the Company and the prices and terms that such members of the Board of Directors believe, in good faith, could reasonably be achieved if the Company or its assets were sold on an orderly basis designed to realize maximum value, or

(C) during such time as there is an Acquiring Person, there shall be any reclassification of securities (including any reverse stock split), or recapitalization of the Company, or any merger or consolidation of the Company with any of its Subsidiaries or any other transaction or series of transactions involving the Company or any of its Subsidiaries, other than a Section 13 Event or series of such Section 13 Events (whether or not with or into or otherwise involving an Acquiring Person) that has the effect, directly or indirectly, of increasing by more than 1% the proportionate share of the outstanding shares of any class of equity securities of the Company or any of its Subsidiaries that is directly or indirectly beneficially owned by any Acquiring Person or any Associate or Affiliate of any Acquiring Person,

then, promptly following the first occurrence of a Section 11(a)(ii) Event, proper provision shall be made so that each holder of a Right (except as provided below and in Section 7(e) hereof) shall thereafter have the right to receive, upon exercise thereof at the then current Purchase Price in accordance with the terms of this Agreement, in lieu of a number of Preferred Share Fractions, such number of Common Shares of the Company as shall equal the result obtained by (x) multiplying the then current Purchase Price by the then number of Preferred Share Fractions for which a Right was exercisable immediately prior to the first occurrence of a Section 11(a)(ii) Event, and (y) dividing that product (which, following such first occurrence, shall thereafter be referred to as the "Purchase Price" for each Right and for all purposes of this Agreement) by 50% of the current market price (as defined in and determined pursuant to Section 11(d) hereof) per Common Share on the date of such first occurrence (such number of shares, the "Adjustment Shares").

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(iii) In the event that the number of Common Shares that are authorized by the Company's Articles of Incorporation but not outstanding or reserved for issuance for purposes other than upon exercise of the Rights are not sufficient to permit the exercise in full of the Rights in accordance with the foregoing subparagraph (ii) of this Section 11(a), the Company shall: (A) determine the excess of the value of the Adjustment Shares issuable upon the exercise of a Right (the "Current Value") over the Purchase Price (such excess, the "Spread"), and (B) with respect to each Right, make adequate provision to substitute for the Adjustment Shares, upon payment of the applicable Purchase Price, (1) cash, (2) a reduction in the Purchase Price, (3) Common Shares of the same or a different class or other equity securities of the Company (including, without limitation, preferred shares or units of preferred shares that a majority of the Board of Directors of the Company has deemed (based, among other things, on the dividend and liquidation rights of such preferred shares) to have substantially the same economic value as Common Shares (such preferred shares, hereinafter referred to as "common share equivalents")), (4) debt securities of the Company, (5) other assets, or (6) any combination of the foregoing, having an aggregate value equal to the Current Value, where such aggregate value has been determined by a majority of the Board of Directors of the Company after considering the advice of a nationally recognized investment banking firm selected by the Board of Directors of the Company; provided, however, if the Company shall not have made adequate provision to deliver value pursuant to clause (B) above within thirty (30) days following the later of (x) the first occurrence of a Section 11(a)(ii) Event and (y) the date on which the Company's right of redemption pursuant to Section 23(a) expires (the later of (x) and (y) being referred to herein as the "Section 11(a)(ii) Trigger Date"), then the Company shall be obligated to deliver, upon the surrender for exercise of a Right and without requiring payment of the Purchase Price, Common Shares (to the extent available) and then, if necessary, cash, which shares and/or cash have an aggregate value equal to the Spread. If the Board of Directors of the Company shall determine in good faith that it is likely that sufficient additional Common Shares could be authorized for issuance upon exercise in full of the Rights, the thirty (30) day period set forth above may be extended to the extent necessary, but not more than ninety (90) days after the Section 11(a)(ii) Trigger Date, in order that the Company may seek shareholder approval for the authorization of such additional shares (such period, as it may be extended, the "Substitution Period"). To the extent that the Company determines that some action need be taken pursuant to the first and/or second sentences of this

Section 11(a)(iii), the Company shall provide, subject to Section 7(e) hereof, that such action shall apply uniformly to all outstanding Rights, and may suspend the exercisability of the Rights until the expiration of the Substitution Period in order to seek any authorization of additional shares and/or to decide the appropriate form of distribution to be made pursuant to such first sentence and to determine the value thereof. The Company shall make a public announcement when the exercisability of the Rights has been temporarily suspended, and again when such suspension is no longer in effect. The Company shall notify the Rights Agent of the suspension of the exercisability of the Rights, and provide the Rights Agent with a copy of such public announcement. For purposes of this Section 11(a)(iii), the value of the Common Shares shall be the current market price (as determined pursuant to Section 11(d) hereof) per Common Share on the Section 11(a)(ii) Trigger Date and the value of any "common share equivalent" shall be deemed to have the same value as the Common Shares on such date.

(b) In case the Company shall fix a record date for the issuance of rights, options or warrants to holders of any security of the Company entitling them to subscribe for or purchase (for a period expiring within forty-five (45) calendar days after such record date) Preferred Shares (or shares having the same rights, privileges and preferences as the Preferred Shares ("equivalent preferred shares")) or securities convertible into Preferred Shares or equivalent preferred shares at a price per Preferred Share or per

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equivalent preferred share (or having a conversion price per share, if a security convertible into Preferred Shares or equivalent preferred shares) less than the current market price (as determined pursuant to Section 11(d) hereof) per Preferred Share on such record date, the Purchase Price to be in effect after such record date shall be determined by multiplying the Purchase Price in effect immediately prior to such record date by a fraction, the numerator of which shall be the number of Preferred Shares outstanding on such record date, plus the number of Preferred Shares that the aggregate offering price of the total number of Preferred Shares and/or equivalent preferred shares so to be offered (and/or the aggregate initial conversion price of the convertible securities so to be offered) would purchase at such current market price, and the denominator of which shall be the number of Preferred Shares outstanding on such record date, plus the number of additional Preferred Shares and/or equivalent preferred shares to be offered for subscription or purchase (or into which the convertible securities so to be offered are initially convertible). In case such subscription price may be paid by delivery of consideration part or all of which may be in a form other than cash, the value of such consideration shall be as determined in good faith by the Board of Directors of the Company, whose determination shall be described in a statement filed with the Rights Agent and shall be binding on the Company, the Rights Agent and the holders of the Rights. Preferred Shares owned by or held for the account of the Company shall not be deemed outstanding for the purpose of any such computation. Such adjustment shall be made successively whenever such a record date is fixed, and in the event that such rights or warrants are not so issued, the Purchase Price shall be adjusted to be the Purchase Price that would then be in effect if such record date had not been fixed.

(c) In case the Company shall fix a record date for a distribution to all holders of Preferred Shares (including any such distribution made in connection with a consolidation or merger in which the Company is the continuing corporation) of evidences of indebtedness, cash (other than a regular quarterly dividend out of the earnings or retained earnings of the Company), assets (other than a regular quarterly dividend referred to above or dividend payable in Preferred Shares, but including any dividend payable in stock other than Preferred Shares) or subscription rights or warrants (excluding those referred to in Section 11(b) hereof), the Purchase Price to be in effect after such record date shall be determined by multiplying the Purchase Price in effect immediately prior to such record date by a fraction, the numerator of which shall be the current market price (as determined pursuant to Section 11(d) hereof) per Preferred Share on such record date, less the then fair market value (as determined in good faith by the Board of Directors of the Company, whose determination shall be described in a statement filed with the Rights Agent and shall be conclusive for all purposes) of the portion of the cash, assets or evidences of indebtedness so to be distributed or of such subscription rights or warrants applicable to a Preferred Share and the denominator of which shall be such current market price (as determined pursuant to Section 11(d) hereof) per Preferred Share. Such adjustments shall be made successively whenever such a record date is fixed, and in the event that such distribution is not so made,

the Purchase Price shall be adjusted to be the Purchase Price which would have been in effect if such record date had not been fixed.

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(d) (i) For the purpose of any computation hereunder, other than computations made pursuant to Section 11(a)(iii) hereof, the "current market price" per Common Share on any date shall be deemed to be the average of the daily closing prices per Common Share for the thirty (30) consecutive Trading Days (as such term is hereinafter defined) immediately prior to and not including such date, and for purposes of computations made pursuant to Section 11(a)(iii) hereof, the "current market price" per Common Share on any date shall be deemed to be the average of the daily closing prices per Common Share for the ten (10) consecutive Trading Days immediately following and not including such date; provided, however, that in the event that the current market price per Common Share is determined during a period following the announcement by the issuer of such Common Share of (A) a dividend or distribution on such Common Share payable in Common Shares or securities convertible into Common Shares (other than the Rights), or (B) any subdivision, combination or reclassification of such Common Shares, and prior to the expiration of the requisite thirty (30) Trading Day or ten (10) Trading Day period, as set forth above, after the ex-dividend date for such dividend or distribution, or the record date for such subdivision, combination or reclassification, then, and in each such case, the "current market price" shall be properly adjusted to take into account ex-dividend trading. The closing price for each Trading Day shall be the last sale price, regular way, or, in case no such sale takes place on such day, the average of the closing bid and asked prices, regular way, in either case as reported in the principal consolidated transaction reporting system with respect to securities listed or admitted to trading on the New York Stock Exchange or, if the Common Shares are not listed or admitted to trading on the New York Stock Exchange, as reported in the principal consolidated transaction reporting system with respect to securities listed on the principal national securities exchange on which the Common Shares are listed or admitted to trading or, if the Common Shares are not listed or admitted to trading on any national securities exchange, the last quoted price or, if not so quoted, the average of the high bid and low asked prices in the over-the-counter market, as reported by the National Association of Securities Dealers, Inc. Automated Quotation System ("Nasdaq") or such other system then in use, or, if on any such date the Common Shares are not quoted by any such organization, the average of the closing bid and asked prices as furnished by a professional market maker making a market in the Common Shares selected by the Board of Directors of the Company. If on any such date no market maker is making a market in the Common Shares, the fair value of such shares on such date as determined in good faith by the Board of Directors of the Company shall be used. The term "Trading Day" shall mean a day on which the principal national securities exchange on which the Common Shares are listed or admitted to trading is open for the transaction of business or, if the Common Shares are not listed or admitted to trading on any national securities exchange, a Business Day. If the Common Shares are not publicly held or not so listed or traded, "current market price" per share shall mean the fair value per share as determined in good faith by the Board of Directors of the Company, whose determination shall be described in a statement filed with the Rights Agent and shall be conclusive for all purposes.

(ii) For the purpose of any computation hereunder, the "current market price" per Preferred Share shall be determined in the same manner as set forth above for the Common Shares in clause (i) of this Section 11(d) (other than the last sentence thereof). If the current market price per Preferred Share cannot be determined in the manner provided above or if the Preferred Shares are not publicly held or listed or traded in a manner described in clause (i) of this Section 11(d), the "current market price" per Preferred Share shall be conclusively deemed to be an amount equal to one hundred (as such number may be appropriately adjusted for such events as stock splits, stock dividends and recapitalizations with respect to the Common Shares occurring after the date of this Agreement) multiplied by the current market price per Common Share. If neither the Common Shares nor the Preferred Shares are publicly held or so listed or traded, "current market price" per Preferred Share shall mean the fair value per share as determined in good faith by the Board of Directors of the Company, whose determination shall be described in a statement filed with the Rights Agent and shall be conclusive for all purposes. For all purposes of this Agreement, the "current market price" of a Preferred Share Fraction shall be equal to the "current market price" of one Preferred Share divided by 1000.

(e) Anything herein to the contrary notwithstanding, no adjustment in the Purchase Price shall be required unless such adjustment would require an increase or decrease of at least one percent (1%) in the Purchase Price; provided, however, that any adjustments which by reason of this Section 11(e) are not required to be made shall be carried forward and taken into account in any subsequent adjustment. All calculations under this Section 11 shall be made to the nearest cent or to the nearest ten-thousandth of a Common Share or one millionth of a Preferred Share, as the case may be. Notwithstanding the first sentence of this subsection (e), any adjustment required by this Section 11 shall be made no later than the earlier of (i) three (3) years from the date of the transaction that mandates such adjustment, or (ii) the Expiration Date.

(f) If as a result of an adjustment made pursuant to Section 11(a)(ii) or Section 13(a) hereof, the holder of any Right thereafter exercised shall become entitled to receive any shares of capital stock other than Preferred Shares, thereafter the number of such other shares so receivable upon exercise of any Right and the Purchase Price thereof shall be subject to adjustment from time to time in a manner and on terms as nearly equivalent as practicable to the provisions with respect to the Preferred Shares contained in Sections 11(a), (b), (c), (e), (g), (h), (i), (j), (k), (m) and (q), and the provisions of Sections 7, 9, 10, 13 and 14 hereof with respect to the Preferred Shares shall apply on like terms to any such other shares.

(g) All Rights originally issued by the Company subsequent to any adjustment made to the Purchase Price hereunder shall evidence the right to purchase, at the adjusted Purchase Price, the number of Preferred Share Fractions purchasable from time to time hereunder upon exercise of the Rights, all subject to further adjustment as provided herein.

(h) Unless the Company shall have exercised its election as provided in Section 11(i), upon each adjustment of the Purchase Price as a result of the calculations made in subsections (b) and (c), each Right outstanding immediately prior to the making of such adjustment shall thereafter evidence the right to purchase, at the adjusted Purchase Price, that number of Preferred Share Fractions (calculated to the nearest one-one millionth of a Preferred Share) obtained by (i) multiplying (x) the number of Preferred Share Fractions covered by a Right immediately prior to this adjustment, by (y) the Purchase Price in effect immediately prior to such adjustment of the Purchase Price, and (ii) dividing the product so obtained by the Purchase Price in effect immediately after such adjustment of the Purchase Price.

(i) The Company may elect on or after the date of any adjustment of the Purchase Price to adjust the number of Rights, in lieu of any adjustment in the number of Preferred Share Fractions purchasable upon the exercise of a Right. Each of the Rights outstanding after the adjustment in the number of Rights shall be exercisable for the number of Preferred Share Fractions for which a Right was exercisable immediately prior to such adjustment. Each Right held of record prior to such adjustment of the number of Rights shall become that number of Rights (calculated to the nearest one-one millionth of a Preferred Share) obtained by dividing the Purchase Price in effect immediately prior to adjustment of the Purchase Price by the Purchase Price in effect immediately after adjustment of the Purchase Price. The Company shall make a public announcement of its election to adjust the number of Rights, indicating the record date for the adjustment, and, if known at the time, the amount of the adjustment to be made. The Company shall forward a copy of such public announcement to the Rights Agent. The record date for the adjustment may be the date on which the Purchase Price is adjusted or any day thereafter, but, if the Rights Certificates have been issued, shall be at least ten (10) days later than the date of the public announcement. If Rights Certificates have been issued, upon each adjustment of the number of Rights pursuant to this Section 11(i), the Company shall, as promptly as practicable, cause to be distributed to holders of record of Rights Certificates on such record date Rights Certificates evidencing, subject to Section 14 hereof, the additional Rights to which such holders shall be entitled as a result of such adjustment, or, at the option of the Company, shall cause to be distributed to such holders of record in substitution and replacement for the Rights Certificates held by such holders prior to the date of adjustment, and upon surrender thereof, if required by the Company, new Rights Certificates evidencing all the Rights to which such holders shall be entitled after such adjustment. Rights Certificates so to be distributed shall be issued, executed and countersigned in the manner provided for herein (and may bear, at the option of the Company, the adjusted Purchase

Price) and shall be registered in the names of the holders of record of Rights Certificates on the record date specified in the public announcement.

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(j) Irrespective of any adjustment or change in the Purchase Price or the number of Preferred Share Fractions issuable upon the exercise of the Rights, the Rights Certificates theretofore and thereafter issued may continue to express the Purchase Price per Preferred Share Fraction and the number of Preferred Share Fractions that were expressed in the initial Rights Certificates issued hereunder.

(k) Before taking any action that would cause an adjustment reducing the Purchase Price below the then stated or par value, if any, of the number of Preferred Share Fractions issuable upon exercise of the Rights, the Company shall take any corporate action that may, in the opinion of its counsel, be necessary in order that the Company may validly and legally issue such number of fully paid and nonassessable Preferred Share Fractions at such adjusted Purchase Price.

(l) In any case in which this Section 11 shall require that an adjustment in the Purchase Price be made effective as of a record date for a specified event, the Company may elect to defer until the occurrence of such event the issuance to the holder of any Right exercised after such record date the number of Preferred Share Fractions and other capital stock or securities of the Company, if any, issuable upon such exercise over and above the number of Preferred Share Fractions and other capital stock or securities of the Company, if any, issuable upon such exercise on the basis of the Purchase Price in effect prior to such adjustment; provided, however, that the Company shall deliver to such holder a due bill or other appropriate instrument evidencing such holder's right to receive such additional shares (fractional or otherwise) or securities upon the occurrence of the event requiring such adjustment, and the Company shall also deliver a copy of such bill or instrument to the Rights Agent.

(m) Anything in this Section 11 to the contrary notwithstanding, the Company shall be entitled to make such reductions in the Purchase Price, in addition to those adjustments expressly required by this Section 11, as and to the extent that in their good faith judgment the Board of Directors of the Company shall determine to be advisable in order that any (i) consolidation or subdivision of the Preferred Shares, (ii) issuance wholly for cash of any Preferred Shares at less than the current market price, (iii) issuance wholly for cash for Preferred Shares or securities which by their terms are convertible into or exchangeable for Preferred Shares, (iv) stock dividends or (v) issuance of rights, options or warrants referred to in this Section 11, hereafter made by the Company to holders of its Preferred Shares shall not be taxable to such shareholders.

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(n) The Company covenants and agrees that it shall not, at any time after the Distribution Date, (i) consolidate with any other Person (other than a Subsidiary of the Company in a transaction which complies with Section 11(o) hereof), (ii) merge with or into any other Person (other than a Subsidiary of the Company in a transaction which complies with Section 11(o) hereof), or (iii) sell or transfer (or permit any Subsidiary to sell or transfer), in one transaction, or a series of related transactions, assets or earning power aggregating more than 50% of the assets or earning power of the Company and its Subsidiaries (taken as a whole) to any other person or persons (other than the Company and/or any of its Subsidiaries in one or more transactions each of which complies with Section 11(o) hereof), if (x) at the time of or immediately after such consolidation, merger or sale there are any rights, warrants or other instruments or securities outstanding or agreements in effect that would substantially diminish or otherwise eliminate the benefits intended to be afforded by the Rights or (y) prior to, simultaneously with or immediately after such consolidation, merger or sale, the shareholders of the Person who constitutes, or would constitute, the "Principal Party" for purposes of Section 13(a) hereof shall have received a distribution of Rights previously owned by such Person or any of its Affiliates and Associates.

(o) The Company covenants and agrees that, after the Distribution Date, it will not, except as permitted by Section 23 or Section 27

hereof, take (or permit any Subsidiary to take) any action if at the time such action is taken it is reasonably foreseeable that such action will diminish substantially or otherwise eliminate the benefits intended to be afforded by the Rights.

(p) Anything in this Agreement to the contrary notwithstanding, in the event that the Company shall at any time after the Rights Dividend Declaration Date and prior to the Distribution Date (i) declare a dividend on the outstanding Common Shares payable in Common Shares, (ii) subdivide the outstanding Common Shares, or (iii) combine the outstanding Common Shares into a smaller number of shares, the number of Rights associated with each Common Share then outstanding, or issued or delivered thereafter but prior to the Distribution Date, shall be proportionately adjusted so that the number of Rights thereafter associated with each Common Share following any such event shall equal the result obtained by multiplying the number of Rights associated with each Common Share immediately prior to such event by a fraction the numerator of which shall be the total number of Common Shares outstanding immediately prior to the occurrence of the event and the denominator of which shall be the total number of Common Shares outstanding immediately following the occurrence of such event.

(q) In the event that the Rights become exercisable following a Section 11(a)(ii) Event, the Company, by action of a majority of the Board of Directors of the Company, may authorize that the Rights, subject to Section 7(e) hereof, either (i) will only be, or (ii) may, at the option of the holder entitled to exercise the Rights be, exercisable for, in either case 50% of the Common Shares (or cash or other securities or assets to be substituted for the Adjustment Shares pursuant to subsection (a)(iii)) that would otherwise be purchasable under subsection (a), in consideration of the surrender to the Company of the Rights so exercised and without other payment of the Purchase Price. Rights exercised under this subsection (q) shall be deemed to have been exercised in full and shall be canceled.

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Section 12. Certificate of Adjusted Purchase Price or Number of Shares. Whenever an adjustment is made as provided in Section 11 or Section 13 hereof, the Company shall (a) promptly prepare a certificate setting forth such adjustment and a brief, reasonably detailed statement of the facts and computations accounting for such adjustment, (b) promptly file with the Rights Agent, and with each transfer agent for the Preferred Shares and the Common Shares, a copy of such certificate, and (c) mail a brief summary thereof to each holder of a Rights Certificate (or, if prior to the Distribution Date, to each holder of a certificate representing Common Shares) in accordance with Section 25 hereof. The Rights Agent shall be fully protected in relying on any such certificate and on any adjustment therein contained and shall have no duty with respect to and shall not be deemed to have knowledge of any such adjustment unless and until it shall have received such a certificate.

Section 13. Consolidation, Merger or Sale or Transfer of Assets or Earning Power.

(a) In the event that, following the Stock Acquisition Date, directly or indirectly, (x) the Company shall consolidate with, or merge with and into, any other Person (other than a Subsidiary of the Company in a transaction which complies with Section 11(o) hereof), and the Company shall not be the continuing or surviving corporation of such consolidation or merger, (y) any person (other than a Subsidiary of the Company in a transaction which complies with Section 11(o) hereof) shall consolidate with, or merge with or into, the Company, and the Company shall be the continuing or surviving corporation of such consolidation or merger and, in connection with such consolidation or merger, all or part of the outstanding Common Shares shall be changed into or exchanged for stock or other securities of any other Person or cash or any other property, or (z) the Company shall sell or otherwise transfer (or one or more of its Subsidiaries shall sell or otherwise transfer), in one transaction or a series of related transactions, assets or earning power aggregating more than 50% of the assets, operating income, cash flow or earning power of the Company and its Subsidiaries (taken as a whole) to any Person or Persons (other than the Company or any Subsidiary of the Company in one or more transactions each of which complies with Section 11(o) hereof), then, and in each such case and except as contemplated by subsection (d), proper provision

shall be made so that:

(i) each holder of a Right, except as provided in Section 7(e) hereof or subsection (e), shall thereafter have the right to receive, upon the exercise thereof at the then current Purchase Price in accordance with the terms of this Agreement, such number of validly authorized and issued, fully paid, non assessable and freely tradeable Common Shares of the Principal Party (as such term is hereinafter defined), not subject to any liens, encumbrances, rights of first refusal or other adverse claims, as shall be equal to the result obtained by (1) multiplying the then current Purchase Price by the number of Preferred Share Fractions for which a Right is exercisable immediately prior to the first occurrence of a Section 13 Event (or, if a Section 11(a)(ii) Event has occurred prior to the first occurrence of a Section 13 Event, multiplying the number of such shares for which a Right was exercisable immediately prior to the first occurrence of a Section 11(a)(ii) Event by the Purchase Price in effect immediately prior to such first occurrence), and (2) dividing that product (which, following the first occurrence of a Section 13 Event, shall be referred to as the "Purchase Price" for each Right and for all purposes of this Agreement) by 50% of the current market price (determined pursuant to Section 11(d)(i) hereof) per Common Share of such Principal Party on the date of consummation of such Section 13 Event;

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(ii) such Principal Party shall thereafter be liable for, and shall assume, by virtue of such Section 13 Event, all the obligations and duties of the Company pursuant to this Agreement;

(iii) the term "Company" shall thereafter be deemed to refer to such Principal Party, it being specifically intended that the provisions of Section 11 hereof shall apply only to such Principal Party following the first occurrence of a Section 13 Event;

(iv) such Principal Party shall take such steps (including, but not limited to, the reservation of a sufficient number of its Common Shares) in connection with the consummation of any such transaction as may be necessary to assure that the provisions hereof shall thereafter be applicable, as nearly as reasonably may be, in relation to its Common Shares thereafter deliverable upon the exercise of the Rights; and

(v) the provisions of Section 11(a)(ii) hereof shall be of no effect following the first occurrence of any Section 13 Event.

(b) "Principal Party" shall mean

(i) in the case of any transaction described in clause (x) or (y) of the first sentence of subsection (a), the Person that is the issuer of any securities into which Common Shares of the Company are converted in such merger or consolidation, and if no securities are so issued, the Person that is the other party to such merger or consolidation; and

(ii) in the case of any transaction described in clause (z) of the first sentence of subsection (a), the Person that is the party receiving the greatest portion of the assets or earning power transferred pursuant to such transaction or transactions;

provided, however, that in the case of either (i) or (ii) above, (1) if the Common Shares of such Person are not at such time and have not been continuously over the preceding twelve (12) month period registered under Section 12 of the Exchange Act, and such Person is a direct or indirect Subsidiary of another Person the Common Shares of which are and have been so registered, "Principal Party" shall refer to such other Person, and (2) in case such Person is a Subsidiary, directly or indirectly, of more than one Person, the Common Shares of two or more of which are and have been so registered, "Principal Party" shall refer to whichever of such Persons is the issuer of the Common Shares having the greatest aggregate market value.

(c) The Company shall not consummate any such consolidation, merger, sale or transfer unless the Principal Party shall have a sufficient number of authorized shares of its Common Shares that have not been issued or reserved for issuance to permit the exercise in full of the Rights in accordance with this Section 13 and unless prior thereto the Company and such Principal Party shall have executed and delivered to the Rights Agent a supplemental agreement providing for the terms set forth in paragraphs (a) and (b) of this

Section 13 and further providing that, as soon as practicable after the date of any Section 13 event, the Principal Party will

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(i) prepare and file a registration statement under the Act, with respect to the Rights and the securities purchasable upon exercise of the Rights on an appropriate form, and will use its best efforts to cause such registration statement to (A) become effective as soon as practicable after such filing and (B) remain effective (with a prospectus at all times meeting the requirements of the Act) until the Expiration Date;

(ii) use its best efforts to qualify or register the Rights and the securities purchasable upon exercise of the Rights under blue sky laws of such jurisdiction, as may be necessary or appropriate; and

(iii) deliver to holders of the Rights historical financial statements for the Principal Party and each of its Affiliates that comply in all respects with the requirements for registration on Form 10 under the Exchange Act. The provisions of this Section 13 shall similarly apply to successive mergers or consolidations or sales or other transfers. In the event that a Section 13 Event shall occur at any time after the occurrence of a Section 11(a)(ii) Event, the Rights that have not theretofore been exercised shall thereafter become exercisable solely in the manner described in Section 13(a).

(d) Notwithstanding anything in this Agreement to the contrary, Section 13 (other than this subsection (d)) shall not be applicable to, and the term "Section 13 Event" shall not include, a transaction described in subparagraphs (x) and (y) of Section 13(a) if (i) such transaction is consummated with a Person, or Persons who acquired Common Shares pursuant to a Qualifying Offer (or a wholly owned Subsidiary of any such Person or Persons), (ii) the price per Common Share offered in such transaction is not less than the price per Common Share paid to all holders of Common Shares whose shares were purchased pursuant to such tender offer or exchange offer and (iii) the form of consideration being offered to the remaining holders of Common Shares pursuant to such transaction is the same as the form of consideration paid pursuant to such tender or exchange offer. Upon consummation of any such transaction contemplated by this subsection (d), all Rights hereunder shall expire.

(e) In the event that the Rights become exercisable under subsection (a) (except as provided in subsection (d)), the Company, by action of a majority of the Board of Directors of the Company, may authorize that the Rights either (i) will only be or (ii) may, at the option of the Principal Party be, exercisable for, 50% of the Common Shares of the Principal Party that would otherwise be purchasable under subsection (a), in consideration of the surrender to the Principal Party, as the successor to the Company under subsection (a) (ii), of the Rights so exercised and without other payment of the Purchase Price. Rights exercised under this subsection (e) shall be deemed to have been exercised in full and shall be canceled.

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Section 14. Fractional Rights and Fractional Shares.

(a) The Company shall not be required to issue fractions of Rights, except prior to the Distribution Date as provided in Section 11(p) hereof, or to distribute Rights Certificates that evidence fractional Rights. In lieu of such fractional Rights, there shall be paid to the registered holders of the Rights Certificates with regard to which such fractional Rights would otherwise be issuable, an amount in cash equal to the same fraction of the current market value of a whole Right. For purposes of this subsection (a), the current market value of a whole Right shall be the closing price of the Rights for the Trading Day immediately prior to the date on which such fractional Rights would have been otherwise issuable. The closing price of the Rights for any day shall be the last sale price, regular way, or, in case no such sale takes place on such day, the average of the closing bid and asked prices, regular way, in either case as reported in the principal consolidated transaction reporting system with respect to securities listed or admitted to trading on the New York Stock Exchange or, if the Rights are not listed or admitted to trading on the New York Stock Exchange, as reported in the principal consolidated transaction reporting system with respect to securities listed on the principal national securities exchange on which the Rights are listed or admitted to trading, or if the Rights are not listed or admitted to trading on

any national securities exchange, the last quoted price or, if not so quoted, the average of the high bid and low asked prices in the over-the-counter market, as reported by Nasdaq or such other system then in use or, if on any such date the Rights are not quoted by any such organization, the average of the closing bid and asked prices as furnished by a professional market maker making a market in the Rights selected by the Board of Directors of the Company. If on any such date no such market maker is making a market in the Rights the fair value of the Rights on such date as determined in good faith by the Board of Directors of the Company shall be used.

(b) The Company shall not be required to issue fractions of Preferred Shares upon exercise of the Rights or to distribute certificates which evidence fractional Preferred Shares, except in each case for fractions which are integral multiples of Preferred Shares. In lieu of fractional Preferred Shares that are not integral multiples of Preferred Shares, the Company may pay to the registered holders of Rights Certificates at the time such Rights are exercised as herein provided an amount in cash equal to the same fraction of the current market value of a Preferred Share. For purposes of this subsection (b), the current market value of one Preferred Share shall be the closing price of a Preferred Share (as determined pursuant to Section 11(d)(ii) hereof) for the Trading Day immediately prior to the date of such exercise.

(c) Following the occurrence of a Triggering Event, the Company shall not be required to issue fractions of Common Shares upon exercise of the Rights or to distribute certificates that evidence fractional Common Shares. In lieu of fractional Common Shares, the Company may pay to the registered holders of Rights Certificates at the time such Rights are exercised as herein provided an amount in cash equal to the same fraction of the current market value of one Common Share. For purposes of this subsection (c), the current market value of one Common Share shall be the closing price of one Common Share (as determined pursuant to Section 11(d)(i) hereof) for the Trading Day immediately prior to the date of such exercise.

(d) Whenever a payment for fractional Rights or fractional shares is to be made by the Rights Agent, the Company shall (i) promptly prepare and deliver to the Rights Agent a certificate setting forth in reasonable detail the facts related to such payment and the process and/or formulas utilized in calculating such payments, and (ii) provide sufficient monies to the Rights Agent in the form of fully collected funds to make such payments. The Rights Agent shall be fully protected in relying on such certificate and shall have no duty with respect to and shall not be deemed to have knowledge of any payment for fractional Rights or fractional shares under this Section 4 unless and until it shall have received such a certificate and sufficient monies.

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(e) The holder of a Right or a beneficial interest in a Right by the acceptance thereof expressly waives his right to receive any fractional Rights or any fractional Common Shares upon exercise of a Right, except as permitted by this Section 14.

Section 15. Rights of Action. All rights of action in respect of this Agreement are vested in the respective registered holders of the Rights Certificates (and, prior to the Distribution Date, the registered holders of the Common Shares); and any registered holder of any Rights Certificate (or, prior to the Distribution Date, of the Common Shares), without the consent of the Rights Agent or of the holder of any other Rights Certificate (or, prior to the Distribution Date, of the Common Shares), may, in his own behalf and for his own benefit, enforce, and may institute and maintain any suit, action or proceeding against the Company to enforce, or otherwise act in respect of, his right to exercise the Rights evidenced by such Rights Certificate in the manner provided in such Rights Certificate and in this Agreement. Without limiting the foregoing or any remedies available to the holders of Rights or beneficial interests therein, it is specifically acknowledged that the holders of Rights or beneficial interests therein would not have an adequate remedy at law for any breach of this Agreement and shall be entitled to specific performance of the obligations hereunder and injunctive relief against actual or threatened violations of the obligations hereunder of any Person subject to this Agreement.

Section 16. Agreement of Rights Holders. Every holder of a Right or a beneficial interest in a Right by accepting the same consents and agrees with the Company and the Rights Agent and with every other such holder that:

(a) prior to the Distribution Date, beneficial interests in

the Rights will be transferable only in connection with the transfer of Common Shares;

(b) after the Distribution Date, the Rights Certificates are transferable only on the registry books of the Rights Agent if surrendered at the office of the Rights Agent designated for such purposes, duly endorsed or accompanied by a proper instrument of transfer and with the appropriate forms and certificates fully executed;

(c) subject to Section 6(a) and Section 7(f) hereof, the Company and the Rights Agent may deem and treat the Person in whose name a Rights Certificate (or, prior to the Distribution Date, the associated Common Share certificate) is registered as the absolute owner thereof and of the Rights evidenced thereby (notwithstanding any notations of ownership or writing on the Rights Certificates or the associated Common Share certificate made by anyone other than the Company or the Rights Agent) for all purposes whatsoever, and neither the Company nor the Rights Agent shall be required to be affected by any notice to the contrary; and

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(d) notwithstanding anything in this Agreement to the contrary, neither the Company nor the Rights Agent shall have any liability to any holder of a Right or a beneficial interest in a Right or other Person as a result of its inability to perform any of its obligations under this Agreement by reason of any preliminary or permanent injunction or other order, decree, judgment or ruling (whether interlocutory or final) issued by a court of competent jurisdiction or by a governmental, regulatory or administrative agency or commission, or any statute, rule, regulation or executive order promulgated or enacted by any governmental authority, prohibiting or otherwise restraining performance of such obligation; provided, however, the Company must use its best efforts to have any such order, decree, judgment or ruling lifted or otherwise overturned as soon as possible.

Section 17. Rights Certificate Holder Not Deemed a Shareholder. No holder, as such, of any Rights Certificate shall be entitled to vote, receive dividends or be deemed for any purpose the holder of the number of Preferred Share Fractions or any other securities of the Company (including the Common Shares) that may at any time be issuable on the exercise of the Rights represented thereby, nor shall anything contained herein or in any Rights Certificate be construed to confer upon the holder of any Rights Certificate, as such, any of the rights of a shareholder of the Company or any right to vote for the election of directors or upon any matter submitted to shareholders at any meeting thereof, or to give or withhold consent to any corporate action, or to receive notice of meetings or other actions affecting shareholders (except as provided in Section 24 hereof), or to receive dividends or subscription rights, or otherwise, until the Right or Rights evidenced by such Rights Certificate shall have been exercised in accordance with the provisions hereof.

Section 18. Concerning the Rights Agent.

(a) The Company agrees to pay to the Rights Agent reasonable compensation for all services rendered by it hereunder and, from time to time, on demand of the Rights Agent, its reasonable expenses and counsel fees and disbursements and other disbursements incurred in the preparation, execution, delivery, amendment, administration and execution of this Agreement and the exercise and performance of its duties hereunder. The Company also agrees to indemnify the Rights Agent and its directors, officers, employees and agents, for and to hold each of them harmless against, any loss, liability, damage, judgment, fine, penalty, claim, demand, settlement, cost or expense, incurred without gross negligence, bad faith or willful misconduct on the part of the Rights Agent or any such indemnified party, for any action taken, suffered or omitted by the Rights Agent in connection with the acceptance or administration of this Agreement or the exercise of its duties hereunder, including without limitation the costs and expenses of defending against any claim of liability in the premises.

(b) The Rights Agent shall be protected and shall incur no liability for or in respect of any action taken, suffered or omitted by it in connection with the acceptance and administration of this Agreement or in the exercise of its duties hereunder in reliance upon any Rights Certificate or certificate for Common Shares or for other securities of the Company, instrument of assignment or transfer, power of attorney, endorsement, affidavit, letter,

notice, direction, consent, certificate, statement, or other paper or document believed by it to be genuine and to be signed, executed and, where necessary, verified or acknowledged, by the proper Person or Persons.

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Section 19. Merger or Consolidation or Change of Name of Rights Agent.

(a) Any Person into which the Rights Agent or any successor Rights Agent may be merged or with which it may be consolidated, or any Person resulting from any merger or consolidation to which the Rights Agent or any successor Rights Agent shall be a party, or any Person succeeding to the shareholder services or stock transfer business of the Rights Agent or any successor Rights Agent, shall be the successor to the Rights Agent under this Agreement without the execution or filing of any paper or any further act on the part of any of the parties hereto; provided, however, that such Person would be eligible for appointment as a successor Rights Agent under the provisions of Section 21 hereof.

(b) In case at any time the name of the Rights Agent shall be changed and at such time any of the Rights Certificates shall have been countersigned but not delivered the Rights Agent may adopt the countersignature under its prior name and deliver Rights Certificates so countersigned; and in case at that time any of the Rights Certificates shall not have been countersigned, the Rights Agent may countersign such Rights Certificates either in its prior name or in its changed name; and in all such cases such Rights Certificates shall have the full force provided in the Rights Certificates and in this Agreement.

Section 20. Duties of Rights Agent. The Rights Agent undertakes the duties and obligations, and only the duties and obligations, expressly imposed by this Agreement (and no implied duties or obligations) upon the following terms and conditions, by all of which the Company and the holders of Rights Certificates or beneficial interests in the Rights, by their acceptance thereof, shall be bound:

(a) The Rights Agent may consult with legal counsel (who may be legal counsel for the Company), and the advice or written opinion of such counsel shall be full and complete authorization and protection to the Rights Agent, and the Rights Agent shall incur no liability for or in respect of, any action taken, suffered or omitted by it in good faith and in accordance with such advice or opinion.

(b) Whenever in the performance of its duties under this Agreement the Rights Agent shall deem it necessary or desirable that any fact or matter (including, without limitation, the identity of any Acquiring Person and the determination of "current market price") be proved or established by the Company prior to taking, suffering or omitting any action hereunder, such fact or matter (unless other evidence in respect thereof be herein specifically prescribed) may be deemed to be conclusively proved and established by a certificate signed by the Chairman of the Board, the President, any Vice President, the Treasurer, any Assistant Treasurer, the Secretary or any Assistant Secretary of the Company and delivered to the Rights Agent; and such certificate shall be full authorization and protection to the Rights Agent and the Rights Agent shall incur no liability for or in respect of any action taken, suffered or omitted in good faith by it under the provisions of this Agreement in reliance upon such certificate.

(c) The Rights Agent shall be liable hereunder only for its own gross negligence, bad faith or willful misconduct; provided, however that the Rights Agent shall not be liable for special, indirect, incidental or consequential loss or damage of any kind whatsoever, even if the Rights Agent has been advised of the likelihood of such loss or damage.

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(d) The Rights Agent shall not be liable for or by reason of any of the statements of fact or recitals contained in this Agreement or in the Rights Certificates or be required to verify the same (except as to its countersignature on such Rights Certificates), but all such statements and recitals are and shall be deemed to have been made by the Company only.

(e) The Rights Agent shall not be under any liability or responsibility in respect of the validity of any provision of this Agreement or the execution and delivery hereof (except the due execution hereof by the Rights Agent) or in respect of the validity or execution of any Rights Certificate (except its countersignature thereof); nor shall it be responsible for any breach by the Company of any covenant or condition contained in this Agreement or in any Rights Certificate; nor shall it be responsible for any adjustment required under the provisions of this Agreement or responsible for the manner, method or amount of any such adjustment or the ascertaining of the existence of facts that would require any such adjustment (except with respect to the exercise of Rights evidenced by Rights Certificates after actual notice of any such adjustment); nor shall it by any act hereunder be deemed to make any representation or warranty as to the authorization or reservation of any Common Shares to be issued pursuant to this Agreement or any Rights Certificate or as to whether any Common Shares or Preferred Shares will, when so issued, be validly authorized and issued, fully paid and nonassessable.

(f) The Company agrees that it will perform, execute, acknowledge and deliver or cause to be performed, executed, acknowledged and delivered all such further and other acts, instruments and assurances as may reasonably be required by the Rights Agent for the carrying out or performing by the Rights Agent of the provisions of this Agreement.

(g) The Rights Agent is hereby authorized and directed to accept instructions with respect to the performance of its duties hereunder from any one of the Chairman of the Board, the President, any Vice President, the Secretary, any Assistant Secretary, the Treasurer or any Assistant Treasurer of the Company, and to apply to such officers for advice or instructions in connection with its duties, and such instructions shall be full authorization and protection for the Rights Agent and the Rights Agent shall incur no liability for or in respect of any action taken, suffered or omitted to be taken by it in good faith in accordance with instructions of any such officer. The Rights Agent may conclusively rely on the most recent instructions provided to it by any such officer.

(h) The Rights Agent and any shareholder, affiliate, director, officer or employee of the Rights Agent may buy, sell or deal in any of the Rights or other securities of the Company or become pecuniarily interested in any transaction in which the Company may be interested, or contract with or lend money to the Company or otherwise act as fully and freely as though it were not the Rights Agent under this Agreement and none of such actions shall constitute a breach of trust. Nothing herein shall preclude the Rights Agent from acting in any other capacity for the Company or for any other Person or legal entity.

(i) The Rights Agent may execute and exercise any of the rights or powers hereby vested in it or perform any duty hereunder either itself or by or through its attorneys or agents, and the Rights Agent shall not be answerable or accountable for any act, default, neglect or misconduct of any such attorneys or agents or for any loss to the Company or any other Person resulting from any such act, default, neglect or misconduct, absent gross negligence, bad faith or willful misconduct in the selection and continued employment thereof.

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(j) No provision of this Agreement shall require the Rights Agent to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder or in the exercise of its rights if it believes that repayment of such funds or adequate indemnification against such risk or liability is not reasonably assured to it.

(k) If, with respect to any Rights Certificate surrendered to the Rights Agent for exercise or transfer, the certificate attached to the form of assignment or form of election to purchase, as the case may be, has either not been completed or indicates an affirmative response to clause 1 and/or 2 thereof, the Rights Agent shall not take any further action with respect to such requested exercise or transfer without first consulting with the Company.

Section 21. Change of Rights Agent. The Rights Agent or any successor Rights Agent may resign and be discharged from its duties under this Agreement upon thirty (30) days' prior written notice mailed to the Company and to each transfer agent of the Common Shares and Preferred Shares by registered or certified mail, and to the holders of the Rights Certificates by first-class mail. In the event the transfer agency relationship in effect between the

Company and the Rights Agent terminates, the Rights Agent will be deemed to resign automatically on the effective date of such termination; and any required notice will be sent by the Company. The Company may remove the Rights Agent or any successor Rights Agent upon thirty (30) days' prior written notice mailed to the Rights Agent or successor Rights Agent, as the case may be, and to each transfer agent of the Common Shares and Preferred Shares, by registered or certified mail, and to the holders of the Rights Certificates by first-class mail. If the Rights Agent shall resign or be removed or shall otherwise become incapable of acting, the Company shall appoint a successor to the Rights Agent. If the Company shall fail to make such appointment within a period of thirty (30) days after giving notice of such removal or after it has been notified in writing of such resignation or incapacity by the resigning or incapacitated Rights Agent or by the holder of a Rights Certificate (who shall, with such notice, submit his Rights Certificate for inspection by the Company), then any registered holder of any Rights Certificate may apply to any court of competent jurisdiction for the appointment of a new Rights Agent. Any successor Rights Agent, whether appointed by the Company or by such a court, shall be (a) a Person organized, doing business and in good standing under the laws of the United States or of any state, having a principal office in the State of New York or the Commonwealth of Pennsylvania, that is authorized by law to exercise shareholder services and stock transfer powers and is subject to supervision or examination by federal or state authority and that has at the time of its appointment as Rights Agent a combined capital and surplus of at least \$50,000,000 or (b) an Affiliate of any such Person. After appointment, the successor Rights Agent shall be vested with the same powers, rights, duties and responsibilities as if it had been originally named as Rights Agent without further act or deed; but the predecessor Rights Agent shall deliver and transfer to the successor Rights Agent any property at the time held by it hereunder, and execute and deliver any further assurance, conveyance, act or deed necessary for the purpose. Not later than the effective date of any such appointment, the Company shall file notice thereof in writing with the predecessor Rights Agent and each transfer agent of the Common Shares and Preferred Shares and mail a notice thereof in writing to the registered holders of the Rights Certificates or, prior to the Distribution Date, to the registered holders of the Common Shares. In case at the time such successor Rights Agent shall succeed to the agency and trust created by this Agreement, any of the Rights Certificates shall have been countersigned but not delivered, any such successor Rights Agent may adopt the countersignature of a predecessor Rights Agent and deliver such Rights Certificates so countersigned; and in case at that time any of the Rights Certificates shall not have been countersigned, any successor Rights Agent may countersign such Rights Certificates either in the name of the predecessor or in the name of the successor Rights Agent; and in all such cases such Rights Certificates shall have the full force provided in the Rights Certificates and in this Agreement. Failure to give any notice provided for in this Section 21, however, or any defect therein, shall not affect the legality or validity of the resignation or removal of the Rights Agent or the appointment of the successor Rights Agent, as the case may be.

Section 22. Issuance of New Rights Certificates. Notwithstanding any of the provisions of this Agreement or of the Rights to the contrary, the Company may, at its option, issue new Rights Certificates evidencing Rights in such form as may be approved by its Board of Directors to reflect any adjustment or change in the Purchase Price and the number or kind or class of shares or other securities or property purchasable under the Rights Certificates made in accordance with the provisions of this Agreement. In addition, in connection with the issuance, sale or delivery of Common Shares following the Distribution Date and prior to the redemption or expiration of the Rights, the Company (a) shall, with respect to Common Shares so issued, sold or delivered pursuant to the exercise of stock options, stock appreciation rights, grants or awards outstanding on the Distribution Date under any benefit plan or arrangement for employees or directors, or upon the exercise, conversion or exchange of securities outstanding on the Record Date or hereinafter issued by the Company, and (b) may, in any other case, if deemed necessary or appropriate by the Board of Directors of the Company, issue Rights Certificates representing the appropriate number of Rights in connection with such issuance or sale; provided, however, that (i) no such Rights Certificate shall be issued if, and to the extent that, the Company shall be advised by counsel that such issuance would create a significant risk of material adverse tax consequences to the Company or the Person to whom such Rights Certificate would be issued, and (ii) no such Rights Certificate shall be issued if, and to the extent that, appropriate adjustment shall otherwise have been made in lieu of the issuance thereof.

Section 23. Redemption and Termination.

(a) The Board of Directors of the Company may, at its option, at any time prior to the earlier of (i) the Close of Business on the tenth day following a Stock Acquisition Date (or, if the Stock Acquisition Date shall have occurred prior to the Record Date, the Close of Business on the tenth day following the Record Date), or (ii) the Close of Business on the Final Expiration Date, redeem all but not less than all the then outstanding Rights at a redemption price of \$.00512 per Right (which amount represents the redemption price of \$.01 set forth in the Original Rights Agreement, adjusted for stock splits occurring between the date of the Original Rights Agreement and the date hereof), as such amount may be appropriately adjusted to reflect any stock split, stock dividend or similar transaction occurring after the date hereof (such redemption price being hereinafter referred to as the "Redemption Price") and the Company may, at its option, pay the Redemption Price either in Common Shares (based on the "current market price", as defined in Section 11(d)(i) hereof, of the Common Shares at the time of redemption) or cash; provided, however, that if, following the occurrence of a Stock Acquisition Date and following the expiration of the right of redemption hereunder but prior to any Triggering Event, (i) an Acquiring Person shall have transferred or otherwise disposed of a number of Common Shares in one transaction or series of transactions, not directly or indirectly involving the Company or any of its Subsidiaries, which did not result in the occurrence of a Triggering Event or the Company shall have issued additional equity securities, in either instance such that such Person is thereafter a Beneficial Owner of 10% or less of the outstanding Common Shares, and (ii) there is no other Acquiring Person immediately following the occurrence of the event described in clause (i), then the right of redemption shall be reinstated thereafter be subject to the provisions of this Section 23. Notwithstanding anything contained in this Agreement to the contrary, the Rights shall not be exercisable after the first occurrence of a Section 11(a)(ii) Event until such time as the Company's right of redemption hereunder has expired.

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(b) Immediately upon the action of the Board of Directors of the Company ordering the redemption of the Rights, without any notice, or further action, the right to exercise the Rights will terminate and the only right thereafter of the holders of Rights shall be to receive the Redemption Price for each Right so held. Promptly after the action of the Board of Directors ordering the redemption of the Rights, the Company shall give notice of such redemption to the Rights Agent and the holders of the then outstanding Rights by, in the case of notice to holders, mailing such notice to all such holders at each holder's last address as it appears upon the registry books of the Rights Agent or, prior to the Distribution Date, on the registry books of the Transfer Agent for the Common Shares. Any notice that is mailed in the manner herein provided shall be deemed given, whether or not the holder receives the notice. Each such notice of redemption will state the method by which the payment of the Redemption Price will be made.

Section 24. Exchange.

(a) The Board of Directors of the Company may, at its option, at any time after any Person becomes an Acquiring Person, exchange all or part of the then outstanding and exercisable Rights (which shall not include Rights that have become null and void pursuant to the provisions of Section 7(e) hereof) for Common Shares at an exchange ratio of one Common Share per Right, appropriately adjusted to reflect any stock split, stock dividend or similar transaction occurring after the date hereof (such exchange ratio being hereinafter referred to as the "Exchange Ratio"). Notwithstanding the foregoing, the Company's Board of Directors shall not be empowered to effect such exchange at any time after any Person (other than the Company, any Subsidiary of the Company, any employee benefit plan of the Company or any such Subsidiary, or any Person organized, appointed or established by the Company for or pursuant to the terms of any such plan), together with all Affiliates and Associates of such Person, becomes the Beneficial Owner of fifty percent (50%) or more of the Common Shares then outstanding.

(b) Immediately upon the action of the Board of Directors of the Company ordering the exchange of any Rights pursuant to subsection (a) of this Section 24 and without any further action and without any notice, the right to exercise such Rights shall terminate and the only right thereafter of the holders of such Rights shall be to receive that number of Common Shares equal to the number of such Rights held by such holder multiplied by the Exchange Ratio.

The Company shall promptly give public notice of any such exchange; provided, however, that the failure to give, or any defect in, such notice shall not affect the validity of such exchange. The Company shall promptly notify the Rights Agent of any such exchange. The Company promptly shall mail a notice of any such exchange to all of the holders of such Rights at their last addresses as they appear upon the registry books of the Rights Agent. Any notice which is mailed in the manner herein provided shall be deemed given, whether or not the holder receives the notice. Each such notice of exchange will state the method by which the exchange of the Common Shares for Rights will be effected and, in the event of any partial exchange, the number of Rights which will be exchanged. Any partial exchange shall be effected pro rata based on the number of Rights (other than Rights which have become void pursuant to the provisions of Section 7(e) hereof) held by each holder of Rights.

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(c) In the event that there shall not be sufficient Common Shares issued but not outstanding or authorized but issued to permit any exchange of Rights as contemplated in accordance with this Section 24, the Company shall take all such action as may be necessary to authorize additional Common Shares for issuance upon exchange of the Rights.

(d) The Company shall not be required to issue fractions of Common Shares or to distribute certificates which evidence fractional Common Shares. In lieu of such fractional Common Shares, there shall be paid to the registered holders of the Rights Certificates with regard to which such fractional Common Shares would otherwise be issuable, an amount in cash equal to the same fraction of the current market value of a whole Common Share. For the purposes of this subsection (d), the current market value of a whole Common Share shall be the closing price of a Common Share (as determined pursuant to the second sentence of Section 11(d) hereof) for the Trading Day immediately prior to the date of exchange pursuant to this Section 24.

Section 25. Notice of Certain Events.

(a) In case the Company shall propose, at any time after the Distribution Date, (i) to pay any dividend payable in stock of any class to the holders of Preferred Shares or to make any other distribution to the holders of Preferred Shares (other than a regular quarterly dividend out of earnings or retained earnings of the Company), or (ii) to offer to the holders of Preferred Shares rights or warrants to subscribe for or to purchase any additional Preferred Shares or shares of stock of any class or any other securities, rights or options, or (iii) to effect any reclassification of its Preferred Shares (other than a reclassification involving only the subdivision of outstanding Preferred Shares), or (iv) to effect any consolidation or merger into or with any other Person (other than a Subsidiary of the Company in a transaction which complies with Section 11(o) hereof), or to effect any sale or other transfer (or to permit one or more of its Subsidiaries to effect any sale or other transfer), in one transaction or a series of related transactions, of more than 50% of the assets or earning power of the Company and its Subsidiaries (taken as a whole) to any other Person or Persons (other than the Company and/or any of its Subsidiaries in one or more transactions each of which complies with Section 11(o) hereof), or (v) to effect the liquidation, dissolution or winding up of the Company, then, in each such case, the Company shall give to the Rights Agent and to each holder of a Rights Certificate, to the extent feasible and in accordance with Section 26 hereof, a notice of such proposed action, which shall specify the record date for the purposes of such stock dividend, distribution of rights or warrants, or the date on which such reclassification, consolidation, merger, sale, transfer, liquidation, dissolution, or winding up is to take place and the date of participation therein by the holders of Preferred Shares, if any such date is to be fixed, and such notice shall be so given in the case of any action covered by clause (i) or (ii) above at least twenty (20) days prior to the record date for determining holders of Preferred Shares for purposes of such action, and in the case of any such other action, at least twenty (20) days prior to the date of the taking of such proposed action or the date of participation therein by the holders of Preferred Shares, whichever shall be the earlier.

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(b) Upon the occurrence of a Section 11(a)(ii) Event, (i) the

Company shall as soon as practicable thereafter give to each holder of a Rights Certificate, to the extent feasible and in accordance with Section 26 hereof, a notice of the occurrence of such event, which shall specify the event and the consequences of the event to holders of Rights under Section 11(a)(ii) hereof, and (ii) all references in the preceding paragraph to Preferred Shares shall be deemed thereafter to refer to Common Shares and/or, if appropriate, other securities.

Section 26. Notices. Notices or demands authorized by this Agreement to be given or made by the Rights Agent or by the holder of any Rights Certificate to or on the Company shall be sufficiently given or made if sent by first-class mail, postage prepaid, addressed (until another address is filed in writing with the Rights Agent) as follows:

Aqua America, Inc.
762 Lancaster Avenue
Bryn Mawr, Pennsylvania 19010
Attention: Corporate Secretary

Subject to the provisions of Section 21, any notice or demand authorized by this Agreement to be given or made by the Company or by the holder of any Rights Certificate to or on the Rights Agent shall be sufficiently given or made if sent by first-class mail, postage prepaid, addressed (until another address is filed in writing with the Company) as follows:

Equiserve Trust Company, N.A.
150 Royall Street
Canton, Massachusetts 02021
Attn: Client Administration

Notices or demands authorized by this Agreement to be given or made by the Company or the Rights Agent to the holder of any Rights Certificate (or, if prior to the Distribution Date to the holder of certificates representing Common Shares) shall be sufficiently given or made if sent by first-class mail, postage prepaid, addressed to such holder at the address of such holder as shown on the registry books of the Company.

Section 27. Supplements and Amendments. Prior to the Distribution Date, the Company may and the Rights Agent shall, if the Company so directs, supplement or amend any provision of this Agreement without the approval of any holders of certificates representing Common Shares. From and after the Distribution Date, the Company may and the Rights Agent shall, if the Company so directs, supplement or amend this Agreement without the approval of any holders of Rights Certificates in order (i) to cure any ambiguity, (ii) to correct or supplement any provision contained herein which may be defective or inconsistent with any other provisions herein, (iii) to shorten or lengthen any time period

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hereunder, or (iv) to change or supplement the provisions hereunder in any manner that the Company may deem necessary or desirable and that shall not adversely affect the interests of the holders of Rights Certificates; provided, this Agreement may not be supplemented or amended to lengthen, pursuant to clause (iii) of this sentence, (A) a time period relating to when the Rights may be redeemed at such time as the Rights are not then redeemable, or (B) any other time period unless such lengthening is for the purpose of protecting, enhancing or clarifying the rights of, and/or the benefits to, the holders of Rights. Upon the delivery of a certificate from an appropriate officer of the Company that states that the proposed supplement or amendment is in compliance with the terms of this Section 27, and if requested by the Rights Agent, an opinion of counsel, the Rights Agent shall execute such supplement or amendment. Notwithstanding anything contained in this Agreement to the contrary, (i) no supplement or amendment shall be made that changes the Redemption Price, the Final Expiration Date, the Purchase Price or the number of Preferred Share Fractions for which a Right is exercisable, and (ii) no supplement or amendment that changes or increases the obligations and duties of the Rights Agent under this Agreement shall be effective without the consent of the Rights Agent. Prior to the Distribution Date, the interests of the beneficial owners of Rights shall be deemed coincident with the interests of the holders of Common Shares. Prior to the Distribution Date, the interests of the beneficial owners of Rights shall be deemed coincident with the interests of the holders of Common Shares.

Section 28. Successors. All the covenants and provisions of this Agreement by or for the benefit of the Company or the Rights Agent shall bind

and inure to the benefit of their respective successors and assigns hereunder.

Section 29. Determinations and Actions by the Board of Directors, etc. For all purposes of this Agreement, any calculation of the number of Common Shares outstanding at any particular time, including for purposes of determining the particular percentage of such outstanding Common Shares of which any Person is the Beneficial Owner, shall be made in accordance with the last sentence of Rule 13d-3(d)(1)(i) of the General Rules and Regulations under the Exchange Act. The Board of Directors of the Company shall have the exclusive power and authority to administer this Agreement and to exercise all rights and powers specifically granted to the Board of Directors of the Company or to the Company, or as may be necessary or advisable in the administration of this Agreement, including, without limitation, the right and power to (i) interpret the provisions of this Agreement, and (ii) make all determinations deemed necessary or advisable for the administration of this Agreement (including a determination to redeem or not redeem the Rights or to amend or supplement the Agreement). All such actions, calculations, interpretations and determinations (including, for purposes of clause (y) below, all omissions with respect to the foregoing) that are done or made by the Board of Directors of the Company in good faith, shall (x) be final, conclusive and binding on the Company, the Rights Agent, the holders of the Rights and all other Persons, and (y) not subject the Board of Directors of the Company to any liability to the holders of the Rights. For purposes of this Agreement, the Rights Agent shall be allowed to assume that all such actions, calculations, interpretations and determinations have been done or made by the Board of Directors of the Company in good faith.

Section 30. Benefits of this Agreement. Nothing in this Agreement shall be construed to give to any Person other than the Company, the Rights Agent and the registered holders of the Rights Certificates (and, prior to the Distribution Date, registered holders of the Common Shares) any legal or equitable right, remedy or claim under this Agreement; but this Agreement shall be for the sole and exclusive benefit of the Company, the Rights Agent and the registered holders of the Rights Certificates (and, prior to the Distribution Date, registered holders of the Common Shares).

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Section 31. Severability. If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction or other authority to be invalid, void or unenforceable for any purpose or under any set of circumstances or as applied to any Person, such invalid, void or unenforceable term, provision, covenant or restriction shall continue in effect to the maximum extent possible for all other purposes, under all other circumstances and as applied to all other Persons; and the remainder of the terms, provisions, covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated; provided, however, that notwithstanding anything in this Agreement to the contrary, if any such term, provision, covenant or restriction is held by such court or authority to be invalid, void or unenforceable and the Board of Directors of the Company determines in its good faith judgment that severing the invalid language from this Agreement would adversely affect the purpose or effect of this Agreement, the right of redemption set forth in Section 23 hereof shall be reinstated and shall not expire until the Close of Business on the tenth day following the date of such determination by the Board of Directors.

Section 32. Governing Law. This Agreement, each Right and each Rights Certificate issued hereunder shall be deemed to be a contract made under the laws of the Commonwealth of Pennsylvania and for all purposes shall be governed by and construed in accordance with the laws of such jurisdiction applicable to contracts made and to be performed entirely within such jurisdiction; except that all provisions regarding the rights, duties and obligations of the Rights Agent shall be governed by and construed in accordance with the laws of the State of New York applicable to contracts made and to be performed entirely within such jurisdiction.

Section 33. Counterparts. This Agreement may be executed in any number of counterparts and each of such counterparts shall for all purposes be deemed to be an original, and all such counterparts shall together constitute but one and the same instrument.

Section 34. Descriptive Headings. Descriptive headings of the several Sections of this Agreement are inserted for convenience only and shall not control or affect the meaning or construction of any of the provisions hereof.

Section 35. Force Majeure. Notwithstanding anything to the contrary contained herein, Rights Agent shall not be liable for any delays or failures in performance resulting from acts beyond its reasonable control including, without limitation, acts of God, terrorist acts, shortage of supply, breakdowns or malfunctions, interruptions or malfunction of computer facilities, or loss of data due to power failures or mechanical difficulties with information storage or retrieval systems, labor difficulties, war, or civil unrest.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed as of the day and year first above written.

AQUA AMERICA, INC.

By /s/ Roy H. Stahl

Name: Roy H. Stahl
Title: Executive Vice President

EQUISERVE TRUST COMPANY, N.A.

By /s/ Joshua P. McGinn

Name: Joshua P. McGinn
Title: Senior Account Manager

EXHIBIT A

RESOLUTION OF THE BOARD OF DIRECTORS OF
PHILADELPHIA SUBURBAN CORPORATION
ESTABLISHING AND DESIGNATING
SERIES A JUNIOR PARTICIPATING PREFERRED SHARES
AS A SERIES OF THE PREFERRED STOCK

RESOLVED, that pursuant to the authority expressly vested in the Board of Directors of Philadelphia Suburban Corporation (the "Corporation") by Article FIFTH of the Articles of Incorporation of the Corporation, the Board of Directors hereby fixes and determines the voting rights, designations, preferences, qualifications, privileges, limitations, restrictions, options, conversion rights and other special or relative rights of the first series of the Series Preferred Stock, par value \$1.00 per share, which shall consist of 100,000 shares and shall be designated as Series A Junior Participating Preferred Shares (the "Series A Preferred Shares").

Special Terms of the Series A Preferred Shares

Section 1. Dividends and Distributions.

(a) The rate of dividends payable per share of Series A Preferred Shares on the first day of January, April, July and October in each year or such other quarterly payment date as shall be specified by the Board of Directors (each such date being referred to herein as a "Quarterly Dividend Payment Date"), commencing on the first Quarterly Dividend Payment Date after the first issuance of a share or fraction of a share of the Series A Preferred Shares, shall be (rounded to the nearest cent) equal to the greater of (i) \$10.00 or (ii) subject to the provision for adjustment hereinafter set forth, 1,000 times the aggregate per share amount of all cash dividends, and 1,000 times the aggregate per share amount (payable in cash, based upon the fair market value at the time the non-cash dividend or other distribution is declared or paid as determined in good faith by the Board of Directors) of all non-cash dividends or other distributions other than a dividend payable in shares of Common Stock or a subdivision of the outstanding shares of Common Stock (by reclassification or otherwise), declared on the Common Stock, \$.50 par value per share, of the Corporation since the immediately preceding Quarterly Dividend Payment Date, or, with respect to the first Quarterly Dividend Payment Date, since the first issuance of any share or fraction of a share of the Series A Preferred Shares. Dividends on the Series A Preferred Shares shall be paid out of funds legally available for such purpose. In the event the Corporation shall at any time after March 1, 1998 (the "Rights Declaration Date") (i) declare any dividend on Common Stock payable in shares of Common Stock, (ii) subdivide the

outstanding shares of Common Stock, or (iii) combine the outstanding shares of Common Stock into a smaller number of shares, then in each such case the amounts to which holders of Series A Preferred Shares were entitled immediately prior to such event under clause (ii) of the preceding sentence shall be adjusted by multiplying each such amount by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

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(b) Dividends shall begin to accrue and be cumulative on outstanding Series A Preferred Shares from the Quarterly Dividend Payment Date next preceding the date of issue of such Series A Preferred Shares, unless the date of issue of such shares is prior to the record date for the first Quarterly Dividend Payment Date, in which case dividends on such shares shall begin to accrue from the date of issue of such shares, or unless the date of issue is a Quarterly Dividend Payment Date or is a date after the record date for the determination of holders of Series A Preferred Shares entitled to receive a quarterly dividend and before such Quarterly Dividend Payment Date, in either of which events such dividends shall begin to accrue and be cumulative from such quarterly Dividend Payment Date. Accrued but unpaid dividends shall not bear interest. Dividends paid on the Series A Preferred Shares in an amount less than the total amount of such dividends at the time accrued and payable on such shares shall be allocated pro rata on a share-by-share basis among all such shares at the time outstanding.

Section 2. Voting Rights. In addition to any other voting rights required by law, the holders of Series A Preferred Shares shall have the following voting rights:

(a) Subject to the provision for adjustment hereinafter set forth, each Series A Preferred Share shall entitle the holder thereof to 1,000 votes on all matters submitted to a vote of the shareholders of the Corporation. In the event the Corporation shall at any time after the Rights Declaration Date (i) declare any dividend on Common Stock payable in shares of Common Stock, (ii) subdivide the outstanding shares of Common Stock, or (iii) combine the outstanding shares of Common Stock into a smaller number of shares, then in each such case the number of votes per share to which holders of Series A Preferred Shares were entitled immediately prior to such event shall be adjusted by multiplying such number by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(b) In the event that dividends upon the Series A Preferred Shares shall be in arrears to an amount equal to six full quarterly dividends thereon, the holders of such Series A Preferred Shares shall become entitled to the extent hereinafter provided to vote noncumulatively at all elections of directors of the Corporation, and to receive notice of all shareholders' meetings to be held for such purpose. At such meetings, to the extent that directors are being elected, the holders of such Series A Preferred Shares voting as a class shall be entitled solely to elect two members of the Board of Directors of the Corporation; and all other directors of the Corporation shall be elected by the other shareholders of the Corporation entitled to vote in the election of directors. Such voting rights of the holders of such Series A Preferred Shares shall continue until all accumulated and unpaid dividends thereon shall have been paid or funds sufficient therefor set aside, whereupon all such voting rights of the holders of shares of such series shall cease, subject to being again revived from time to time upon the reoccurrence of the conditions above described as giving rise thereto.

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At any time when such right to elect directors separately as a class shall have so vested, the Corporation may, and upon the written request of the holders of record of not less than 20% of the then outstanding total number of shares of all the Series A Preferred Shares having the right to elect directors in such circumstances shall, call a special meeting of holders of such Series A Preferred Shares for the election of directors. In the case of such a written request, such special meeting shall be held within 90 days after the

delivery of such request, and, in either case, at the place and upon the notice provided by law and in the By-laws of the Corporation; provided, that the Corporation shall not be required to call such a special meeting if such request is received less than 120 days before the date fixed for the next ensuing annual or special meeting of shareholders of the Corporation. Upon the mailing of the notice of such special meeting to the holders of such Series A Preferred Shares, or, if no such meeting be held, then upon the mailing of the notice of the next annual or special meeting of shareholders for the election of directors, the number of directors of the Corporation shall, ipso facto, be increased to the extent, but only to the extent, necessary to provide sufficient vacancies to enable the holders of such Series A Preferred Shares to elect the two directors hereinabove provided for, and all such vacancies shall be filled only by vote of the holders of such Series A Preferred Shares as hereinabove provided. Whenever the number of directors of the Corporation shall have been increased, the number as so increased may thereafter be further increased or decreased in such manner as may be permitted by the By-laws and without the vote of the holders of Series A Preferred Shares, provided that no such action shall impair the right of the holders of Series A Preferred Shares to elect and to be represented by two directors as herein provided.

So long as the holders of Series A Preferred Shares are entitled hereunder to voting rights, any vacancy in the Board of Directors caused by the death or resignation of any director elected by the holders of Series A Preferred Shares, shall, until the next meeting of shareholders for the election of directors, in each case be filled by the remaining director elected by the holders of Series A Preferred Shares having the right to elect directors in such circumstances.

Upon termination of the voting rights of the holders of any series of Series A Preferred Shares the terms of office of all persons who shall have been elected directors of the Corporation by vote of the holders of Series A Preferred Shares or by a director elected by such holders shall forthwith terminate.

(c) Except as otherwise provided herein, in the Articles of Incorporation of the Corporation or by law, the holders of Series A Preferred Shares and the holders of Common Stock (and the holders of shares of any other series or class entitled to vote thereon) shall vote together as one class on all matters submitted to a vote of shareholders of the Corporation.

Section 3. Reacquired Shares. Any Series A Preferred Shares purchased or otherwise acquired by the Corporation in any manner whatsoever shall be retired and canceled promptly after the acquisition thereof. All such shares shall upon their cancellation become authorized but unissued Series Preferred Stock and may be reissued as part of a new series of Series Preferred Stock to be created by resolution or resolutions of the Board of Directors.

Section 4. Liquidation, Dissolution or Winding Up. In the event of any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, the holders of Series A Preferred Shares shall be entitled to receive the greater of (a) \$100.00 per share, plus accrued dividends to the date of distribution, whether or not earned or declared, or (b) an amount per share, subject to the provision for adjustment hereinafter set forth, equal to 1,000 times the aggregate amount to be distributed per share to holders of Common Stock. In the event the Corporation shall at any time after the Rights Declaration Date (i) declare any dividend on Common Stock payable in shares of Common Stock, (ii) subdivide the outstanding shares of Common Stock, or (iii) combine the outstanding shares of Common Stock into a smaller number of shares, then in each such case the amount to which holders of Series A Preferred Shares were entitled immediately prior to such event pursuant to clause (b) of the preceding sentence shall be adjusted by multiplying such amount by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

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Section 5. Consolidation, Merger, etc. In case the Corporation shall enter into any consolidation, merger, combination or other transaction in which the shares of Common Stock are exchanged for or changed into other stock or securities, cash and/or any other property, then in any such case the Series A Preferred Shares shall at the same time be similarly exchanged or changed in an amount per share (subject to the provision for adjustment hereinafter set forth) equal to 1,000 times the aggregate amount of stock, securities, cash and/or any

other property (payable in kind), as the case may be, into which or for which each share of Common Stock is changed or exchanged. In the event the Corporation shall at any time after the Rights Declaration Date (i) declare any dividend on Common Stock payable in shares of Common Stock, (ii) subdivide the outstanding shares of Common Stock, or (iii) combine the outstanding shares of Common Stock into a smaller number of shares, then in each such case the amount set forth in the preceding sentence with respect to the exchange or change of shares of Series A Preferred Shares shall be adjusted by multiplying such amount by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

Section 6. No Redemption. The Series A Preferred Shares shall not be redeemable.

Section 7. Ranking. The Series A Preferred Shares shall rank junior to all other series of the Corporation's Series Preferred Stock as to the payment of dividends and the distribution of assets, unless the terms of any such series shall provide otherwise.

Section 8. Fractional Shares. Series A Preferred Shares may be issued in fractions of a share which shall entitle the holder, in proportion to such holder's fractional shares, to exercise voting rights, receive dividends, participate in distributions and to have the benefit of all other rights of holders of Series A Preferred Shares.

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EXHIBIT B

[Form of Rights Certificate]

Certificate No. R-

_____ Rights

NOT EXERCISABLE AFTER MARCH 1, 2008 OR AFTER EARLIER REDEMPTION BY THE COMPANY. THE RIGHTS ARE SUBJECT TO REDEMPTION, AT THE OPTION OF THE COMPANY, AT \$.01 PER RIGHT ON THE TERMS SET FORTH IN THE RIGHTS AGREEMENT. UNDER CERTAIN CIRCUMSTANCES, RIGHTS BENEFICIALLY OWNED BY AN ACQUIRING PERSON OR AN AFFILIATE OR ASSOCIATE OF AN ACQUIRING PERSON (AS SUCH TERMS ARE DEFINED IN THE RIGHTS AGREEMENT) AND ANY SUBSEQUENT HOLDER OF SUCH RIGHTS MAY BECOME NULL AND VOID. [THE RIGHTS REPRESENTED BY THIS RIGHTS CERTIFICATE ARE OR WERE BENEFICIALLY OWNED BY A PERSON WHO WAS OR BECAME AN ACQUIRING PERSON OR AN AFFILIATE OR ASSOCIATE OF AN ACQUIRING PERSON (AS SUCH TERMS ARE DEFINED IN THE RIGHTS AGREEMENT). ACCORDINGLY, THIS RIGHTS CERTIFICATE AND THE RIGHTS REPRESENTED HEREBY MAY BECOME NULL AND VOID IN THE CIRCUMSTANCES SPECIFIED IN SECTION 7(e) OF SUCH AGREEMENT.]*

* The bracketed portion of the legend shall be inserted only if applicable and shall replace the preceding sentence.

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AQUA AMERICA, INC.

RIGHTS CERTIFICATE

This certifies that _____, or registered assigns, is the registered owner of the number of Rights set forth above, each of which entitles the owner thereof, subject to the terms, provisions and conditions of the First Amended and Restated Rights Agreement, dated as of _____, 2004, (the "Rights Agreement"), between Aqua America, Inc., a Pennsylvania corporation (the "Company"), and Equiserve Trust Company, N.A. (the "Rights Agent"), to purchase from the Company at any time prior to 5:00 P.M. (Philadelphia time) on March 1, 2008 at the office or offices of the Rights Agent designated for such purpose, or its successors as Rights Agent, one one-thousandth of a fully paid, nonassessable share of Series A Junior Participating Preferred Stock (the "Preferred Share") of the Company, at a purchase price (the "Purchase Price") of \$46.08 per one one-thousandth of a Preferred Share (such fraction, a "Preferred Share Fraction"), upon presentation and surrender of this Rights Certificate with the Form of Election to Purchase and related Certificate duly executed. Except as provided in Sections 11(q) and 13(e) of the Rights Agreement, the Purchase Price shall be paid, at the option of the Company, in cash or Common Stock, of the Company (the "Common Shares") having an equivalent value. The number of Rights evidenced by this Rights Certificate (and the number of Preferred Share Fractions that may be purchased upon exercise thereof) set forth above, and the Purchase Price per Preferred Share Fraction set forth above, are the number and Purchase Price as of March 1, 1998, based on the Preferred Shares as constituted at such date.

Except as otherwise provided in the Rights Agreement, upon the occurrence of any Section 11(a)(ii) Event (as such term is defined in the Rights Agreement), if the Rights evidenced by this Rights Certificate are beneficially owned by (i) an Acquiring Person or Associate or Affiliate or Associate of any Acquiring Person (as such terms are defined in the Rights Agreement), (ii) a transferee of any Acquiring Person (of any such Associate or Affiliate) who becomes a transferee after the Acquiring Person becomes such, or (iii) under certain circumstances specified in the Rights Agreement, a transferee of a person who, after such transfer, became an Acquiring Person, or an Affiliate or Associate of an Acquiring Person, such Rights shall become null and void and no holder hereof shall have any right with respect to such Rights from and after the occurrence of any such Section 11(a)(ii) Event.

As provided in the Rights Agreement, the Purchase Price and the number and kind of Preferred Shares or other securities that may be purchased upon the exercise of the Rights evidenced by this Rights Certificate are subject to modification and adjustment upon the happening of certain events, including Triggering Events and a Section 11 (a) (ii) Event.

This Rights Certificate is subject to all of the terms, covenants and restrictions of the Rights Agreement, which terms, covenants and restrictions are hereby incorporated herein by reference and made a part hereof and to which Rights Agreement reference is hereby made for a full description of the rights, limitations of rights, obligations, duties and immunities hereunder of the Rights Agent, the Company and the holders of the Rights Certificates, which limitations of rights include the temporary suspension of the exercisability of such Rights under the specific circumstances set forth in the Rights Agreement. Copies of the Rights Agreement are on file at the above-mentioned office of the Rights Agent and are also available upon written request to the Company.

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This Rights Certificate, with or without other Rights Certificates, upon surrender at the office of the Rights Agent designated for such purpose, may be exchanged for another Rights Certificate or Rights Certificates of like tenor and date evidencing Rights entitling the holder to purchase a like aggregate number of Preferred Share Fractions as the Rights evidenced by the Rights Certificate or Rights Certificates surrendered shall have entitled such holder to purchase. If this Rights Certificate shall be exercised in part, the holder shall be entitled to receive upon surrender hereof another Rights Certificate or Rights Certificates for the number of whole Rights not exercised.

Subject to the provisions of the Rights Agreement, the Rights evidenced by this Certificate may be redeemed by the Company at its option at a redemption price of \$.00512 per Right at any time prior to the earlier of the Close of Business (as such term is defined in the Rights Agreement) on (i) the tenth day following the Stock Acquisition Date (as such time period may be extended pursuant to the Rights Agreement), and (ii) the Final Expiration Date.

No fractional Preferred Shares will be issued upon the exercise of any Right or Rights evidenced hereby (other than fractions which are integral multiples of a Preferred Share, which may, as the election of the Company, be evidenced by depositary receipts), but in lieu thereof a cash payment will be made, as provided in the Rights Agreement.

No holder of this Rights Certificate shall be entitled to vote or receive dividends or be deemed for any purpose the holder of Preferred Shares or of any other securities of the Company (including Common Shares) that may at any time be issuable on the exercise hereof, nor shall anything contained in the Rights Agreement or herein be construed to confer upon the holder hereof, as such, any of the rights of a shareholder of the Company or any right to vote for the election of directors or upon any matter submitted to shareholders at any meeting thereof, or to give or withhold consent to any corporate action, or, to receive notice of meetings or other actions affecting shareholders (except as provided in the Rights Agreement), or to receive dividends or subscription rights, or otherwise, until the Right or Rights evidenced by this Rights Certificate shall have been exercised as provided in the Rights Agreement.

This Rights Certificate shall not be valid or obligatory for any purpose until it shall have been countersigned by the Rights Agent.

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WITNESS the facsimile signature of the proper officers of the Company and its corporate seal.

Dated as of _____, 19__

ATTEST

AQUA AMERICA, INC.

By

Secretary

Title:

Countersigned

EQUISERVE TRUST COMPANY, N.A.

By _____
Authorized Signature

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[Form of Reverse Side of Rights Certificate]

FORM OF ASSIGNMENT

(To be executed by the registered holder if such holder desires to transfer the Rights Certificate.)

FOR VALUE RECEIVED _____ hereby sells,
assigns and transfers unto _____
(Please print name and address of transferee)

_____ this Rights Certificate, together with all right, title and interest therein, and does hereby irrevocably constitute and appoint _____ Attorney, to transfer the within Rights Certificate on the books of the within-named Company, with full power of substitution.

Dated: _____, 20 __

Signature

Signature Guaranteed:

Certificate

The undersigned hereby certifies by checking the appropriate boxes that:

(1) this Rights Certificate [] is [] is not being sold, assigned and transferred by or on behalf of a Person who is or was an Acquiring Person or an Affiliate or Associate of any such Acquiring Person (as such terms are defined pursuant to the Rights Agreement);

(2) after due inquiry and to the best knowledge of the undersigned, it [] did [] did not acquire the Rights evidenced by this Rights Certificate from any Person who is, was or subsequently became an Acquiring Person or an Affiliate or Associate of an Acquiring Person.

Dated: _____, 20__

Signature

Signature Guaranteed:

NOTICE

The signatures to the foregoing Assignment and Certificate must correspond to the name as written upon the face of this Rights Certificate in every particular, without alteration or enlargement or any change whatsoever.

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FORM OF ELECTION TO PURCHASE

(To be executed if holder desires to exercise Rights represented by the Rights Certificate.)

To: AQUA AMERICA, INC.:

The undersigned hereby irrevocably elects to exercise _____ Rights represented by this Rights Certificate to purchase the Preferred Shares issuable upon the exercise of the Rights (or Common Shares or such other securities of the Company or of any other person that may be issuable upon the exercise of the Rights) and requests that certificates for such shares be issued in the name of and delivered to:

Please insert social security
or other identifying number

(Please print name and address)

If such number of Rights shall not be all the Rights evidenced by this Rights Certificate, a new Rights Certificate for the balance of such Rights shall be registered in the name of and delivered to:

Please insert social security
or other identifying number

(Please print name and address)

Dated: _____, 20__

Signature

Signature Guaranteed:

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Certificate

The undersigned hereby certifies by checking the appropriate boxes that

(1) the Rights evidenced by this Rights Certificate [] are []
are not being exercised by or on behalf of a Person who is or was an Acquiring
Person or an Affiliate or Associate of any such Acquiring Person (as such terms
are defined pursuant to the Rights Agreement);

(2) after due inquiry and to the best knowledge of the undersigned, it
[] did [] did not acquire the Rights evidenced by this Rights Certificate from
any Person who is, was or became an Acquiring Person or an Affiliate or
Associate of an Acquiring Person.

Dated: _____, 20__

Signature

Signature Guaranteed:

NOTICE

The signatures to the foregoing Election to Purchase and Certificate
must correspond to the name as written upon the face of this Rights Certificate
in every particular, without alteration or enlargement or any change whatsoever.

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FIFTH AMENDMENT TO CREDIT AGREEMENT

THIS FIFTH AMENDMENT TO CREDIT AGREEMENT is made as of this 14th day of December, 2003, by and among PENNSYLVANIA SUBURBAN WATER COMPANY, a Pennsylvania corporation and successor by merger to Philadelphia Suburban Water Company ("Borrower"), the several banks which are parties to this Agreement (each a "Bank" and collectively, "Banks") and PNC BANK, NATIONAL ASSOCIATION in its capacity as agent for Banks (in such capacity, "Agent").

BACKGROUND

A. Borrower, Agent and Banks are parties to a Credit Agreement, dated as of December 22, 1999, as amended by a First Amendment to Credit Agreement dated as of November 28, 2000, a Second Amendment to Credit Agreement dated as of December 18, 2001, a Third Amendment to Credit Agreement dated as of December 16, 2002 and a Fourth Amendment dated as of December 24, 2002 (as so amended, the "Credit Agreement"), pursuant to which Banks agreed to make revolving credit loans to Borrower in an aggregate outstanding amount of up to \$70,000,000 (the "Loans"). The Loans are evidenced by Borrower's Revolving Credit Notes in the aggregate principal face amount of \$70,000,000.

B. Borrower, Agent and Banks desire to extend the Termination Date of the facility, all on the terms and subject to the conditions herein set forth.

NOW THEREFORE, the parties hereto, intending to be legally bound hereby, agree as follows:

AGREEMENT

1. Terms. Capitalized terms used herein and not otherwise defined herein shall have the meanings given to such terms in the Credit Agreement.

2. Amendments to Credit Agreement. Effective on December 14, 2003 (the "Effective Date") the Credit Agreement is hereby amended as follows:

(a) The definition of Termination Date in Section 1.1 is hereby amended and restated to read in full as follows:

" "Termination Date": the earlier of (a) December 12, 2004 or any later date to which the Termination Date shall have been extended pursuant to subsection 2.8(d) hereof and (b) the date the Commitments are terminated as provided herein."

3. Loan Documents. Except where the context clearly requires otherwise, all references to the Credit Agreement in any of the Loan Documents or any other document delivered to Banks or Agent in connection therewith shall be to the Credit Agreement as amended by this Agreement.

4. Borrower's Ratification. Borrower agrees that it has no defenses or set-offs against Banks or Agent or their respective officers, directors, employees, agents or attorneys, with respect to the Loan Documents, all of which are in full force and effect, and that all of the terms and conditions of the Loan Documents not inconsistent herewith shall remain in full force and effect unless and until modified or amended in writing in accordance with their terms. Borrower hereby ratifies and confirms its obligations under the Loan Documents as amended hereby and agrees that the execution and delivery of this Agreement does not in any way diminish or invalidate any of its obligations thereunder.

5. Representations and Warranties. Borrower hereby represents and warrants to Agent and Banks that:

(a) Except as otherwise previously disclosed to Agent and Banks, the representations and warranties made in the Credit Agreement, as amended by this Agreement, are true and correct as of the date hereof;

(b) No Default or Event of Default under the Credit Agreement exists on the date hereof; and

(c) This Agreement has been duly authorized, executed and delivered so as to constitute the legal, valid and binding obligations of Borrower, enforceable in accordance with its terms.

All of the above representations and warranties shall survive the making of this Agreement.

6. Conditions Precedent. The effectiveness of the amendments set forth herein is subject to the fulfillment, to the satisfaction of Agent and its counsel, of the following conditions precedent on or before the Effective Date:

(a) Borrower shall have delivered to Agent, with copies or counterparts for each Bank as appropriate, the following, all of which shall be in form and substance satisfactory to Agent and shall be duly completed and executed:

- (i) This Agreement;
- (ii) Copies, certified by the Secretary or an Assistant Secretary of Borrower as of a recent date, of resolutions of the board of directors of Borrower in effect on the date hereof authorizing the execution, delivery and performance of this Agreement and the other documents and transactions contemplated hereby;
- (iii) Copies, certified by its corporate secretary as of a recent date, of the articles of incorporation, certificate of formation, and by-laws of Borrower as in effect, or a certificate stating that there have been no changes to any such documents since the most recent date, true and correct copies thereof were delivered to Agent; and
- (iv) Such additional documents, certificates and information as Agent or Banks may require pursuant to the terms hereof or otherwise reasonably request.

(b) The representations and warranties set forth in the Credit Agreement shall be true and correct on and as of the date hereof.

(c) No Default or Event of Default shall have occurred and be continuing as of the date hereof.

(d) Borrower shall have paid to Agent for the benefit of Banks an extension fee of \$84,000 to be distributed pro rata to Banks.

7. Miscellaneous.

(a) All terms, conditions, provisions and covenants in the Loan Documents and all other documents delivered to Agent and Banks in connection therewith shall remain unaltered and in full force and effect except as modified or amended hereby. To the extent that any term or provision of this Agreement is or may be deemed expressly inconsistent with any term or provision in any Loan Document or any other document executed in connection therewith, the terms and provisions hereof shall control.

(b) The execution, delivery and effectiveness of this Agreement shall neither operate as a waiver of any right, power or remedy of Agent or Banks under any of the Loan Documents nor constitute a waiver of any Default or Event of Default or default thereunder.

(c) In consideration of Agent's and Banks' agreement to amend the existing credit facility, Borrower hereby waives and releases Agent and Banks and their respective officers, attorneys, agents and employees from any liability, suit, damage, claim, loss or expense of any kind or failure whatsoever and howsoever arising that it ever had up until, or has as of, the date of this Agreement.

(d) This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior and contemporaneous understandings and agreements.

(e) In the event any provisions of this Agreement shall be held

invalid or unenforceable by any court of competent jurisdiction, such holding shall not invalidate or render unenforceable any other provision hereof.

(f) This Agreement shall be governed by and construed according to the laws of the Commonwealth of Pennsylvania.

(g) This Agreement shall inure to the benefit of, and be binding upon, the parties hereto and their respective successors and assigns and may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

(h) The headings used in this Agreement are for convenience of reference only, do not form a part of this Agreement and shall not affect in any way the meaning or interpretation of this Agreement.

IN WITNESS WHEREOF, Borrower, Agent and Banks have caused this Agreement to be executed by their duly authorized officers as of the date first above written.

PENNSYLVANIA SUBURBAN
WATER COMPANY

By: KATHY L. PAPE

Title: Vice President and Treasurer

PNC BANK, NATIONAL ASSOCIATION, as a
Bank and as Agent

By: FORREST B. PATTERSON, JR.

Title: Senior Vice President

CITIZENS BANK OF PENNSYLVANIA

By: MARK W. TORIE

Title: Senior Vice President

FLEET NATIONAL BANK

By: WILLIAM B. WILLIAMSON

Title: Senior Vice President

NATIONAL CITY BANK

By: DAVID P. DOBSTAFF

Title: Senior Vice President

THE AQUA AMERICA, INC. 1994 EQUITY COMPENSATION PLAN
(as Amended Effective August 5, 2003)

1. Purpose

The purpose of this plan (the "Plan") is to provide an incentive, in the form of a proprietary interest in Aqua America, Inc. (the "Corporation"), to officers, other key employees and Non-employee Directors, as defined below, of the Corporation and its subsidiaries and key consultants who are in a position to contribute materially to the successful operation of the business of the Corporation, to increase their interest in the Corporation's welfare, and to provide a means through which the Corporation can attract and retain officers, other key employees and Non-employee Directors and key consultants of significant abilities.

2. Administration

This Plan shall be administered by a Committee (the "Committee") of the Board of Directors of the Corporation. The Committee shall consist of three or more of those members of the Board of Directors, each of whom may be an "outside director" as defined under section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code"), and related Treasury regulations and each of whom shall also be a "non-employee director" as defined under Rule 16b-3 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). However, the Board of Directors may ratify or approve any grants made by the Committee if the Committee deems it appropriate in a particular circumstance.

From time to time the Committee may make grants, subject to the terms of the Plan, with respect to such number of shares of Common Stock of the Corporation as the Committee, acting in its sole discretion, may determine. All references to the Committee hereunder shall also mean the Board of Directors to the extent that the Board of Directors is acting pursuant to its authority to ratify or approve grants under the Plan. Non-employee Directors, as defined below, may only receive stock grants pursuant to the provisions of Section 7(f).

Subject to the provisions of the Plan, the Committee shall be authorized to interpret the Plan and the grants made under the Plan, to establish, amend and rescind any rules and regulations relating to the Plan, to determine the terms and provisions of the agreement related to grants described in Section 9 hereof, and to make all other determinations, including factual determinations, necessary or advisable for the administration of the Plan. The Committee may correct any defect, supply any omission and reconcile any inconsistency in the Plan or in any option or grant in the manner and to the extent it shall be deemed desirable to carry it into effect. The determinations of the Committee in the administration of the Plan, as described herein, shall be final and conclusive. The Committee may adopt such rules and regulations as it deems necessary for governing its affairs. All powers of the Committee shall be executed in its sole discretion, in the best interest of the Corporation, not as a fiduciary, and in keeping with the objectives of the Plan and need not be uniform as to similarly situated individuals. An Agreement, as defined below, shall be executed by each grantee and shall constitute that grantee's acknowledgement and acceptance of the terms of the Plan and the Committee's authority and discretion.

3. Grants

Pursuant to the terms of the Plan, the Committee shall have the authority to grant stock options to officers and other key employees and key consultants and restricted stock and dividend equivalents to officers and other key employees; provided, however, that Non-employee Directors, as defined below, may receive stock grants in accordance with Section 7(f) (hereinafter collectively referred to as the "Grants"). All Grants shall be subject to the terms and conditions set forth herein and to those other terms and conditions consistent with this Plan as the Committee deems appropriate and as are specified in writing by the Committee in the agreement described in Section 9 of the Plan (the "Agreement"). Grants under a particular Section of the Plan need not be uniform as among the grantees and Grants under two or more Sections of the Plan may be combined in one instrument.

4. Shares Subject to the Plan

Subject to adjustment as provided in Section 15, the maximum aggregate number of shares of the Common Stock of the Corporation that may be issued or transferred under the Plan shall be 6,405,692 shares; provided, however, that no more than 50% of these shares shall be available for issuance as restricted stock. The maximum number of shares of Common Stock that may be subject to Grants made under the Plan to any individual during any calendar year shall be 150,000 shares. Shares deliverable under the Plan may be authorized and unissued shares or treasury shares, as the Committee may from time to time determine. Shares of Common Stock related to the unexercised or undistributed portion of any terminated, expired or forfeited Grant also may be made available for distribution in connection with future Grants under the Plan."

5. Eligibility

Only officers, key employees, members of the Board of Directors who are not employed in any capacity by the Corporation (hereinafter referred to as "Non-employee Directors") and key consultants of the Corporation and its subsidiaries shall be eligible for Grants under the Plan; provided, however, that Grants to Non-employee Directors shall be made only in accordance with Section 7(f). The term "subsidiaries" shall mean any corporation in an unbroken chain of corporations beginning with the Corporation, if at the time of the Grant, each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

6. Granting of Options

The Committee may, from time to time, grant stock options to eligible officers and other key employees and shall designate options at the time of grant as either "incentive stock options" intended to qualify as such under section 422 of the Internal Revenue Code of 1986, as from time to time amended or any successor statute of similar purpose (the "Code"), or "nonqualified stock options", which options are not intended to so qualify. The Committee may, from time to time, grant nonqualified stock options to key consultants. Except as hereinafter provided, options granted pursuant to the Plan shall be subject to the following terms and conditions:

(a) Price. The purchase price per share of stock deliverable upon the issuance of shares pursuant to the exercise of each option shall be not less than 100% of the fair market value of the Corporation's Common Stock on the date the option is granted. The fair market value shall be the mean of the high and low sale prices of the Corporation's Common Stock on the New York Stock Exchange - Composite Transactions or other recognized market source, as determined by the Committee, on the date the option is granted, or if there is no sale on such date, then the mean of such high and low sale prices on the last previous day on which a sale is reported. In any event, in case of the grant of an incentive stock option, the fair market value shall be determined in a manner consistent with section 422 of the Code.

Shares may be purchased only by delivering a notice of exercise to the Committee with payment of the purchase price therefore to be paid in full prior to the issuance of the shares. Such notice may instruct the Corporation to deliver shares of Common Stock due upon the exercise of the option to any registered broker or dealer in lieu of delivery to the grantee. Such instructions must designate the account into which the shares are to be deposited. The grantee may tender this notice of exercise, which has been properly executed by the grantee, and the aforementioned delivery instructions to any broker or dealer. With the consent of the Committee, payment of the purchase price may be made, in whole or in part, through the surrender of shares of the Common Stock of the Corporation (including without limitation shares of Common Stock acquired pursuant to the option then being exercised) at the fair market value of such shares determined as of the last trading day prior to the date on which the option is exercised, in the same manner set forth in the above paragraph.

(b) Terms of Options. The term during which each incentive stock option may be exercised shall be determined by the Committee, but in no

event shall an incentive stock option be exercisable in whole or in part more than 10 years from the date it is granted and in no event shall a nonqualified stock option be exercisable in whole or in part more than 10 years and one day from the date it is granted. All rights to purchase pursuant to an option shall, unless sooner terminated, expire at the date designated by the Committee. The Committee shall determine the date on which each option shall become exercisable and may provide that an option shall become exercisable in installments. The shares comprising each installment may be purchased in whole or in part at any time after such installment becomes exercisable. The Committee may, in its sole discretion, accelerate the time at which any option may be exercised in whole or in part. Notwithstanding any determinations by the Committee regarding the exercise period of any option, all outstanding options shall become immediately exercisable upon a Change of Control of the Corporation (as defined herein).

(c) Termination of Employment. Upon the termination of a grantee's employment for any reason (except as a result of retirement, disability or death), the options held by such grantee shall terminate. Notwithstanding the fact that, in all cases, a grantee's employment shall be deemed to have terminated upon the sale of a "subsidiary" of the Corporation (an entity in which the Corporation has at least a 50% ownership of the entity's total voting power) that employs such grantee, the Committee, in its sole discretion, may extend the period during which any option held by such a grantee may be exercised after such sale to the earliest of (i) a date which is not more than three years from the date of the sale of the subsidiary, (ii) the date of the grantee's termination of employment with the subsidiary (or successor employer) following such sale for reasons other than retirement, disability or death, (iii) the date which is one year from the date of the grantee's termination of employment with the subsidiary on account of the grantee's total disability (as defined in section 22(e)(3) of the Code), or three months from the date of such termination if on account of death, retirement or a disability other than a total disability, or (iv) the expiration of the original term of the option as established at the time of grant. The Committee, in its sole discretion, may similarly extend the period of exercise of any option held by a grantee employed by the Corporation whose employment with the Corporation is terminated in connection with the sale of a subsidiary of the Corporation. To the extent that any option is not otherwise exercisable as of the date on which the grantee ceases to be employed by the subsidiary or the Corporation, as applicable, such unexercisable portion of the option shall terminate as of such date.

Upon termination of a grantee's employment as a result of retirement, disability or death, the period during which the options may be exercised shall not exceed: (i) one year from the date of such termination of employment in the case of death; (ii) two years from the date of such termination in the case of permanent and total disability (within the meaning of section 22(e)(3) of the Code) or retirement; and (iii) three months from the date of such termination of employment in the case of other disability; provided, however, that in no event shall the period extend beyond the expiration of the option term. To the extent that any option is not otherwise exercisable as of the date on which the grantee ceases to be employed by the Corporation or any subsidiary, as applicable, such unexercisable portion of the option shall terminate as of such date.

Subject to the foregoing, in the event of death, such options may be exercised by a grantee's legal representative or beneficiary, but only to the extent that an option has become exercisable as of the date of death. Notwithstanding the foregoing, the Committee, in its sole discretion, may determine that any portion of an option that has not become exercisable as of the date of the grantee's death, termination of employment on account of permanent and total disability (within the meaning of section 22(e)(3) of the Code) or other termination of employment may also be exercised by a grantee, or in the case of death, a grantee's legal representative or beneficiary. Transfer from the Corporation to a subsidiary, from a subsidiary to the Corporation, or from one subsidiary to another, shall not be deemed to be a termination of employment. All references in this Section 6(c) to the termination of a grantee's employment shall include the termination of a consultant's relationship with the Corporation or any subsidiary.

(d) Limits on Incentive Stock Options. Each Grant of an incentive

stock option shall provide that it (i) is not transferable by the grantee otherwise than by will or the laws of descent and distribution and (ii) is exercisable, during the grantee's lifetime, only by the grantee and that the aggregate fair market value of the Common Stock on the date of the Grant with respect to which incentive stock options are exercisable for the first time by a grantee during any calendar year under the Plan and under any other stock option plan of the Corporation shall not exceed the limitation set forth in section 422(d) of the Code.

An incentive stock option shall not be granted to any grantee who, at the time of grant, owns stock possessing more than 10 percent of the total combined voting power of all classes of stock of the Corporation or subsidiary of the Corporation, unless the exercise price of the incentive stock option is no less than 110% of the fair market value per share on the date of grant and the term of the incentive stock option is not more than five years. Unless a grantee could otherwise transfer Common Stock issued pursuant to an incentive stock option granted hereunder without incurring liability under section 16(b) of the Exchange Act, at least six months must elapse from the date of acquisition of an incentive stock option to the date of disposition of the Common Stock issued upon exercise of such option.

7. Restricted Stock Grants

The Committee may issue or transfer shares of Common Stock of the Corporation to an eligible officer or other key employee. The following provisions are applicable to restricted stock grants:

(a) General Requirements. Shares of Common Stock of the Corporation issued pursuant to restricted stock grants may be issued for consideration or for no consideration. Subject to any other restrictions by the Committee as provided pursuant to Section 7(e), restrictions on the transfer of shares of Common Stock set forth in Section 7(c) shall lapse on such date or dates as the Committee may approve until the restrictions have lapsed on 100% of the shares; provided, however, that upon a Change of Control of the Corporation, all restrictions on the transfer of the shares which have not, prior to such date, been forfeited shall immediately lapse. The period of years during which the restricted stock grant will remain subject to restrictions will be designated in the Agreement (the "Restriction Period"). Prior to the lapse of the Restriction Period the shares of Common Stock granted to any grantee shall be held by the Corporation, subject to the provisions of Section 15 with respect to voting and dividends.

(b) Number of Shares. The Committee may grant to each grantee a number of shares of Common Stock of the Corporation determined in its sole discretion.

(c) Requirement of Employment. If the grantee's employment terminates during the Restriction Period, the restricted stock grant terminates as to all shares covered by the Grant as to which restrictions on transfer have not lapsed, and those shares of Common Stock must be immediately returned to the Corporation. The Committee may, however, provide for complete or partial exceptions to this requirement as it deems equitable.

(d) Restrictions on Transfer and Legend on Stock Certificate. During the Restriction Period, a grantee may not sell, assign, transfer, pledge, or otherwise dispose of the shares of Common Stock to which such Restriction Period applies except to a Successor Grantee (as defined in Section 10 of the Plan). Each certificate for a share issued or transferred under a restricted stock grant shall contain a legend giving appropriate notice of the restrictions in the Grant. The grantee shall be entitled to have the legend removed from the stock certificate or certificates covering any of the shares subject to restrictions when all restrictions on such shares have lapsed.

(e) Lapse of Restrictions. All restrictions imposed under the restricted stock grant shall lapse upon the expiration of the applicable Restriction Period; provided, however, that upon the death of the grantee or a Change of Control of the Corporation, all

restrictions on the transfer of shares which have not, prior to such date, been forfeited shall immediately lapse. In addition, the Committee may determine as to any or all restricted stock grants, that all the restrictions shall lapse, without regard to any Restriction Period, under such circumstances as it deems equitable.

(f) Stock grants to Non-employee Directors. As of the first day of the month following the Corporation's annual meeting of shareholders, each Non-employee Director shall receive a grant of 875 shares of Common Stock. Such shares shall not be sold for 6 months following the date of grant. No other restrictions shall apply to such shares. Notwithstanding any other provision of the Plan, this Section 7(f) may not be amended more than once every 12 months, except for amendments necessary to conform the Plan to changes of the provisions of, or the regulations relating to, the Code.

8. Dividend Equivalents

The Committee may grant dividend equivalents to eligible officers and other key employees either alone or in conjunction with all or part of any option granted under the Plan. A dividend equivalent shall be equal to the dividend payable on a share of Common Stock of the Corporation. The amount of dividend equivalents for any grantee (the "Dividend Equivalent Amount") is determined by multiplying the number of dividend equivalents subject to the Grant by the per-share cash dividend, or the per-share fair market value (as determined by the Committee) of any dividend in other than cash, paid by the Corporation on each record date for the payment of a dividend during the period described in Section 8(a).

(a) Amount of Dividend Equivalent Credited. The Corporation shall credit to an account for each grantee maintained by the Corporation in its books and records on each record date, from the date of grant until the earlier of the date of (i) the end of the applicable accumulation period designated by the Committee at the time of grant, (ii) the date of the termination of employment for any reason (including retirement), other than total disability (as defined in section 22(e)(3) of the Code) or death of the grantee, or as otherwise determined by the Committee, in its sole discretion, at the time of a grantee's termination of employment or (iii) the end of a period of four years from the date of grant, that portion of the Dividend Equivalent Amount for each such grantee attributable to each record date. The Corporation shall maintain in its books and records separate accounts which identify each Grantee's Dividend Equivalent Amount. Except as set forth in Section 8(e) below, no interest shall be credited to any such account.

(b) Payment of Credited Dividend Equivalents. The Committee, at the time of grant, shall designate the percentage of each grantee's Dividend Equivalent Amount that shall be paid to the grantee at the end of an applicable performance period (the "Performance Period"), generally being four years from the date of grant (the Committee, in its sole discretion, shall retain the right to designate a longer or shorter Performance Period at the time of grant); provided, however, that such Performance Period shall be:

(i) reduced by one year for each calendar year during the applicable Performance Period ending after the date of grant in which the measurable performance criteria established by the Committee at the time of grant for the applicable Performance Period exceeds the targets for such criteria established by the Committee at the time of grant.

(ii) increased by one year for each calendar year during the applicable Performance Period ending after the date of grant in which the measurable performance criteria established by the Committee at the time of grant for the applicable Performance Period is less than the targets for such criteria established by the Committee at the time of grant.

(iii) In no event shall the Performance Period be reduced to less than two years or increased to more than eight years from the date of grant.

(iv) In the event that the Performance Period is shorter than the period described in Section 8(a), a grantee shall receive the payment of the amount credited to his account at the end of the applicable Performance Period and any portion of the Dividend Equivalent Amount not yet so credited to his account shall be paid on the Corporation's normal dividend payment dates until the grantee's Dividend Equivalent Amount for the period described in Section 8(a) is fully paid to the grantee.

(c) Timing of Payment of Dividend Equivalents. Except as otherwise determined by the Committee in the event of a grantee's termination from employment prior to the end of the applicable Performance Period, no payments of the Dividend Equivalent Amount shall be made until the end of the applicable Performance Period and no payments shall be made to any grantee whose employment by the Corporation or a subsidiary terminates prior to the end of the applicable Performance Period for any reason other than retirement under the Corporation's or a subsidiary's retirement plan, death or total disability (as defined in section 22(e)(3) of the Code). Subject to Section 8(b)(iv), as soon as practicable after the end of such Performance Period, unless a grantee shall have made an election under Section 8(f) to defer receipt of any portion of such amount, a grantee shall receive 100% of the Dividend Equivalent Amount payable to him. Notwithstanding the foregoing, upon a Change of Control of the Corporation, any Dividend Equivalent Amount or portion thereof, which has not, prior to such date, been paid to the grantee or forfeited shall immediately become payable to the grantee without regard to whether the applicable Performance Period has ended.

(d) Form of Payment. The Committee shall have the sole discretion to determine whether the Corporation's obligation in respect of the payment of a Dividend Equivalent Amount shall be paid solely in credits to be applied toward payment of the option price under then exercisable options, solely in cash or partly in such credits and partly in cash.

(e) Interest on Dividend Equivalents. From a date which is 45 days after the end of the applicable Performance Period until the date that the Dividend Equivalent Amount payable to the grantee is paid to such grantee, the account maintained by the Corporation in its books and records with respect to such dividend equivalents shall be credited with interest at a market rate determined by the Committee.

(f) Deferral of Dividend Equivalents. A grantee shall have the right to defer receipt of any Dividend Equivalent Amount payments if he shall elect to do so on or prior to December 31 of the year preceding the beginning of the last full year of the applicable Performance Period (or such other time as the Committee shall determine is appropriate to make such deferral effective under the applicable requirements of federal tax laws). The terms and conditions of any such deferral (including the period of time thereof and any earnings on the deferral) shall be subject to approval by the Committee and all deferrals shall be made on a form provided a grantee for this purpose.

9. Agreement with Grantees

Each grantee who receives a Grant under the Plan shall enter into an agreement with the Corporation which shall contain such provisions, consistent with the provisions of the Plan, as may be established from time to time by the Committee and shall constitute that grantee's acknowledgement and acceptance of the terms of the Plan and the Committee's authority and discretion.

10. Transferability of Grants

(a) Nontransferability of Grants. Only a grantee or his or her authorized legal representative may exercise rights under a Grant. Such persons may not transfer those rights except by will or by the laws of descent and distribution or, with respect to Grants other than incentive stock options, if permitted in any specific case by the Committee in their sole discretion, pursuant to a domestic relations order as defined under the Code or Title I of ERISA or the rules thereunder. When a grantee dies, the personal representative or other person entitled to succeed to the rights of the grantee ("Successor Grantee") may exercise such rights. A Successor Grantee must furnish proof satisfactory to the Corporation of his or her right to receive

the Grant under the grantee's will or under the applicable laws of descent and distribution.

(b) Transfer of Nonqualified Stock Options. Notwithstanding the foregoing, the Committee may provide, in the Agreement, that a grantee may transfer nonqualified stock options to family members, one or more trusts for the benefit of family members, or one or more partnerships of which family members are the only partners, according to such terms as the Committee may determine; provided that the grantee receives no consideration for the transfer of an option and the transferred option shall continue to be subject to the same terms and conditions as were applicable to the option immediately before the transfer.

11. Funding of the Plan

This Plan shall be unfunded. The Corporation shall not be required to establish any special or separate fund or to make any other segregation of assets to assure the payment of any Grants under this Plan. Subject to Section 8(e), in no event shall interest be paid or accrued on any Grant, including unpaid installments of Grants.

12. Rights of Grantees

Nothing in this Plan shall entitle any grantee or other person to any claim or right to receive a Grant under this Plan or to any of the rights and privileges of, a shareholder of the Corporation in respect of any shares related to any Grant or purchasable upon the exercise of any option, in whole or in part, unless and until certificates for such shares have been issued. Notwithstanding the foregoing, a grantee who receives a grant of restricted stock shall have all rights of a shareholder, except as set forth in Section 7(d), during the Restriction Period, including the right to vote and receive dividends. Neither this Plan nor any action taken hereunder shall be construed as giving any grantee any rights to be retained in the employ of the Corporation, to be retained as a consultant by the Corporation or to be retained as a Non-employee Director by the Corporation.

13. Withholding of Taxes

The Corporation shall have the right to deduct from all Grants paid in cash any federal, state or local taxes required by law to be withheld with respect to such cash awards. The grantee or other person receiving such shares shall be required to pay to the Corporation the amount of any such taxes which the Corporation is required to withhold with respect to such Grants. With respect to Grants of restricted stock or nonqualified stock options, the Corporation shall have the right to require that the grantee make such provision, or furnish the Corporation such authorization as may be necessary or desirable so that the Corporation may satisfy its obligation, under applicable income tax laws, to withhold for income or other taxes due upon or incident to such restricted stock or the exercise of such nonqualified stock options.

The Committee may adopt such rules, forms and procedures as it considers necessary or desirable to implement such withholding procedures, which rules, forms and procedures shall be binding upon all grantees, and which shall be applied uniformly to all grantees similarly situated.

14. Listing and Registration

Each Grant shall be subject to the requirement that, if at any time the Committee shall determine in its discretion that the listing, registration or qualification of the Grant or the shares subject to the Grant upon any securities exchange or under any state or federal law, or the consent or approval of any governmental regulatory body, is necessary or desirable as a condition of, or in connection with, such Grant or the issue or purchase of shares thereunder, no such Grant may be exercised in whole or in part unless such listing, registration, qualification, consent or approval shall have been effected or obtained free of any conditions not acceptable to the Committee.

15. Adjustment of and Changes in Common Stock of the Corporation.

In the event of a reorganization, recapitalization, change of shares, stock split, spin-off, stock dividend, reclassification, subdivision or combination of shares, merger, consolidation, rights offering, or any other change in the corporate structure or shares of the Corporation, the Committee

may make such adjustment as it deems appropriate in the number and kind of shares authorized by the Plan, in the number and kind of shares covered by Grants made under the Plan, in the purchase prices of outstanding options or the terms and conditions applicable to dividend equivalents. Any adjustment determined by the Committee shall be final, binding and conclusive.

16. Change of Control of the Corporation

As used herein, the following defined terms shall have the meanings described in this Section:

(a) "Affiliate" and "Associate" shall have the respective meanings ascribed to such terms in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended (the "Exchange Act").

(b) A Person shall be deemed the "Beneficial Owner" of any securities: (i) that such Person or any of such Person's Affiliates or Associates, directly or indirectly, has the right to acquire (whether such right is exercisable immediately or only after the passage of time) pursuant to any agreement, arrangement or understanding (whether or not in writing) or upon the exercise of conversion rights, exchange rights, rights, warrants or options, or otherwise; provided, however, that a Person shall not be deemed the "Beneficial Owner" of securities tendered pursuant to a tender or exchange offer made by such Person or any of such Person's Affiliates or Associates until such tendered securities are accepted for payment, purchase or exchange; (ii) that such Person or any of such Person's Affiliates or Associates, directly or indirectly, has the right to vote or dispose of or has "beneficial ownership" of (as determined pursuant to Rule 13d-3 of the General Rules and Regulations under the Exchange Act), including without limitation pursuant to any agreement, arrangement or understanding, whether or not in writing; provided, however, that a Person shall not be deemed the "Beneficial Owner" of any security under this clause (ii) as a result of an oral or written agreement, arrangement or understanding to vote such security if such agreement, arrangement or understanding (A) arises solely from a revocable proxy given in response to a public proxy or consent solicitation made pursuant to, and in accordance with, the applicable provisions of the General Rules and Regulations under the Exchange Act, and (B) is not then reportable by such Person on Schedule 13D under the Exchange Act (or any comparable or successor report); or (iii) that are beneficially owned, directly or indirectly, by any other Person (or any Affiliate or Associate thereof) with which such Person (or any of such Person's Affiliates or Associates) has any agreement, arrangement or understanding (whether or not in writing) for the purpose of acquiring, holding, voting (except pursuant to a revocable proxy as described in the proviso to clause (ii) above) or disposing of any voting securities of the Corporation; provided, however, that nothing in this subsection (b) shall cause a Person engaged in business as an underwriter of securities to be the "Beneficial Owner" of any securities acquired through such Person's participation in good faith in a firm commitment underwriting until the expiration of forty days after the date of such acquisition.

(c) "Change of Control" shall mean:

(i) any Person (including any individual, firm, corporation, partnership or other entity except the Corporation, any subsidiary of the Corporation, any employee benefit plan of the Corporation or of any subsidiary, or any Person or entity organized, appointed or established by the Corporation for or pursuant to the terms of any such employee benefit plan), together with all Affiliates and Associates of such Person, shall become the Beneficial Owner in the aggregate of 20% or more of the Common Stock of the Corporation then outstanding;

(ii) during any twenty-four month period, individuals who at the beginning of such period constitute the Board cease for any reason to constitute a majority thereof, unless the election, or the nomination for election by the Corporation's shareholders, of at least seventy-five percent of the directors who were not directors at the beginning of such period was approved by a vote of at least seventy-five percent of the directors in office at the time of such election or nomination who were directors at the beginning of such period; or

(iii) there occurs a sale of 50% or more of the aggregate assets or earning power of the Corporation and its subsidiaries, or its liquidation is approved by a majority of its shareholders or the Corporation is merged into or is merged with an unrelated entity such that following the merger

the shareholders of the Corporation no longer own more than 50% of the resultant entity.

Notwithstanding anything in this subsection (c) to the contrary, a Change of Control shall not be deemed to have taken place under clause (c)(i) above if (i) such Person becomes the beneficial owner in the aggregate of 20% or more of the Common Stock of the Corporation then outstanding as a result, in the determination of a majority of those members of the Board of Directors of the Corporation in office prior to the acquisition, of an inadvertent acquisition by such Person if such Person, as soon as practicable, divests itself of a sufficient amount of its Common Stock so that it no longer owns 20% or more of the Common Stock then outstanding, or (ii) such Person becomes the beneficial owner in the aggregate of 20% or more of the common stock of Corporation outstanding as a result of an acquisition of common stock by the Corporation which, by reducing the number of common stock outstanding, increases the proportionate number of shares of common stock beneficially owned by such Person to 20% or more of the shares of common stock then outstanding; provided, however that if a Person shall become the beneficial owner of 20% or more of the shares of common stock then outstanding by reason of common stock purchased by the Corporation and shall, after such share purchases by the Corporation become the beneficial owner of any additional shares of common stock, then the exemption set forth in this clause shall be inapplicable.

17. Amendment and Termination

(a) The Plan may be amended by the Board of Directors of the Corporation as it shall deem advisable to ensure such qualification and conform to any change in the law or regulations applicable thereto, including such new regulations as may be enacted pertaining to the tax treatment of incentive stock options to be granted under this Plan, or in any other respect that the Board may deem to be in the best interest of the Corporation; provided, however, that the Board may not amend the Plan, without the authorization and approval of the shareholders of this Corporation, if such approval is required by section 422 of the Code or section 162(m) of the Code.

The Board of Directors shall not amend the Plan if the amendment would cause the Plan or the Grant or exercise of an incentive stock option under the Plan to fail to comply with the requirements of section 422 of the Code including, without limitation, a reduction of the option price set forth in Section 6(a) or an extension of the period during which an incentive stock option may be exercised as set forth in Section 6(b).

(b) The Board of Directors of the Corporation may, in its discretion, terminate, or fix a date for the termination of, the Plan. Unless previously terminated, the Plan shall terminate on May 15, 2014 and no Grants shall be made under the Plan after such date.

(c) A termination or amendment of the Plan that occurs after a Grant is made shall not result in the termination or amendment of the Grant unless the grantee consents or unless the Committee acts under Section 18. The termination of the Plan shall not impair the power and authority of the Committee with respect to an outstanding Grant. Whether or not the Plan has terminated, an outstanding Grant may be terminated or amended under this Section 17 or may be amended by agreement of the Corporation and the grantee consistent with the Plan.

18. Compliance with Law

The Plan, the exercise of Grants and the obligations of the Corporation to issue or transfer shares of Common Stock under Grants shall be subject to all applicable laws, including any applicable federal or Pennsylvania state law, and to approvals by a governmental or regulatory agency as may be required. With respect to persons subject to Section 16 of the Exchange Act, it is the intent of the Corporation that the Plan and all transactions under the Plan comply with all applicable conditions of Rule 16b-3 or its successors under the Exchange Act. In addition, it is the intent of the Corporation that the Plan and applicable Grants of stock options under the Plan comply with the applicable provisions of sections 162(m) and 422 of the Code. The Committee may revoke any Grant if it is contrary to law or modify a Grant to bring it into compliance with any valid and mandatory government regulation. The Committee may also adopt rules regarding the withholding of taxes on payments to grantees. The Committee

may, in its sole discretion, agree to limit its authority under this Section.

19. Effective Date of the Plan

The Plan was effective as of March 1, 1994. The Plan is now amended as of May 15, 2003.

PHILADELPHIA SUBURBAN CORPORATION

AMENDED AND RESTATED
EXECUTIVE DEFERRAL PLAN

In recognition of the services provided by certain key employees, the Board of Directors of Philadelphia Suburban Corporation adopted the Plan to make additional retirement benefits available to those individuals.

ARTICLE 1

Definitions

- 1.1 "Account" means a bookkeeping account established pursuant to Section 3.1 which reflects the amount standing to the credit of the Participant under the Plan.
- 1.2 "Affiliated Company" means any affiliate or subsidiary of the Company.
- 1.3 "Base Salary" means the annual amount of base salary and wages paid by the Employer to an Employee for any calendar year of employment, but excluding all Employer contributions to benefit plans and all other forms of compensation.
- 1.4 "Beneficiary" means the person(s) designated by a Participant to receive any benefits payable under this Plan subsequent to the Participant's death. The Committee shall provide a form for this purpose. In the event a Participant has not filed a Beneficiary designation with the Company, the Beneficiary shall be the Participant's estate.
- 1.5 "Board" means the Board of Directors of the Company.
- 1.6 "Bonus" shall mean bonus compensation due to the Employee, if any, under the Company's Incentive Compensation Plan.
- 1.7 "Code" means the Internal Revenue Code of 1986, as amended.
- 1.8 "Committee" means the Compensation Committee of the Board which shall act for the Company in making decisions and performing specified duties with respect to the Plan.
- 1.9 "Company" means Philadelphia Suburban Corporation and its successors.
- 1.10 "Effective Date" means January 1, 1995.
- 1.11 "Employee" means any individual employed by the Employer as an officer, senior manager or other highly compensated employee, as designated by the Committee, on a regular, full-time basis (in accordance with the personnel policies and practices of the Employer).
- 1.12 "Employer" means the Company and/or any Participating Employer, either collectively or individually, as the context requires.
- 1.13 "Participant" means any Employee who satisfies the eligibility requirements set forth in Article 2. In the event of the death or incompetency of a Participant, the term shall mean his personal representative or guardian. An individual shall remain a Participant until that individual has received full distribution of any amount credited to the Participant's Account.
- 1.14 "Participating Employer" means any Affiliated Company which is designated by the Board as a Participating Employer under the Plan and whose designation as such has become effective upon acceptance of such status by the board of directors of the Affiliated Company. A Participating Employer may revoke its acceptance of such designation at any time, but until such acceptance has been revoked, all the provisions of the Plan and amendments thereto shall apply to the Employees of the Participating Employer. In the event the designation

as a Participating Employer is revoked by the board of directors of an Affiliated Company, the Plan shall be deemed terminated only with respect to such Participating Employer.

- 1.15 "Plan" means the Philadelphia Suburban Corporation Amended and Restated Executive Deferral Plan as the same is set forth herein, and as it may be amended from time to time.
- 1.16 "Plan Year" means the calendar year.
- 1.17 "Separates from Employment" means the Employee's termination of employment from the Employer for any reason. Except as otherwise provided herein, a Separation from Employment shall be deemed to have occurred on the last day of the Employee's service to the Employer and shall be determined without reference to any compensation continuation arrangement or severance benefit arrangement that may be applicable.
- 1.18 "Thrift Plan" means the Philadelphia Suburban Corporation Thrift Plan, as it may be amended from time to time.

ARTICLE 2

Eligibility

- 2.1 Each Employee shall be eligible to participate in the Plan on such date as is specified by the Committee. A list of the individuals participating in the Plan on the Effective Date is attached hereto as Exhibit A; such list may be modified from time to time by the Committee.

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ARTICLE 3

Benefits

- 3.1 The Employer shall create and maintain on its books an Account for each Participant to which it shall credit amounts contributed to the Plan pursuant to this Article 3. The Employer shall also credit each Participant's Account with deemed earnings for each Plan Year in accordance with the provisions of Article 8 hereof.
- 3.2 Prior to the end of the first quarter of any Plan Year, or within 30 days after first being eligible to participate hereunder, a Participant may elect to have the Employer credit to the Participant's Account (as a result of payroll reduction) an amount equal to any whole percentage or dollar amount of the Participant's Bonus, if any, to be earned for such Plan Year. Prior to the first day of any calendar month in a Plan Year, a Participant may also elect to have the Employer contribute to the Participant's Account (as a result of payroll reduction) an amount equal to any whole percentage or dollar amount of the Participant's Base Salary for services to be rendered during the balance of such Plan Year. If an election is made to have a contribution credited to the Participant's Account for a Plan Year, the credit shall be made at the time that such amount would otherwise have been paid and shall reduce the Participant's Bonus or Base Salary, as applicable with respect to that Plan Year by a corresponding amount. The Committee may establish minimum or maximum amounts that may be deferred under this Section and may change such standards from time to time. Any such limits shall be communicated by the Committee to the Participants prior to the commencement of a Plan Year.
- 3.3 Any elections under this Article shall be made in writing on such form and at such time as the Committee shall specify consistent with the provisions of Section 3.2. Any election by a Participant pursuant to this Section 3.3 shall be irrevocable as to any credits made to a Participant's Account in a Plan Year and may not be modified in any respect.
- 3.4 For each Plan Year, the Employer shall also credit to the Participant's Account an amount equal to the excess of the contribution that would have been made by the Employer under the Thrift Plan on behalf of the Participant if it were not for the limitations imposed by the Code over

the amount actually contributed by the Employer to the Thrift Plan on behalf of the Participant. In addition, the Employer may make an additional credit to each Participant's Account for any Plan Year in such amount as shall be approved by the Committee. Such credits shall be deemed to have occurred at the time such amounts would otherwise have been contributed to the Thrift Plan or at such other time as is specified by the Employer.

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ARTICLE 4

Distributions to Participants

- 4.1 A Participant's benefit under the Plan shall be distributed in one lump sum, or, if at least \$25,000 is credited to a Participant's Account, in 12 annual installments (with the balance to be distributed continuing to be credited with deemed earnings for each subsequent Plan Year in accordance with the provisions of Article 8 hereof) equal to 1\12, 1\11, 1\10, 1\9, 1\8, 1\7, 1\6, 1\5, 1\4, 1\3, 1\2, and 1\1 of the balance then credited to the Participant's Account, and shall be paid, or commence, as soon as practicable following the completion of the valuation of the Participant's Account for the last day of the month in which the Participant Separates from Employment; provided however, that each Participant shall make an election, in the form and manner specified by the Committee, as to the form of payment on or before the end of the year preceding the year of payment. If no such election has been made by the first day of the year in which the Participant Separates from Employment then distribution shall be delayed and shall be made, or commence, as soon as practicable after the first day of the year following the year in which the Participant Separates from Employment. Notwithstanding anything herein to the contrary, in the event that such a Participant fails to make an election, distribution shall be in the form of one lump sum payment paid as soon as practicable after the first day of the year following the date the Participant Separates from Employment.
- 4.2 In the event that a Participant incurs a "significant financial hardship" while employed by the Employer, as determined by the Committee, the Participant may apply, in writing, for a withdrawal of all or a portion of the balance credited to the Participant's Account in the form of a lump sum in cash. All determinations by the Committee regarding the existence of a financial hardship shall be made in accordance with the provisions of the Company's Thrift Plan dealing with whether a financial hardship exists for purposes of permitting withdrawals thereunder. The Committee shall determine whether to permit such a withdrawal and, based upon the Participant's application, the amount necessary to satisfy that hardship, which shall be distributed in a single sum as soon as practicable after the Committee's determination.

ARTICLE 5

Death Benefit

- 5.1 In the event of the death of a Participant prior to the payment of the full benefit due pursuant to Article 4, the Participant's Beneficiary shall receive a lump sum distribution equal to the balance of the Participant's Account on the date of death. The benefit payment to the Beneficiary will be made as soon as practicable following the completion of the valuation of the deceased Participant's Account. In the event of the death of a Participant after payment of a benefit has commenced in installments, pursuant to Section 4.1 hereof, the Participant's Beneficiary shall receive the payments due following the Participant's death; provided, however, that prior to receiving the next annual installment, the Beneficiary may elect to receive, on the next payment date, in full satisfaction of the Beneficiary's entitlement under the Plan, a lump sum distribution equal to the remaining balance then credited to the Participant's Account.

ARTICLE 6

Vesting

- 6.1 The balance credited to a Participant's Account attributable to Section 3.2 shall be fully vested at all times. Credits attributable to Section 3.4 shall vest at the same time as the Participant's accrued benefit under the terms of the Retirement Plan for Employees of Philadelphia Suburban Corporation and Subsidiaries.

ARTICLE 7

Funding

- 7.1 The Board may, but shall not be required to, authorize the establishment of a trust by the Employer to serve as the funding vehicle for the benefits described in Article 3 hereof. In any event, the Employer's obligation hereunder shall constitute a general, unsecured obligation, payable solely out of its general assets, and no Participant shall have any right to any specific assets of the Employer. In addition, it is the intention of the Employer that the Plan be unfunded for tax purposes and for purposes of Title I of the Employee Retirement Income Security Act of 1974, as amended.

ARTICLE 8

Investments

- 8.1 Except as provided otherwise below, the balance credited to a Participant's Account shall be deemed to be invested in an interest bearing instrument which shall provide for interest to be credited and compounded monthly at an effective rate equal to 100 basis points in excess of the prime commercial lending rate established by Mellon Bank N.A., or such other bank determined by the Committee to be the Company's primary bank as of the beginning of any Plan Year, as in effect on the 15th day of each month (or if such day is a non-business day, on the first business day thereafter) during which there is a positive balance in a Participant's Account. Interest shall be applied to the average balance of each Participant's Account during the prior 30-day period. For any Plan Year, the Committee may determine to make available, and announce to the Participants the procedure to elect, other deemed forms of investment for the amounts credited to the Accounts. Notwithstanding anything herein to the contrary, the Company may, but shall not be required to, actually invest any funds in the forms of investment made available hereunder and, in any event, any such investments shall at all times remain the property of the Company. Any such other deemed forms of investment shall be described on Exhibit A hereto, as in effect and amended from time to time, and shall be incorporated herein by reference.

ARTICLE 9

Administration

- 9.1 The Committee shall have full power and authority to interpret the Plan, to prescribe, amend and rescind any rules, forms and procedures as it deems necessary or appropriate for the proper administration of the Plan and to make any other determinations and to take any other such actions as it deems necessary or advisable in carrying out its duties under the Plan. All action taken by the Committee arising out of or in connection with, the administration of the Plan or any rules adopted thereunder, shall in each case, lie within its sole discretion, and shall be final, conclusive and binding upon the Employer, the

Board, all Employees, all beneficiaries of Employees and all persons and entities having an interest therein.

- 9.2 Members of the Committee shall serve without compensation for their services unless otherwise determined by the Board. All expenses of administering the Plan shall be paid by the Employer.
- 9.3 The Company shall indemnify and hold harmless each member of the Committee from any and all claims, losses, damages, expenses (including counsel fees) and liability (including any amounts paid in settlement of any claim or any other matter with the consent of the Board) arising from any act or omission of such member, except when the same is due to gross negligence or willful misconduct.
- 9.4 Any decisions, actions or interpretations to be made under the Plan by the Company, Employer or the Committee (other than in the administration of the Plan) shall be made in its sole discretion, not in any fiduciary capacity and need not be uniformly applied to similarly situated individuals and shall be final, binding and conclusive on all persons interested in the Plan.

ARTICLE 10

Amendment

- 10.1 The Plan may be amended by the Committee at any time and from time to time all without prior notice to any person or entity; provided, however, that no such amendment shall have the effect of divesting a Participant of the benefit which the Participant would otherwise receive hereunder at the time the amendment is adopted.

ARTICLE 11

Termination

- 11.1 Continuance of the Plan is completely voluntary and is not assumed as a contractual obligation of the Employer. The Committee, acting on behalf of the Employer, shall have the right to terminate the Plan in whole or in part at any time all without prior notice to any person or entity; provided, however, that such termination shall not have the effect of divesting a Participant of the benefit which the Participant would otherwise receive hereunder at the time of the termination.

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ARTICLE 12

Miscellaneous

- 12.1 Nothing contained herein (a) shall be deemed to exclude a Participant from any compensation, bonus, pension, insurance, severance pay or other benefit to which he otherwise is or might become entitled as an Employee or (b) shall be construed as conferring upon an Employee the right to continue in the employ of the Employer.
- 12.2 Any amounts payable hereunder shall not be deemed salary or other compensation to a Participant for the purposes of computing benefits to which the Participant may be entitled under any other arrangement established by the Employer for the benefit of its employees.
- 12.3 The rights and obligations created hereunder shall be binding on a Participant's heirs, executors and administrators and on the successors and assigns of the Employer.
- 12.4 The masculine pronoun whenever used shall include the feminine and the singular shall be construed as the plural, where applicable.
- 12.5 The provisions of the Plan shall be construed and applied under the laws of the Commonwealth of Pennsylvania.
- 12.6 The rights of any Participant under this Plan are personal and may not be assigned, transferred, pledged or encumbered. Any attempt to do so shall be void. In addition, a Participant's rights hereunder are not subject, in any manner, to anticipation, alienation, sale, transfer,

assignment, pledge, encumbrance, attachment or garnishment by creditors of the Participant or the Participant's Beneficiary.

- 12.7 If any provision of the Plan shall be held invalid or unenforceable, such invalidity or unenforceability shall not effect any other provisions hereof and the Plan shall be construed and enforced as if such provisions had not been included.
- 12.8 The headings and captions herein are provided for convenience only, and shall not be construed as part of the Plan, and shall not be employed in the construction of the Plan.
- 12.9 Any benefit payable to or for the benefit of a payee who is a minor, an incompetent person, or is otherwise incapable of receipting therefore shall be deemed paid when paid to such person's guardian or to the party providing, or a reasonably appearing to provide, the care for such person, and such payment shall fully discharge the Employer, the Committee, the Board and all other parties with respect thereto.

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EXHIBIT A

Effective February 1, 1995, the following additional deemed investments may be elected by a Participant:

1. Company Stock - A Participant may elect, at the time and in the manner specified by the Committee, to direct that any portion or all of the amounts elected to be deferred under Section 3.2 of the Plan be deemed invested in common shares of Philadelphia Suburban Corporation. The purchase price for shares deemed purchased or sold under the Plan shall, except as otherwise provided in the next sentence, be the sum of (a) 90% of the average of the high and the low price for common shares of the Company as reported on the New York Stock Exchange for the date an amount to be invested in such shares is credited to the Participant's Account under Article 3 (or, if no such price is reported for that date, as of the next preceding date) and (b) any transfer, excise or similar tax that would be imposed on the transaction pursuant to which a share would be purchased. The purchase price for shares deemed purchased with dividends credited to shares shall be an amount equal to 95% of the average of the high and low sales price for such shares as reported in the NYSE-Composite Transactions for each of the five trading days immediately preceding the date that an amount to be invested in such shares is credited to the Participant's Account under Article 3. The sale price for shares deemed sold under the Plan shall be 100% of the average of the high and low price for the common stock of the Company as reported on the New York Stock Exchange for the date the shares are deemed sold (or, if no price is reported for that date, as of the next preceding date), less any transfer, excise or similar tax that would be imposed on the transaction pursuant to which a share would be sold.

2. Life Insurance - A Participant (who is insurable) may elect, at the time and in the manner specified by the Committee, to direct that any portion or all of the amounts elected to be deferred under Section 3.2 of the Plan be deemed invested in a life insurance contract on the Participant's life with the amount of the death benefit determined by the Committee (taking into account, among other things the Participant's insurability) and permitting the Participant to direct the investment of any funds deemed invested under the insurance contract in excess of that necessary to keep the death benefit in force. Upon a distribution event under Article 4, and notwithstanding anything in the Plan to the contrary, the Committee may determine to distribute an insurance contract to the Participant in the event that the Company had determined to purchase such a life insurance contract in light of the Participant's election hereunder. If the Company determines to purchase a contract hereunder, it may permit the Participant to designate a beneficiary under the contract to receive the death benefit in the event of the Participant's death prior to a distribution event under Article 4, which shall be taken into account in determining whether any additional sums are owed under Article 5.

PHILADELPHIA SUBURBAN CORPORATION
DIRECTOR DEFERRAL PLAN
(as amended and restated effective January 1, 2003)

In recognition of the services provided by non-employee directors, Philadelphia Suburban Corporation wishes to make a vehicle available to them that will facilitate the provision of additional retirement benefits to those individuals under the terms and conditions hereinafter set forth. The provisions of this Plan reflect the effect of the merger of the Consumers Water Company 1992 Deferred Compensation Plan for Directors Plan B (the "Consumers Directors' Plan") with and into the Philadelphia Suburban Corporation Director Deferral Plan effective as of January 1, 2003.

ARTICLE 1
Definitions

1.1 "Account" means a bookkeeping account established pursuant to Section 3.1 which reflects the amount standing to the credit of the Participant under the Plan.

1.2 "Affiliated Company" means any affiliate or subsidiary of the Company.

1.3 "Base Retainer" means the annual amount of retainer paid by the Company to a Director for any calendar year including meeting fees, committee fees and fees for committee chairs.

1.4 "Beneficiary" means the person(s) designated by a Participant to receive any benefits payable under this Plan subsequent to the Participant's death. The Committee shall provide a form for this purpose. In the event a Participant has not filed a Beneficiary designation with the Company, the Beneficiary shall be the Participant's estate.

1.5 "Board" means the PSC Board or the board of directors of an Employer. "PSC Board" means the Board of Directors of the Company.

1.6 "Committee" means the Compensation Committee of the PSC Board which shall act for the Company in making decisions and performing specified duties with respect to the Plan.

1.7 "Company" means Philadelphia Suburban Corporation and its successors.

1.8 "Director" means each individual who serves as a non-employee member of the Board. "Former Director" means an individual who was a participant in the Consumers Directors' Plan and who is eligible to participate in the Plan as a result of the merger of the Consumers Directors' Plan into the Plan as of the Amendment Effective Date. In the event of the death or incompetence of a Participant, the term shall mean the Participant's personal representative or guardian.

1.9 "Effective Date" means January 1, 1995. "Amendment Effective Date" means January 1, 2003.

1.10 "Employer" means the Company and/or any Participating Employer, either collectively or individually, as the context requires.

1.11 "Participant" means (a) any Director and (b) any Former Director.

1.12 "Participating Employer" means any Affiliated Company which is designated by the PSC Board as a Participating Employer under the Plan and whose designation as such has become effective upon acceptance of such status by the board of directors of the Affiliated Company. A Participating Employer may revoke its acceptance of such designation at any time, but until such acceptance has been revoked, all the provisions of the Plan and amendments thereto shall apply to each Director of the Participating Employer. In the event the designation as a Participating Employer is revoked by the board of directors of an Affiliated Company, the Plan shall be deemed terminated only with respect to

such Participating Employer.

1.13 "Plan" means the Philadelphia Suburban Corporation Director Deferral Plan as the same is set forth herein, and as it may be amended from time to time.

1.14 "Plan Year" means the calendar year.

1.15 "Termination from Service" means the Director's resignation or other termination from service as a member of the Board for any reason. Except as otherwise provided herein, a Termination from Service shall be deemed to have occurred on the last day of the Director's service as a member of the Board. With respect to the Participants who were participants in the Consumers Directors' Plan, "Termination from Service" means the later of (i) the Participant's resignation from service as a member of the Board of Consumers Water Company or termination from service as a member of the Board for any reason, if later and (ii) the Participant's attainment of age 65.

ARTICLE 2 Eligibility

2.1 Each Director shall be eligible to participate in the Plan on the first day of the calendar quarter following election as a Director. Former Directors shall be eligible to participate in the Plan as of the Amendment Effective Date.

ARTICLE 3 Benefits

3.1 The Employer shall create and maintain on its books an Account for each Participant to which it shall credit amounts contributed to the Plan pursuant to this Article 3. The Employer shall also credit each Participant's Account with deemed earnings for each Plan Year in accordance with the provisions of Article 8 hereof.

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3.2 At least 30 days prior to the commencement of any calendar quarter in a Plan Year, a Director may elect to have the Employer credit to the Director's Account an amount equal to any whole percentage or dollar amount (or shares of stock of the Employer ("Shares") to the extent that the Base Retainer would otherwise be paid in Shares) of the Director's Base Retainer, if any, to be earned for the balance of such Plan Year. If an election is made to have a contribution credited to the Director's Account for a Plan Year, the credit shall be made at the time that such amount would otherwise have been paid (or Shares distributed) and shall reduce the Director's Base Retainer with respect to that Plan Year by a corresponding amount. The Committee may establish minimum or maximum amounts that may be deferred under this Section and may change such standards from time to time. Any such limits shall be communicated by the Committee to the Directors prior to the commencement of a Plan Year.

3.3 Any elections under this Article shall be made in writing on such form as the Committee shall specify. Any election by a Director pursuant to this Section 3.3 shall be irrevocable and may not be modified in any respect.

ARTICLE 4 Distributions to Participants

4.1 A Participant's benefit under the Plan shall be distributed in one lump sum (including Shares to the extent the Director elected to defer the receipt of such Shares pursuant to Section 3.2), or, if the value of the Participant's Account is at least \$25,000, in 12 annual installments (with the balance to be distributed, including Shares, if applicable, continuing to be credited with deemed earnings for each subsequent Plan Year in accordance with the provisions of Article 8 hereof) equal to 1\12, 1\11, 1\10, 1\9, 1\8, 1\7, 1\6, 1\5, 1\4, 1\3, 1\2, and 1\1 of the balance then credited to the Participant's Account, and shall be paid, or commence, as soon as practicable following the completion of the valuation of the Participant's Account for the last day of the month in which the Participant has a Termination from Service; provided however, that each Participant shall make an election, in the form and manner specified by the Committee, as to the form of payment on or before the end of the year preceding the year of payment. If no such election has been made

by the first day of the year in which the Participant has a Termination from Service then distribution shall be delayed and shall be made, or commence, as soon as practicable after the first day of the year following the year in which the Participant has a Termination from Service. Notwithstanding anything herein to the contrary, (i) in the event that such a Participant fails to make an election, distribution shall be in the form of one lump sum payment, including Shares, paid as soon as practicable after the first day of the year following the date the Participant has a Termination from Service and (ii) payments of the amount credited to a Former Director's Account (or portion of the Account attributable to the Consumers Directors' Plan, in the case of a Former Director who is also a Director) shall be made in equal monthly installments over a period of 120 months, beginning on January 1 of the Plan Year following the Former Director's Termination of Service. Interest credited in accordance with Article 8 during the period in which periodic installments are paid pursuant to this Section 4.1 shall be distributed currently.

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4.2 In the event that a Participant incurs a "significant financial hardship" while a Participant, as determined by the Committee, the Participant may apply, in writing, for a withdrawal of all or a portion of the balance credited to the Participant's Account (including Shares, if elected by the Participant) in the form of a lump sum. All determinations by the Committee regarding the existence of a financial hardship shall be made in accordance with the provisions of the Company's Thrift Plan dealing with whether a financial hardship exists for purposes of permitting withdrawals thereunder. The Committee shall determine whether to permit a such a withdrawal and, based upon the Participant's application, the amount necessary to satisfy that hardship, which shall be distributed in a single sum (including any Shares, as elected by the Director) as soon as practicable after the Committee's determination.

4.3 Upon the request of a Former Director, the Committee may, in its sole discretion, approve payments of the amount credited to his or her Account (or portion of the Account attributable to the Consumers Directors' Plan, in the case of a Former Director who is also a Director), (i) beginning on a date prior to that specified in Section 4.1, (ii) in installments over a shorter period than that specified in Section 4.1, and (iii) in a single lump sum, in each case to be made or commence being made in the Plan Year following the Plan Year in which such request is made to the Committee.

ARTICLE 5 Death Benefit

5.1 In the event of the death of a Participant prior to the payment of the full benefit due pursuant to Article 4, or in the event of the death of a Former Director receiving any form of distribution, the Participant's Beneficiary shall receive a lump sum distribution equal to the balance of the Participant's Account on the date of death. The benefit payment to the Beneficiary will be made as soon as practicable following the completion of the valuation of the deceased Participant's Account. In the event of the death of a Participant who was a Director, after payment of a benefit has commenced in installments, pursuant to Section 4.1 hereof, the Participant's Beneficiary shall receive the payments due following the Participant's death; provided, however, that prior to receiving the next annual installment, the Beneficiary may elect to receive, on the next payment date, in full satisfaction of the Beneficiary's entitlement under the Plan, a lump sum distribution (including any Shares then credited to the Director's Account) equal to the remaining balance then credited to the Participant's Account.

ARTICLE 6 Vesting

6.1 The balance credited to a Participant's Account attributable to Section 3.2 shall be fully vested at all times.

ARTICLE 7 Funding

7.1 The PSC Board may, but shall not be required to, authorize the establishment of a trust by the Employer to serve as the funding vehicle for the benefits described in Article 3 hereof. In any event, the Employer's obligation hereunder shall constitute a general, unsecured obligation, payable solely out

of its general assets, and no Participant shall have any right to any specific assets of the Employer. In addition, it is the intention of the Employer that the Plan be unfunded for tax purposes and for purposes of Title I of the Employee Retirement Income Security Act of 1974, as amended.

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ARTICLE 8
Investments

8.1 The balance credited to a Participant's Account (other than Shares) shall be deemed to be invested in an interest bearing instrument which shall provide for interest to be credited and compounded monthly at an effective rate equal to 100 basis points in excess of the prime commercial lending rate established by Mellon Bank N.A., or such other bank determined by the Committee to be the Company's primary bank as of the beginning of any Plan Year, as in effect on the 15th day of each month (or if such day is a non-business day, on the first business day thereafter) during which there is a positive balance in a Participant's Account. Interest shall be applied to the average balance of each Participant's Account during the prior 30-day period. For Participants who are Former Directors, the interest rate stated in the foregoing sentence shall be the only form of interest or earnings credited to such Participants' Account (or portion of the Account attributable to the Consumers Directors' Plan, in the case of a Former Director who is also a Director) from and after the Amendment Effective Date. The Committee may determine to make available for Directors, and announce to those Directors the procedure to elect, other deemed forms of investment for the amounts credited to the Accounts. Such other forms of investment shall be set forth in Exhibit A attached to this Plan. A Director's Account, to the extent credited with any Shares, shall be deemed to earn any dividends paid with respect to such Shares and the accumulated dividends, as and when sufficient in amount, shall be deemed invested in additional whole Shares.

ARTICLE 9
Administration

9.1 The Committee shall have full power and authority to interpret the Plan, to prescribe, amend and rescind any rules, forms and procedures as it deems necessary or appropriate for the proper administration of the Plan and to make any other determinations and to take any other such actions as it deems necessary or advisable in carrying out its duties under the Plan. All action taken by the Committee arising out of, or in connection with, the administration of the Plan or any rules adopted thereunder, shall, in each case, lie within its sole discretion, and shall be final, conclusive and binding upon the Employer, the Board, all Employees, all beneficiaries of Employees and all persons and entities having an interest therein.

9.2 Members of the Committee shall serve without compensation for their services unless otherwise determined by the PSC Board. All expenses of administering the Plan shall be paid by the Employer.

9.3 The Company shall indemnify and hold harmless each member of the Committee from any and all claims, losses, damages, expenses (including counsel fees) and liability (including any amounts paid in settlement of any claim or any other matter with the consent of the PSC Board) arising from any act or omission of such member, except when the same is due to gross negligence or willful misconduct.

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9.4 Any decisions, actions or interpretations to be made under the Plan by the Company, the Employer or the Committee (other than in the administration of the Plan) shall be made in its sole discretion, not in any fiduciary capacity and need not be uniformly applied to similarly situated individuals and shall be final, binding and conclusive on all persons interested in the Plan.

ARTICLE 10
Amendment

10.1 The Plan may be amended by the Committee at any time and from time to time all without prior notice to any person or entity; provided, however,

that no such amendment shall have the effect of divesting a Participant of the benefit which the Participant would otherwise receive hereunder at the time the amendment is adopted.

ARTICLE 11
Termination

11.1 Continuance of the Plan is completely voluntary and is not assumed as a contractual obligation of the Employer. The Committee, acting on behalf of the Employer, shall have the right to terminate the Plan in whole or in part at any time all without prior notice to any person or entity; provided, however, that such termination shall not have the effect of divesting a Participant of the benefit which the Participant would otherwise receive hereunder at the time of the termination.

ARTICLE 12
Miscellaneous

12.1 Nothing contained herein shall be construed as conferring upon a Director the right to continue in such capacity.

12.2 The rights and obligations created hereunder shall be binding on a Participant's heirs, executors and administrators and on the successors and assigns of the Employer.

12.3 The provisions of the Plan shall be construed and applied under the laws of the Commonwealth of Pennsylvania.

12.4 The rights of any Participant under this Plan are personal and may not be assigned, transferred, pledged or encumbered. Any attempt to do so shall be void. In addition, a Participant's rights hereunder are not subject, in any manner, to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, attachment or garnishment by creditors of the Participant or the Participant's Beneficiary.

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12.5 If any provision of the Plan shall be held invalid or unenforceable, such invalidity or unenforceability shall not effect any other provisions hereof and the Plan shall be construed and enforced as if such provisions had not been included.

12.6 The headings and captions herein are provided for convenience only, and shall not be construed as part of the Plan, and shall not be employed in the construction of the Plan.

12.7 Any benefit payable to or for the benefit of a payee who is a minor, an incompetent person, or is otherwise incapable of receipting therefore shall be deemed paid when paid to such person's guardian or to the party providing, or a reasonably appearing to provide, the care for such person, and such payment shall fully discharge the Employer, the Committee, the Board and all other parties with respect thereto.

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EXHIBIT A

Effective January 1, 1999, the following additional deemed investments may be elected by a Director.

1. Company Stock - A Director may elect, at the time and in the manner specified by the Committee, to direct that any portion or all of the amounts elected to be deferred under Section 3.2 of the Plan be deemed invested in common shares of Philadelphia Suburban Corporation. The purchase price for shares deemed purchased under the Plan shall, except as otherwise provided in the next sentence, be the sum of (a) 95% of the average of the high and the low price for common shares of the Company as reported on the New York Stock Exchange for the date an amount to be invested in such shares is credited to the Director's Account under Article 3 (or, if no such price is reported for that date, as of the next preceding date) and (b) any transfer, excise or similar tax that would be imposed on the transaction pursuant to which a share would be

purchased. The purchase price for shares deemed purchased with dividends credited to shares shall be an amount equal to 95% of the average of the high and low sales price for such shares as reported in the NYSE-Composite Transactions for each of the five trading days immediately preceding the date that an amount to be invested in such shares is credited to the Director's Account under Article 3. The sale price for shares deemed sold under the Plan shall be 100% of the average of the high and low price for common shares of the Company as reported on the New York Stock Exchange for the date the shares are deemed sold (or, if no price is reported for that date, as of the next preceding date), less any transfer, excise or similar tax that would be imposed on the transaction pursuant to which a share would be sold.

AMENDED AGREEMENT

THIS Amended Agreement made as of the 7th day of August, 2001, by and among Philadelphia Suburban Water Company, a Pennsylvania corporation (the "Company"), Philadelphia Suburban Corporation, a Pennsylvania corporation ("PSC"), and Richard D. Hugus (the "Executive").

WHEREAS, the Executive is presently employed by the Company, as its Vice President - Corporate Development; and

WHEREAS, the Company considers it essential to foster the employment of well-qualified, key management personnel, and, in this regard, the boards of directors of the Company and PSC recognize that, as is the case with many publicly-held corporations such as PSC, the possibility of a change of control of PSC may exist and that such possibility, and the uncertainty and questions which it may raise among management, may result in the departure or distraction of key management personnel to the detriment of the Company;

WHEREAS, the boards of directors of the Company and PSC have determined that appropriate steps should be taken to reinforce and encourage the continued attention and dedication of key members of the Company's management to their assigned duties without distraction in the face of potentially disturbing circumstances arising from the possibility of a change of control of PSC, although no such change is now contemplated;

WHEREAS, in order to induce the Executive to remain in the employ of the Company, the Company and PSC, for which certain of the employees of the Company, such as the Executive, provide key executive services, entered into an Agreement, effective as of January 1, 1997, to provide that the Executive would receive certain compensation in the event his employment with the Company is terminated subsequent to a "Change of Control" (as defined in Section 1 hereof) of PSC as a cushion against the financial and career impact on the Executive of any such Change of Control; and

WHEREAS, the agreement was amended effective as of November 30, 1998 and as of February 1, 1999, to clarify the term of the Agreement; and

WHEREAS, the Company wishes to amend and restate the Agreement at this time to clarify certain rights of the Executive, incorporate the amendment that was made to the Agreement effective as of February 1, 1999, and to make other desirable changes; and

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WHEREAS, PSC is willing to guarantee that such compensation is paid to the Executive in light of his role in the management of the affairs of PSC or its subsidiaries;

NOW, THEREFORE, in consideration of the foregoing and the mutual covenants and agreements hereinafter set forth and intending to be legally bound hereby, the parties hereto agree that the Agreement shall be amended and restated to read as follows:

1. Definitions. For all purposes of this Agreement, the following terms shall have the meanings specified in this Section unless the context clearly otherwise requires:

(a) "Affiliate" and "Associate" shall have the respective meanings ascribed to such terms in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended (the "Exchange Act").

(b) "Base Compensation" shall mean the average of the total of cash base salary and annual bonus paid to, and dividend equivalents under the Equity Compensation Plan accrued for, the Executive in each calendar year in all capacities with the Company, and its Subsidiaries or Affiliates, as would be reported for Federal income tax purposes on Form W-2 if currently subject to tax, together with (i) any amounts the payment of which has been deferred by the Executive under any deferred compensation plan of the Company, and its Subsidiaries or Affiliates, or otherwise, (ii) any and all salary reduction authorized amounts under any of the benefit plans or programs of the

Company, and its Subsidiaries or Affiliates, (iii) the value, as shown in PSC's Proxy, for each calendar year in which a grant was made, of the stock option grants made to the Executive under the Equity Compensation Plan, but excluding any amounts attributable to the exercise of stock options, and (iv) the value, based on the average value of shares vesting in each year, of any grants of Restricted Stock made to the Executive under the Equity Compensation Plan, for the three calendar years (or such number of actual full calendar years of employment, if less than three) immediately preceding the calendar year in which occurs a Change of Control or the Executive's Termination Date, whichever period produces the higher amount.

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(c) A Person shall be deemed the "Beneficial Owner" of any securities: (i) that such Person or any of such Person's Affiliates or Associates, directly or indirectly, has the right to acquire (whether such right is exercisable immediately or only after the passage of time) pursuant to any agreement, arrangement or understanding (whether or not in writing) or upon the exercise of conversion rights, exchange rights, rights, warrants or options, or otherwise; provided, however, that a Person shall not be deemed the "Beneficial Owner" of securities tendered pursuant to a tender or exchange offer made by such Person or any of such Person's Affiliates or Associates until such tendered securities are accepted for payment, purchase or exchange; (ii) that such Person or any of such Person's Affiliates or Associates, directly or indirectly, has the right to vote or dispose of or has "beneficial ownership" of (as determined pursuant to Rule 13d-3 of the General Rules and Regulations under the Exchange Act), including without limitation pursuant to any agreement, arrangement or understanding, whether or not in writing; provided, however, that a Person shall not be deemed the "Beneficial Owner" of any security under this clause (ii) as a result of an oral or written agreement, arrangement or understanding to vote such security if such agreement, arrangement or understanding (A) arises solely from a revocable proxy given in response to a public proxy or consent solicitation made pursuant to, and in accordance with, the applicable provisions of the General Rules and Regulations under the Exchange Act, and (B) is not then reportable by such Person on Schedule 13D under the Exchange Act (or any comparable or successor report); or (iii) that are beneficially owned, directly or indirectly, by any other Person (or any Affiliate or Associate thereof) with which such Person (or any of such Person's Affiliates or Associates) has any agreement, arrangement or understanding (whether or not in writing) for the purpose of acquiring, holding, voting (except pursuant to a revocable proxy as described in the proviso to clause (ii) above) or disposing of any voting securities of PSC; provided, however, that nothing in this Section 1(c) shall cause a Person engaged in business as an underwriter of securities to be the "Beneficial Owner" of any securities acquired through such Person's participation in good faith in a firm commitment underwriting until the expiration of forty days after the date of such acquisition.

(d) "Board" shall mean the board of directors of PSC.

(e) "Change of Control" shall mean:

(i) any Person (including any individual, firm, corporation, partnership or other entity except PSC or the Company or any employee benefit plan of the PSC or the Company or of any Affiliate or Associate, any Person or entity organized, appointed or established by PSC or the Company for or pursuant to the terms of any such employee benefit plan), together with all Affiliates and Associates of such Person, shall become the Beneficial Owner in the aggregate of 20% or more of the Common Stock of PSC then outstanding;

(ii) during any twenty-four month period, individuals who at the beginning of such period constitute the Board cease for any reason to constitute a majority thereof, unless the election, or the nomination for election by PSC's shareholders, of at least seventy-five percent of the directors who were not directors at the beginning of such period was approved by a vote of at least seventy-five percent of the directors in office at the time of such election or nomination who were directors at the beginning of such period; or

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(iii) there occurs a sale of substantially all of the assets of PSC or its liquidation is approved by a majority of its shareholders or PSC is merged into or is merged with an unrelated entity such that following the merger the shareholders of PSC no longer own more than 51% of the resultant entity.

Notwithstanding anything in this Section 1(e) to the contrary, a Change of Control shall not be deemed to have taken place under clause (e)(i) above if (a) such Person becomes the beneficial owner in the aggregate of 20% or more of the Common Stock of PSC then outstanding as a result of an inadvertent acquisition by such Person if such Person, as soon as practicable, divests itself of a sufficient amount of its Common Stock so that it no longer owns 20% or more of the Common Stock then outstanding, as determined by the Board of Directors of PSC, or (ii) the shares of Common Stock required to be counted in order to meet the 20% minimum threshold described under such clause (i) include any of the shares described in subsections (i) through (iv) of section 2543(b) of the Pennsylvania Business Corporation Law of 1988 (15 Pa.C.S.A. '2543(b)) as in effect on the date of adoption of the Plan.

(f) "Cause" shall mean 1) misappropriation of funds, 2) habitual insobriety or substance abuse, 3) conviction of a crime involving moral turpitude, or 4) gross negligence in the performance of duties, which gross negligence has had a material adverse effect on the business, operations, assets, properties or financial condition of the Company.

(g) "Equity Compensation Plan" shall mean PSC's 1994 Equity Compensation Plan, and its predecessors and successors.

(h) "Good Reason Termination" shall mean a Termination of Employment initiated by the Executive upon one or more of the following occurrences:

(i) any failure of the Company or its successor(s) to comply with and satisfy any of the terms of this the Agreement;

(ii) any significant involuntary reduction of the authority, duties, responsibilities or reporting relationships held by the Executive immediately prior to the Change of Control;

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(iii) any involuntary removal of the Executive from the employment grade, compensation level or officer positions which the Executive holds with the Company or, if the Executive is employed by a Subsidiary, with a Subsidiary, held by him immediately prior to the Change of Control, except in connection with promotions to higher office;

(iv) any involuntary reduction in the Executive's target level of annual and long-term compensation as in effect immediately prior to the Change of Control;

(v) any transfer of the Executive, without his express written consent, to a location which is outside the Bryn Mawr, Pennsylvania area by more than 50 miles, other than on a temporary basis (less than 6 months); or

(vi) the Executive being required to undertake business travel to an extent substantially greater than the Executive's business travel obligations immediately prior to the Change of Control.

(i) "Normal Retirement Date" shall mean the first day of the calendar month coincident with or next following the Executive's 65th birthday.

(j) "Subsidiary" shall mean any corporation in which PSC, directly or indirectly, owns at least a 50% interest or an unincorporated entity of which PSC, directly or indirectly, owns at least 50% of the profits or capital interests.

(k) "Termination Date" shall mean the date of receipt of the Notice of Termination described in Section 2 hereof or any later date specified therein, as the case may be.

(1) "Termination of Employment" shall mean the termination of the Executive's actual employment relationship with the Company and any of its Subsidiaries that actually employs the Executive.

2. Notice of Termination. Any Termination of Employment following a Change of Control shall be communicated by a Notice of Termination to the other party hereto given in accordance with Section 14 hereof. For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific provision in this Agreement relied upon, (ii) briefly summarizes the facts and circumstances deemed to provide a basis for the Executive's Termination of Employment under the provision so indicated, and (iii) if the Termination Date is other than the date of receipt of such notice, specifies the Termination Date (which date shall not be more than 15 days after the giving of such notice).

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3. Severance Compensation upon Termination.

(a) Subject to the provisions of Section 11 hereof, in the event of the Executive's involuntary Termination of Employment for any reason other than Cause or in the event of a Good Reason Termination, in either event within two years after a Change of Control, the Company shall pay to the Executive, upon the execution of a release in the form required by the Company of its terminating executives prior to the Change of Control, within 15 days after the Termination Date (or as soon as possible thereafter in the event that the procedures set forth in Section 11(b) hereof cannot be completed within 15 days), an amount in cash equal to two times the Executive's Base Compensation, subject to required employment taxes and deductions. PSC hereby guarantees the obligations of the Company and, in the event that the Company does not satisfy its obligation hereunder within the required time period, PSC shall pay or cause to be paid all compensation, benefits and other amounts remaining due to the Executive upon prompt written notice to PSC that the Company has not satisfied its obligation (or a portion thereof) to the Executive.

(b) In the event the Executive's Normal Retirement Date would occur prior to 12 months after the Termination Date, the aggregate cash amount determined as set forth in (a) above shall be reduced by multiplying it by a fraction, the numerator of which shall be the number of days from the Termination Date to the Executive's Normal Retirement Date and the denominator of which shall be 365 days. In the event the Termination Date occurs after the Executive's Normal Retirement Date, no payments shall be made under this Section 3.

4. Other Payments and Benefits. The payment due under Section 3 hereof shall be in addition to and not in lieu of any payments or benefits due to the Executive under any other plan, policy or program of the Company, and its Subsidiaries or Affiliates. In addition, the Executive shall be entitled to (i) a continuation of health, dental, life and welfare benefits, excluding disability benefits, otherwise provided to senior level executives or employees generally, as the same may be amended for all such individuals from time to time, for the period of two years, (ii) continued use of the automobile furnished to the Executive for the lesser of (1) two years after the Termination Date or (2) the balance of the applicable lease term, if any, in either case to the same extent as was provided to the Executive in the calendar year immediately preceding the Change of Control and the ability to purchase such automobile from the Company at its book value at the completion of such period, and (iii) fully-paid executive level outplacement services from the provider of the Executive's choice for 6 months following the Termination Date.

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5. Trust Fund. PSC sponsors an irrevocable trust fund pursuant to a trust agreement to hold assets to satisfy its obligations to the Executive under this Agreement. Funding of such trust fund shall be subject to the discretion of PSC's President, as set forth in the agreement pursuant to which the fund has been established.

6. Enforcement.

(a) In the event that the Company (or PSC, as appropriate) shall fail or refuse to make payment of any amounts due the Executive under Sections 3 and 4 hereof within the respective time periods provided therein, the Company shall pay to the Executive, in addition to the payment of any other sums provided in this Agreement, interest, compounded daily, on any amount remaining unpaid from the date payment is required under Section 3 or 4, as appropriate, until paid to the Executive, at the rate from time to time announced by PNC Bank as its "prime rate" plus 1%, each change in such rate to take effect on the effective date of the change in such prime rate.

(b) It is the intent of the parties that the Executive not be required to incur any expenses associated with the enforcement of his rights under this Agreement by arbitration, litigation or other legal action because the cost and expense thereof would substantially detract from the benefits intended to be extended to the Executive hereunder. Accordingly, the Company shall pay the Executive on demand the amount necessary to reimburse the Executive in full for all reasonable expenses (including all attorneys' fees and legal expenses) incurred by the Executive in enforcing any of the obligations of the Company under this Agreement.

7. No Mitigation. The Executive shall not be required to mitigate the amount of any payment or benefit provided for in this Agreement by seeking other employment or otherwise, nor shall the amount of any payment or benefit provided for herein be reduced by any compensation earned by other employment or otherwise.

8. Non-exclusivity of Rights. Nothing in this Agreement shall prevent or limit the Executive's continuing or future participation in or rights under any benefit, bonus, incentive or other plan or program provided by the Company, or any of its Subsidiaries or Affiliates, and for which the Executive may qualify.

9. No Set-Off. The Company's obligation to make the payments provided for in this Agreement and otherwise to perform its obligations hereunder shall not be affected by any circumstances, including, without limitation, any set-off, counterclaim, recoupment, defense or other right which the Company may have against the Executive or others.

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10. Taxes. Any payment required under this Agreement shall be subject to all requirements of the law with regard to the withholding of taxes, filing, making of reports and the like, and the Company shall use its best efforts to satisfy promptly all such requirements.

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11. Certain Reduction of Payments.

(a) Anything in this Agreement to the contrary notwithstanding, in the event that it shall be determined that any payment or distribution by the Company to or for the benefit of the Executive, whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise (a "Payment"), would constitute an "excess parachute payment" within the meaning of Section 280G of the Internal Revenue Code of 1986, as amended (the "Code"), the aggregate present value of amounts payable or distributable to or for the benefit of the Executive pursuant to this Agreement (such payments or distributions pursuant to this Agreement are hereinafter referred to as "Agreement Payments") shall be reduced (but not below zero) to the Reduced Amount. The "Reduced Amount" shall be an amount expressed in present value, which maximizes the aggregate present value of Agreement Payments without causing any Payment to be subject to the loss of deduction under Section 280G of the Code. For purposes of this Section 11, present value shall be determined in accordance with Section 280G(d) (4) of the Code.

(b) All determinations to be made under this Section 11 shall be made by PSC's independent public accountant immediately prior to the Change of Control (the "Accounting Firm"), which firm shall provide its determinations and any supporting calculations both to the Company and the Executive within 10 days of the Termination Date. Any such determination by the Accounting Firm shall be binding upon the Company and the Executive. The Executive shall then have the right to determine which of the Agreement Payments shall be eliminated or reduced in order to produce the Reduced Amount in accordance with the requirements of this Section. Within five days after this determination, the Company shall pay (or cause to be paid) or distribute (or cause to be distributed) to or for the benefit of the Executive such amounts as are then due to the Executive under this Agreement.

(c) As a result of the uncertainty in the application of Section 280G of the Code at the time of the initial determination by the Accounting Firm hereunder, it is possible that Agreement Payments, as the case may be, will have been made by the Company which should not have been made ("Overpayment") or that additional Agreement Payments which have not been made by the Company could have been made ("Underpayment"), in each case, consistent with the calculations required to be made hereunder. Within two years after the Termination of Employment, the Accounting Firm shall review the determination made by it pursuant to the preceding paragraph and the Company shall cooperate and provide all information necessary for such review. In the event that the Accounting Firm determines that an Overpayment has been made, any such Overpayment shall be treated for all purposes as a loan to the Executive which the Executive shall repay to the Company together with interest from the date of payment under this Agreement at the applicable Federal rate provided for in Section 7872(f)(2) of the Code (the "Federal Rate"); provided, however, that no amount shall be payable by the Executive to the Company if and to the extent such payment would not reduce the limit on the amount that is deductible under Section 280G of the Code. In the event that the Accounting Firm determines that an Underpayment has occurred, any such Underpayment shall be promptly paid by the Company to or for the benefit of the Executive together with interest from the date of payment under this Agreement at the Federal Rate.

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(d) All of the fees and expenses of the Accounting Firm in performing the determinations referred to in subsections (b) and (c) above shall be borne solely by the Company. The Company agrees to indemnify and hold harmless the Accounting Firm of and from any and all claims, damages and expenses resulting from or relating to its determinations pursuant to subsections (b) and (c) above, except for claims, damages or expenses resulting from the gross negligence or willful misconduct of the Accounting Firm.

12. Term of Agreement. The term of this Agreement shall be indefinite until the Company notifies the Executive in writing that this Agreement will not be renewed at least sixty days prior to the proposed termination; provided, however, that (i) after a Change of Control during the term of this Agreement, this Agreement shall remain in effect until all of the obligations of the parties hereunder are satisfied or have expired, and (ii) this Agreement shall terminate if, prior to a Change of Control, the employment of the Executive with the Company and its Subsidiaries, as the case may be, shall terminate for any reason; provided, however, that if a Change of Control occurs within 18 months after (a) the Executive's termination incurred for any reason other than a voluntary resignation or retirement (a Good Reason Termination shall not be deemed voluntary) or termination for Cause or (b) the termination of this Agreement, the Executive shall be entitled to all of the terms and conditions of this Agreement as if the Executive's termination had occurred on the date of the Change of Control.

13. Successor Company. PSC shall require any successor or successors (whether direct or indirect, by purchase, merger or otherwise) to all or substantially all of the business and/or assets of PSC or the Company, or of any of their Subsidiaries that actually employ the Executive, by agreement in form and substance satisfactory to the Executive, to acknowledge expressly that this Agreement is binding upon and enforceable against the successor or successors, in accordance with the terms hereof, and to become jointly and severally obligated with PSC and the Company to perform this Agreement in the same manner and to the same extent that PSC and the Company would be required to perform if no such succession or successions had taken place. Failure of PSC or the Company to notify the Executive in writing as to such successorship, to

provide the Executive the opportunity to review and agree to the successor's assumption of this Agreement or to obtain such agreement prior to the effectiveness of any such succession shall be a breach of this Agreement. As used in this Agreement, PSC and the Company shall mean PSC and the Company, respectively, and their Subsidiaries as hereinbefore defined and any such successor or successors to their business and/or assets, jointly and severally.

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14. Notice. All notices and other communications required or permitted hereunder or necessary or convenient in connection herewith shall be in writing and shall be delivered personally or mailed by registered or certified mail, return receipt requested, or by overnight express courier service, as follows:

If to PSC or to the Company, to:

Philadelphia Suburban Corporation
762 W. Lancaster Avenue
Bryn Mawr, PA 19010-3489
Attention: Chairman, Executive Compensation
and Employee Benefits Committee

If to the Executive, to:

Mr. Richard D. Hugus
1350 Julieanna Drive
West Chester, PA 193801

or to such other names or addresses as the Company or the Executive, as the case may be, shall designate by notice to the other party hereto in the manner specified in this Section; provided, however, that if no such notice is given by the Company following a Change of Control, notice at the last address of the Company or to any successor pursuant to Section 13 hereof shall be deemed sufficient for the purposes hereof. Any such notice shall be deemed delivered and effective when received in the case of personal delivery, five days after deposit, postage prepaid, with the U.S. Postal Service in the case of registered or certified mail, or on the next business day in the case of overnight express courier service.

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15 Governing Law. This Agreement shall be governed by and interpreted under the laws of the Commonwealth of Pennsylvania without giving effect to any conflict of laws provisions.

16. Contents of Agreement, Amendment and Assignment. This Agreement supersedes all prior agreements, sets forth the entire understanding between the parties hereto with respect to the subject matter hereof and cannot be changed, modified, extended or terminated except upon written amendment executed by the Executive and the Company's Chairman of the Company's Executive Compensation and Employee Benefits Committee, or its successor. The provisions of this Agreement may require a variance from the terms and conditions of certain compensation or bonus plans under circumstances where such plans would not provide for payment thereof in order to obtain the maximum benefits for the Executive. It is the specific intention of the parties that the provisions of this Agreement shall supersede any provisions to the contrary in such plans, and such plans shall be deemed to have been amended to correspond with this Agreement without further action by the Company or the Board.

17. No Right to Continued Employment. Nothing in this Agreement shall be construed as giving the Executive any right to be retained in the employ of the Company.

18. Successors and Assigns. All of the terms and provisions of this Agreement shall be binding upon and inure to the benefit of and be enforceable by the respective heirs, representatives, successors and assigns of the parties hereto, except that the duties and responsibilities of PSC and the Company hereunder shall not be assignable in whole or in part.

19. Severability. If any provision of this Agreement or application thereof to anyone or under any circumstances shall be determined to

be invalid or unenforceable, such invalidity or unenforceability shall not affect any other provisions or applications of this Agreement which can be given effect without the invalid or unenforceable provision or application.

20. Remedies Cumulative; No Waiver. No right conferred upon the Executive by this Agreement is intended to be exclusive of any other right or remedy, and each and every such right or remedy shall be cumulative and shall be in addition to any other right or remedy given hereunder or now or hereafter existing at law or in equity. No delay or omission by the Executive in exercising any right, remedy or power hereunder or existing at law or in equity shall be construed as a waiver thereof.

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21. Miscellaneous. All section headings are for convenience only. This Agreement may be executed in several counterparts, each of which is an original. It shall not be necessary in making proof of this Agreement or any counterpart hereof to produce or account for any of the other counterparts.

22. Arbitration. In the event of any dispute under the provisions of this Agreement other than a dispute in which the sole relief sought is an equitable remedy such as an injunction, the parties shall be required to have the dispute, controversy or claim settled by arbitration in Bryn Mawr, Pennsylvania, in accordance with the National Rules for the Settlement of Employment Disputes of the American Arbitration Association, before one arbitrator who shall be an executive officer or former executive officer of a publicly traded corporation, selected by the parties. Any award entered by the arbitrator shall be final, binding and nonappealable and judgment may be entered thereon by either party in accordance with applicable law in any court of competent jurisdiction. This arbitration provision shall be specifically enforceable. The arbitrator shall have no authority to modify any provision of this Agreement or to award a remedy for a dispute involving this Agreement other than a benefit specifically provided under or by virtue of the Agreement. The Company shall be responsible for all of the fees of the American Arbitration Association and the arbitrator and any expenses relating to the conduct of the arbitration (including reasonable attorneys' fees and expenses).

IN WITNESS WHEREOF, the undersigned, intending to be legally bound, have executed this Agreement as of the date first above written.

ATTEST: PHILADELPHIA SUBURBAN CORPORATION
/s/Suzanne Falcone By /s/ Roy H. Stahl

Ass't Secretary

ATTEST: PHILADELPHIA SUBURBAN WATER COMPANY
/s/ Suzanne Falcone By /s/ Roy H. Stahl

Ass't Secretary

EXECUTIVE
/s/ Patricia K. Hugus /s/ Richard D. Hugus

Witness

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AQUA AMERICA, INC.
and SUBSIDIARIES
2004 ANNUAL CASH INCENTIVE COMPENSATION PLAN

BACKGROUND

- o In 1989, the Company and its compensation consultant conducted a feasibility study to determine whether the Company should implement an incentive compensation plan. The study was prompted by the positive experience of other investor-owned water companies with incentive compensation.
- o The study included interviews with executives and an analysis of competitive compensation levels. Based on the results, the compensation consultant recommended that the Company's objectives and competitive practice supported the adoption of an annual incentive plan (the "Plan"). The Company has had a cash incentive compensation plan in place since 1990 and management and the Board of Directors believe it has had a positive effect on the Company's operations, aiding employees, shareholders (higher earnings) and customers (better service and controlling expenses).
- o The Plan has two components - a Management Incentive Program and an Employee Recognition ("Chairman's Award") Program.
- o The Plan is designed to provide an appropriate incentive to the officers, managers and certain other key employees of the Company. The 2004 Management Incentive Program will cover officers, managers and certain key employees of Aqua America, Inc., and its subsidiaries that adopt the Plan.
- o The plan is periodically reviewed by the Company's outside compensation consultant and the target bonus percentages are reviewed and approved each year as part of the compensation consultant's annual review of the Company's total compensation plan.

MANAGEMENT INCENTIVE PROGRAM

- o Performance Measures
 - Annual incentive bonus awards are calculated by multiplying an individual's Target Bonus by a Company Rating Factor based on the applicable company's performance and an Individual Rating Factor based on the individual employee's performance.

The approach of having a plan tied to the applicable company's income performance is appropriate as the participants' assume some of the same risks and rewards as the shareholders who are investing in the company and making its capital construction and acquisition programs possible. Customers also benefit from the participants' individual objectives being met, as improvements in performance are accomplished by controlling costs, improving efficiencies and enhancing customer service. For these reasons, future rate relief should be lessened and less frequent, which directly benefits all customers.
 - The applicable company's actual after-tax net income from continuing operations or earnings before interest, taxes and depreciation ("EBITD") relative to its annual budget will be the primary measure for the company's performance. The measurement to be used as the Company Factor for each

participant will be proposed by the Chairman of the Company and approved by the Executive Compensation Committee. Each year a "Target Net Income or EBITD" level will be established. Starting in 2000, portions of the Company Rating Factor may be tied to the financial targets of more than one company for some participants. For purposes of the Plan, the Target Net Income or EBITD may differ from the budgeted net income or EBITD level. For 2004, the Target Net Income or EBITD will exclude the impact of any unbudgeted extraordinary gains or losses as a result of changes in accounting principles.

- Based on a review of historic performance, the minimum or threshold level of performance is set at 90 percent of the Target Net Income or EBITD. That is, no bonus awards will be made if actual net income is less than 90 percent of the Target or EBITD for the year. No additional bonus will be earned for results exceeding 110 percent of the Target Net Income or EBITD.
- Each individual's performance and achievement of his or her objectives will also be evaluated and factored into the bonus calculation (the "Individual Factor"). Performance objectives for each participant are established at the beginning of the year and are primarily directed toward controlling costs, improving efficiencies and productivity, enhancing customer service and growing the company's customer base. Each objective has specific performance measures that are used to determine the level of achievement for each objective. A participant's target Individual Factor should be no more than 90 points, with the possibility of additional points being awarded for measurable performance above the participant's targeted performance level. Participants must achieve at least 70 points for their Individual Factor to be eligible for a bonus award under the Plan.

o Participation

- Eligible participants consist of officers, managers and certain key employees.
- Participation in the Management Incentive Program will be determined each year. Each participant will be assigned a "Target Bonus Percentage" ranging from 5 to 60 percent depending on duties and responsibilities.
- For each company, the Target Bonus Percentage for all the participants within that company will be applied to either their base salary or their salary grade midpoint as designated by the Company's chairman, subject to the approval of the Executive Compensation and Employee Benefits Committee.
- Actual bonuses may range from 0, if the company's financial results fall below the minimum threshold or the participant does not make sufficient progress toward achieving his or her objectives (i.e. performance measure points totaling less than 70 points), to 187.5 percent if performance -- both Company and individual -- is rated at the maximum.
- New employees who are hired into a position that is eligible to participate in the Management Incentive Plan, will normally be eligible to receive a portion of the bonus calculated in accordance with this Plan that is pro-rated based on the number of full calendar months between the new employee's hire date and the end of the calendar year.
- Employees who would otherwise be eligible to participate in this Management Incentive Plan, but who leave employment with the company either voluntarily, involuntarily or as a result of retirement, will not receive a bonus for the year in which their employment terminates. If an employee who would otherwise be eligible to participate in this Management Incentive Plan dies, the company will pay the deceased

employee's estate a portion of the bonus the deceased employee would otherwise have been entitled to assuming a 100% Individual Rating Factor, but pro-rated for the number of full calendar months the employee completed before his or her death.

o Company Performance

-- Company performance will be measured on the following schedule:

	Percent of Target -----	Company Rating -----
Threshold.....	90%	0%
	90	50
	92	65
	95	80
	96	85
	97	90
	98	94
	99	97
Plan.....	100	100
	105	110
	110	125

-- The actual Company Factor should be calculated by interpolation between the points shown in the table above.

-- Regardless of the Company rating resulting from this Schedule, the Executive Compensation and Employee Benefits Committee retains the authority to determine the final Company Rating for purposes of this Plan.

o Individual Performance

-- Individual performance will be measured on the following scale:

Performance Measure Points -----	Individual Rating Factor -----
0 - 69	0%
70	70%
80	80%
90	90%
100	100%
110	110%

-- In addition, up to 40 additional points and additional percentage points may be awarded to a participant at the discretion of the Chief Executive Officer for exemplary performance. Individual performance points for the Chief Executive Officer are determined by the Executive Compensation and Employee Benefits Committee.

Sample Calculations

o Example 1

Salary or midpoint	\$70,000
Target Bonus	10 percent (\$7,000)
Company Rating	100 percent
Individual Rating	90 percent

Calculation:

Target Bonus	x	Rating	x	Company Rating	=	Individual Bonus Earned
-----		-----		-----		-----
\$7,000	x	100%	x	90%	=	\$6,300
						=====

o Example 2

-- Using the same salary and target bonus, but assuming Company performance was less than 90 percent of Target EBITD, there would be no bonus earned.

Calculation:

$$\$7,000 \times 0 \times 90\% = 0$$

o Example 3

-- Similarly, if the Individual Factor is rated below 70 points, no bonus would be earned regardless of the Company Factor.

Calculation:

$$\$7,000 \times 100\% \times 0 = 0$$

o Example 4

-- If the Company Rating Factor is allocated between two companies, the bonus will be calculated separately based on the allocation.

Calculation:

Target Bonus x		Company Rating x		Company Allocation x		Individual Rating	= Bonus Earned
-----		-----		-----		-----	
\$7,000	x	100%	x	20%	x	90%	= \$1,260
\$7,000	x	110%	x	80%	x	90%	= \$5,544

Total Bonus							= \$6,804

o Example 5

-- It is also possible that one portion of the applicable Company Rating Factor is zero, for which there would be no bonus, regardless of the participant's Individual Rating Factor.

Calculation:

Target Bonus x		Company Rating x		Company Allocation x		Individual Rating	= Bonus Earned
-----		-----		-----		-----	
\$7,000	x	0%	x	20%	x	90%	= \$0
\$7,000	x	110%	x	80%	x	90%	= \$5,544

Total Bonus							= \$5,544

EMPLOYEE RECOGNITION ("CHAIRMAN'S AWARD") PROGRAM

1. In addition to the Management Incentive Program, the Company maintains an Employee Recognition Program known as the Chairman's Award program to reward non-union employees not eligible for the management bonus plan for superior performance that contains costs, improves efficiency and productivity of the workforce and better serves our customers. Awards may also be made for a special action or heroic deed, or for a project that positively impacts the performance or image of the Company.
2. Awards will be made from an annual pool designated by the Chairman of Aqua America with the approval of the Executive Compensation and Employee Benefits Committee. Unused funds will not be carried over to the next year. If financial performance warrants, management may request permission from the Executive Compensation and Employee Benefits Committee for special awards under the program.
3. In general, Chairman's Awards will not be made to employees of a company that does not achieve at least 90% of its net income objective for the year.
4. Awards may be made throughout the year, however, no more than one-third of a company's Chairman's Award pool may be awarded until the company's final net income for the year is determined.
5. Nominations for employees to receive Chairman's Awards will be made to the applicable officer and should include documentation on the reasons for the recommendations. The applicable officer will review the nominations and forward their recommendations to the Chairman of Aqua America.
6. The Chairman will determine the individuals to actually receive a bonus and the amount. The maximum award to any one employee is \$5,000.

Aqua America, Inc.

Selected Portions of Annual Report to Shareholders for the
Year ended December 31, 2003

AQUA AMERICA, INC. AND SUBSIDIARIES

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

FORWARD-LOOKING STATEMENTS

This report by Aqua America, Inc. ("Aqua America," "we" or "us") contains, in addition to historical information, forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve risks, uncertainties and other factors, many of which are outside our control, that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. In some cases you can identify forward-looking statements where statements are preceded by, followed by or include the words "believes," "expects," "anticipates," "plans," "future," "potential" or the negative of such terms or similar expressions. Forward-looking statements in this report, include, but are not limited to, statements regarding:

- o recovery of capital expenditures and expenses in rates;
- o projected capital expenditures and related funding requirements;
- o dividend payment projections;
- o future financing plans;
- o future pension contributions;
- o opportunities for future acquisitions and success of pending acquisitions;
- o acquisition-related costs and synergies;
- o the capacity of our water supplies and facilities; and
- o general economic conditions.

Because forward-looking statements involve risks and uncertainties, there are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements, including but not limited to:

- o changes in general economic, business and financial market conditions;
- o changes in government regulations and policies, including public utility regulations and policies;
- o changes in environmental conditions, including those that result in water use restrictions;
- o abnormal weather conditions;
- o changes in capital requirements;
- o changes in our credit rating;
- o our ability to integrate businesses, technologies or services which we may acquire;

- o our ability to manage the expansion of our business;
- o the extent to which we are able to develop and market new and improved services;
- o unanticipated capital requirements;
- o increasing difficulties in obtaining insurance and increased cost of insurance;

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AQUA AMERICA, INC. AND SUBSIDIARIES

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

- o cost overruns relating to improvements or the expansion of our operations; and
- o civil disturbance or terroristic threats or acts.

Given these uncertainties, you should not place undue reliance on these forward-looking statements. You should read this report with the understanding that our actual future results may be materially different from what we expect. These forward-looking statements represent our estimates and assumptions only as of the date of this report. Except for our ongoing obligations to disclose material information under the federal securities laws, we are not obligated to update these forward-looking statements, even though our situation may change in the future. We qualify all of our forward-looking statements by these cautionary statements.

GENERAL INFORMATION

Name Change

On January 16, 2004, we changed our name from Philadelphia Suburban Corporation to Aqua America, Inc. The new name better represents our expanded service territory and reflects our position as the largest U.S.-based publicly-traded water utility. In addition, we have changed our ticker symbol from PSC to WTR on the New York Stock Exchange and Philadelphia Stock Exchange effective as of the opening of trading on January 20, 2004.

Overview

Aqua America, Inc. is the holding company for regulated utilities providing water or wastewater services to approximately 2.5 million people in Pennsylvania, Ohio, Illinois, Texas, New Jersey, Indiana, Virginia, Florida, North Carolina, Maine, Missouri, New York, South Carolina and Kentucky. Our largest operating subsidiary, Aqua Pennsylvania, Inc. - formerly Pennsylvania Suburban Water Company, accounts for approximately 60% of our operating revenues and provides water or wastewater services to approximately 1.3 million residents in the suburban areas north and west of the City of Philadelphia and in 19 other counties in Pennsylvania. Our other subsidiaries provide similar services in 13 other states. In addition, we provide water and wastewater service through operating and maintenance contracts with municipal authorities and other parties close to our operating companies' service territories. We are the largest U.S.-based publicly-traded water utility based on number of people served.

The mission of the investor-owned water utility industry is to provide quality and reliable water service at an affordable price for the customer, and provide a fair return to its shareholders. A number of challenges face the industry, including:

- o strict environmental, health and safety standards;
- o the need for substantial capital investment;
- o economic regulation by local and/or state government; and
- o the impact of weather and drought conditions on water sales demand.

Aqua America, Inc. strives to achieve the industry mission by effective planning and efficient use of its resources to meet the industry challenges. We maintain a rate case management capability to provide timely and adequate returns on the capital investments that we make in improving or replacing water mains, treatment plants and other infrastructure. This factor is important in

our continued profitability and in providing a fair return to our shareholders, and thus providing access to capital markets to help fund these investments. Often these utility investments are required by a changed federal or state environmental standard, to improve our ability to deliver quality customer service, or to assist in our ability to supply water in sufficient quantities for future demand or when experiencing drought conditions. A strategy to meet the above challenges is to actively explore opportunities to expand our utility operations through acquisitions of water and wastewater utilities either in areas adjacent to our existing service areas or in new service areas. This growth-through-acquisition strategy allows us to operate more efficiently and provides an important source of growth. The ability to successfully execute these strategies and meet the industry challenges is largely due to our qualified and trained workforce, which we strive to retain by treating employees fairly and providing our employees with development and growth opportunities.

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AQUA AMERICA, INC. AND SUBSIDIARIES

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

We believe that acquisitions will continue to be an important source of growth for us. With more than 50,000 community water systems in the U.S., 84% of which serve less than 3,300 customers, the water industry is the most fragmented of the major utility industries (telephone, natural gas, electric, water and wastewater). In the states where we operate, we believe there are over 22,000 public water systems of widely varying size, with the majority of the population being served by government-owned water systems.

Although not as fragmented as the water industry, the wastewater industry in the U.S. also presents opportunities for consolidation. According to the U.S. Environmental Protection Agency's (EPA) most recent survey of publicly-owned wastewater treatment facilities in 2000, there are approximately 16,000 such facilities in the nation serving approximately 72% of the U.S. population. The remaining population represents individual homeowners with their own treatment facilities; for example, community on-lot disposal systems and septic tank systems. The vast majority of wastewater facilities are government-owned rather than privately-owned. The EPA survey also indicated that there are approximately 6,800 wastewater facilities in operation or planned in the 14 states where we operate.

Because of the fragmented nature of the water and wastewater utility industries, we believe that there are many potential water and wastewater system acquisition candidates throughout the United States. We believe the factors driving the consolidation of these systems are:

- o the benefits of economies of scale;
- o increasingly stringent environmental regulations;
- o the need for capital investment; and
- o the need for technological and managerial expertise.

On July 31, 2003, we completed the acquisition of four operating water and wastewater subsidiaries of AquaSource, Inc., a subsidiary of DQE, Inc., including selected, integrated operating and maintenance contracts and related assets, for \$190,717 in cash, as adjusted and subject to further adjustment pursuant to the purchase agreement. The acquired operations of AquaSource serve over 130,000 water and wastewater customer accounts in 11 states; including the Connecticut operations which we sold in October 2003. The operating results of AquaSource have been included in our consolidated financial statements beginning August 1, 2003.

On November 21, 2003, we entered into a purchase agreement with ALLETE Water Services, Inc., a subsidiary of ALLETE, Inc., to acquire the capital stock of Heater Utilities, Inc., which owns water and wastewater systems located in North Carolina. The purchase agreement provides for a cash purchase price of \$48,000 and the assumption of approximately \$28,000 in debt, reflecting an acquisition premium of approximately \$18,000. We intend to seek the ability to recover a portion of this premium through customer rates via the North Carolina Utilities Commission approval process. The acquisition, which is subject to regulatory approval, is expected to close in mid-2004. This acquisition will add approximately 50,000 customers in the areas of suburban Raleigh, Charlotte, Gastonia and Fayetteville, North Carolina.

AQUA AMERICA, INC. AND SUBSIDIARIES

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

We are actively exploring other opportunities to expand our water and wastewater utility operations through acquisitions or otherwise. We intend to continue to pursue acquisitions of municipally-owned and investor-owned water and wastewater systems of all sizes that provide services in areas adjacent to our existing service territories or in new service areas.

Following are our selected five-year financial statistics:

Years ended December 31,	2003 (a)	2002	2001	2000	1999
Operating revenues	\$ 367,233	\$322,028	\$307,280	\$274,014	\$256,546
Net income available to common stock	\$70,785	\$67,154	\$60,005	\$52,784	\$36,275
Income from operations before non-recurring items (b)	\$70,785	\$63,464	\$60,005	\$50,548	\$44,871
Operating Statistics					
Selected operating results as a percentage of operating revenues:					
Operations and maintenance	38.3%	36.6%	36.4%	37.1%	38.5%
Depreciation and amortization	14.0%	13.8%	13.1%	12.4%	12.4%
Taxes other than income taxes	5.9%	6.0%	6.8%	8.2%	8.5%
Interest expense, net	12.2%	12.5%	11.9%	12.9%	12.9%
Allowance for funds used during construction	(0.6)%	(0.4)%	(0.4)%	(1.0)%	(0.8)%
Net income available to common stock	19.3%	20.9%	19.5%	19.3%	14.1%
Effective tax rates	39.3%	38.5%	39.3%	39.2%	42.2%

Income from operations before non-recurring items is a measure that is not determined in accordance with generally accepted accounting principles (GAAP) and may not be comparable to similarly titled measures reported by other companies. This Non-GAAP measure should not be considered as an alternative to net income as determined in accordance with GAAP. We believe that this is useful as an indicator of operating performance, as we measure it for management purposes, because it provides a better understanding of our results of operations by highlighting our ongoing operations and the underlying profitability of our core business.

(a) 2003 includes five months of financial results for the operations acquired in the AquaSource acquisition.

(b) Non-recurring items represent the 2002 gain of \$3,690 (\$5,676 pre-tax) realized on the sale of a portion of our Ashtabula, Ohio water system, the 2000 gain of \$2,236 (\$4,041 pre-tax) for the partial recovery of the merger costs related to the 1999 merger with Consumers Water Company, and the 1999 charges of \$8,596 (\$10,121 pre-tax) for transaction costs and restructuring costs related to the merger with Consumers Water Company.

AQUA AMERICA, INC. AND SUBSIDIARIES

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

We consider the following nonfinancial measure and financial measures to be the fundamental basis by which we evaluate our performance: number of customers, operating revenues, net income and our dividend rate on common stock. In addition, we consider other key financial measures in evaluating our operating results: the ratio of operations and maintenance expense compared to

operating revenues (this percentage is termed "operating expense ratio"); return on revenues (net income divided by operating revenues); and earnings before interest, taxes, depreciation and amortization. These measurements are reviewed regularly and compared to historical periods as well as our operating budget as approved by the Aqua America, Inc. Board of Directors.

Our operating expense ratio is one measure that we use to evaluate our operating efficiency and management effectiveness. As reported in the above table and as anticipated, our operating expense ratio increased for 2003 as compared to 2002 as a result of the additional operating costs associated with the AquaSource acquisition which closed on July 31, 2003. The business model of the acquired AquaSource operations is different from the rest of the Aqua America operations. The AquaSource operations are comprised of approximately 600 small systems, which are generally clustered in regions to achieve some level of operating efficiency. However, the fragmented nature of the AquaSource operations results in the additional operating revenues generated by the AquaSource operations being accompanied by a higher ratio of operations and maintenance expenses than the level Aqua America experiences in the rest of the Aqua America operations. The AquaSource operations can be characterized as having relatively-higher fixed operating costs in contrast to the rest of the Aqua America operations which generally have fewer, but larger, interconnected systems resulting in higher fixed capital costs (utility plant investment) per customer. For the twelve-month period ending June 30, 2003, the last reporting period before the July 31, 2003 closing of AquaSource, our operating expense ratio declined to 36.5%, from 36.6% for the year ended December 31, 2002. The operating results of AquaSource have been included in our consolidated financial statements beginning August 1, 2003. We are implementing management systems over time that will allow us to further control costs and improve efficiencies, but the effect of this acquisition will be to increase our overall operating expense ratio in 2004 from the levels experienced during the past five years. Consequently, we anticipate our return on revenues, net income divided by operating revenues, to be lower in 2004 than in the past four years as a result of the impact of the AquaSource operations.

Following are our selected five-year operating and sales statistics:

Years ended December 31,		2003	2002	2001	2000	1999
Customers	Residential water	624,355	535,506	526,776	512,442	497,937
	Commercial water	33,015	30,355	29,745	29,317	29,241
	Industrial water	1,397	1,423	1,454	1,446	1,430
	Other water	20,483	16,466	9,947	9,500	9,067
	Wastewater	70,241	21,724	19,615	12,441	11,262
	Total	749,491	605,474	587,537	565,146	548,937
Operating Revenues (a)	Residential water	\$218,487	\$197,190	\$188,303	\$170,597	\$154,881
	Commercial water	61,343	55,962	53,103	47,109	45,192
	Industrial water	17,675	17,221	16,141	14,943	13,944
	Other water	40,048	36,255	35,681	29,582	31,999
	Wastewater	17,874	8,210	6,960	5,414	5,235
	Total	\$367,233	\$322,028	\$307,280	\$274,014	\$256,546

(a) 2003 includes five months of financial results for the operations acquired in the AquaSource acquisition.

AQUA AMERICA, INC. AND SUBSIDIARIES

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

RESULTS OF OPERATIONS

Our net income has grown at an annual compound rate of approximately 9.6% during the five-year period ended December 31, 2003. During this same

period, operating revenues grew at a compound rate of 7.9% and total expenses, exclusive of income taxes, grew at a compound rate of 7.0%.

Operating Revenues

The growth in revenues over the past five years is a result of increases in both the customer base and in water rates. The number of customers increased at an annual compound rate of 7.3% in the past five years primarily as a result of acquisitions of water and wastewater systems, including the AquaSource acquisition completed July 31, 2003. Acquisitions made during the five-year period ended December 31, 2003 have provided water and wastewater revenues of approximately \$41,368 in 2003, \$14,246 in 2002 and \$11,157 in 2001. Excluding the effect of acquisitions, our customer base increased at a five-year annual compound rate of 0.9%. Rate increases implemented during the past three years have provided additional operating revenues of approximately \$19,900 in 2003, \$14,700 in 2002 and \$13,100 in 2001. In addition to water and wastewater operating revenues, we had other non-regulated revenues that were primarily associated with operating and maintenance contracts, and data processing service fees of \$11,806 in 2003, \$7,190 in 2002 and \$7,092 in 2001. The increase in 2003 resulted from the additional revenues for contract operations of \$3,743, for five months, associated with the July 31, 2003 acquisition of AquaSource.

Economic Regulation - Most of our water and wastewater utility operations are subject to regulation by their respective state regulatory commissions, which have broad administrative power and authority to regulate rates and charges, determine franchise areas and conditions of service, approve acquisitions and authorize the issuance of securities. Some of our operations are subject to rate regulation by county or city government. The profitability of our utility operations is influenced a great extent by the timeliness and adequacy of rate allowances in the various states in which we operate. Accordingly, we maintain a rate case management capability to provide that the tariffs of the utility operations reflect, to the extent practicable, the timely recovery of increases in costs of operations, capital, taxes, energy, materials and compliance with environmental regulations. In assessing our rate case strategy, we consider the amount of utility plant additions and replacements made since the previous rate decision, the changes in the cost of capital, changes in the capital structure and changes in other costs. Based on these assessments, our utility operations periodically file rate increase requests with their respective state regulatory commissions.

In November 2003, our Pennsylvania operating subsidiary filed an application with the Pennsylvania Public Utility Commission (PAPUC) requesting a \$25,300 or 10.2% increase in annual revenues. The application is currently pending before the PAPUC and a final determination is anticipated by August 2004. On August 1, 2002, the PAPUC granted our Pennsylvania operating subsidiary a \$21,226 or 10.2% rate increase. The rates in effect at the time of the filing included \$9,400 in Distribution System Improvement Charges (DSIC) at 5.0%. Consequently, the total base rates increased by \$30,626 and the DSIC was reset to zero.

Operating subsidiaries located in other states were allowed annual rate increases of \$1,275 in 2003 resulting from eight rate decisions, \$3,024 in 2002 resulting from thirteen rate decisions and \$4,799 in 2001 resulting from nine rate decisions. Revenues from these increases realized in the year of grant were approximately \$839 in 2003, \$1,403 in 2002 and \$4,200 in 2001. These operating subsidiaries currently have eight rate requests in process requesting a \$7,803 increase in annual revenues. These requests are currently under review by the respective state regulatory commission. During 2004, we intend to file 16 rate requests requesting an aggregate of approximately \$17,700 of increased annual revenues.

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AQUA AMERICA, INC. AND SUBSIDIARIES

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

Revenue Surcharges - Four states in which we operate permit water utilities, and in some states wastewater utilities, to add a surcharge to their water or wastewater bills to offset the additional depreciation and capital costs associated with certain capital expenditures related to replacing and rehabilitating infrastructure systems. Prior to these mechanisms being approved, water and wastewater utilities absorbed all of the depreciation and capital

costs of these projects between base rate increases without the benefit of additional revenues. The gap between the time that a capital project is completed and the recovery of its costs in rates is known as regulatory lag. The infrastructure rehabilitation surcharge mechanism is intended to substantially reduce regulatory lag which often acted as a disincentive to water and wastewater utilities to rehabilitate their infrastructure. In addition, our subsidiaries in certain states use a surcharge or credit on their bill to reflect certain changes in costs until such time as the costs are incorporated in base rates.

Currently, Pennsylvania, Illinois, Ohio and Indiana allow for the use of infrastructure rehabilitation surcharges. In Pennsylvania, this mechanism is referred to as a DSIC. These mechanisms typically adjust periodically based on additional qualified capital expenditures completed or anticipated in a future period. The infrastructure rehabilitation surcharge is capped as a percentage of base rates, generally 5% of base rates, 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. Infrastructure rehabilitation surcharges provided revenues of \$8,147 in 2003, \$5,518 in 2002 and \$6,671 in 2001.

Sendout - "Sendout" represents the quantity of treated water delivered to our distribution systems. We use sendout as an indicator of customer demand. Weather conditions tend to impact water consumption, particularly in our northern service territories during the late spring and summer months when nonessential and recreational use of water is at its highest. Consequently, a higher proportion of annual operating revenues is realized in the second and third quarters. In general during this period, an extended period of dry weather increases water consumption, while above average rainfall decreases water consumption. Also, an increase in the average temperature generally causes an increase in water consumption. Conservation efforts, construction codes which require the use of low flow plumbing fixtures, as well as mandated water use restrictions in response to drought conditions, also affect water consumption.

The geographic diversity of our customer base reduces our exposure to extreme or unusual weather conditions in any one area of our service territory. Our geographic diversity has continued to widen as a result of the AquaSource acquisition which closed on July 31, 2003. During the quarter ended December 31, 2003, which was the first quarter containing three months of AquaSource operating results, our operating revenues were derived principally from the following states: 60% in Pennsylvania, 9% in Ohio, 7% in Illinois, 7% in Texas, 5% in New Jersey, 4% in Indiana, and 3% in Florida.

On occasion, drought warnings and water use restrictions are issued by governmental authorities for portions of our service territories in response to extended periods of dry weather conditions. The timing and duration of the warnings and restrictions can have an impact on our water revenues and net income. In general, water consumption in the summer months is affected by drought warnings and restrictions to a higher degree because nonessential and recreational use of water is highest during the summer months, particularly in our northern service territories. At other times of the year, warnings and restrictions generally have less of an effect on water consumption. In November 2001, a drought warning was declared in nine counties in Pennsylvania, including one of the five counties we serve in southeastern Pennsylvania. A drought warning calls for a 10 to 15 percent voluntary reduction of water use, particularly non-essential uses of water. In February 2002, a drought emergency was declared in 24 counties in Pennsylvania, including all five of the counties we serve in southeastern Pennsylvania where approximately 275,000 of our customers are located. A drought emergency imposes a ban on nonessential water use. In mid-2002, drought restrictions were relaxed in three of the five counties we serve in southeastern Pennsylvania, moving from the mandatory drought emergency to a voluntary drought warning. However, by early September 2002, the Commonwealth of Pennsylvania reinstated the drought emergency in the three counties where restrictions had been relaxed because of hot, dry weather in August. In November and December 2002, the Commonwealth of Pennsylvania removed the drought restrictions in the counties we serve in Pennsylvania. Water use restrictions were also imposed and relaxed at various times during 2002 in our service territories in New Jersey. Currently there are no drought warnings or restrictions in any of the areas we serve.

(In thousands of dollars, except per share amounts)

Operations and Maintenance Expenses

Operations and maintenance expenses totaled \$140,602 in 2003, \$117,735 in 2002 and \$111,885 in 2001. Most elements of operating costs are subject to the effects of inflation, as well as the effects of changes in the number of customers served, in water consumption and the degree of water treatment required due to variations in the quality of the raw water. The principal elements of operating costs are labor and employee benefits, electricity, chemicals, maintenance expenses and insurance costs. Electricity and chemical expenses vary in relationship to water consumption, raw water quality, and to a lesser extent the competitive electric market in some of the states in which we operate. Maintenance expenses are sensitive to extremely cold weather, which can cause water mains to rupture. Operations and maintenance expenses increased in 2003 as compared to 2002 by \$22,867 or 19.4% due to additional operating costs associated with acquisitions of \$18,526, primarily from AquaSource, higher postretirement costs, and additional maintenance costs, offset in part by reduced bad debt expense. The postretirement benefits expense increase resulted principally from higher pension costs and increased retiree medical costs. The increased maintenance expenses are primarily a result of additional main break repairs resulting from the relatively harsh winter weather experienced in early 2003 in our northern service territory.

Operations and maintenance expenses increased in 2002 as compared to 2001 by \$5,850 or 5.2% due to additional operating costs associated with acquisitions, transaction costs related to planned and completed acquisitions, increased insurance expense, higher bad debt expense and increased wages as a result of normal wage rate increases.

Depreciation and Amortization Expenses

Depreciation expense was \$48,522 in 2003, \$41,424 in 2002 and \$37,979 in 2001, and has increased principally as a result of the significant capital expenditures made to expand and improve the utility facilities, and as a result of acquisitions of water systems.

Amortization expense was \$2,941 in 2003, \$2,898 in 2002 and \$2,189 in 2001. The increase in 2003 and 2002 is due to the amortization of the costs associated with, and other costs being recovered in, various rate filings. Expenses associated with filing rate cases are deferred and amortized over periods that generally range from one to three years.

Taxes Other than Income Taxes

Taxes other than income taxes increased by \$2,140 or 11.0% in 2003 as compared to 2002, and decreased by \$1,420 or 6.8% in 2002 as compared to 2001. The increase in 2003 is due to additional taxes associated with the AquaSource acquisition and additional state taxes. The decrease in 2002 is due to a reduction in state taxes and a decrease in the Pennsylvania Capital Stock Tax. The decrease in state taxes is a result of a reduction in assessments and the Capital Stock Tax declined due to a reduction in the base on which the tax is applied and a legislated decrease in the tax rate.

Interest Expense, net

Net interest expense was \$44,662 in 2003, \$40,396 in 2002 and \$39,859 in 2001. Interest income of \$395 in 2003, \$287 in 2002 and \$367 in 2001 was netted against interest expense. Interest expense increased in 2003 and in 2002 primarily as a result of higher levels of borrowings, offset partially by the effects of decreased interest rates on borrowings. The higher level of borrowings in 2003 was used to finance the acquisition of AquaSource and capital expenditures. 2002 borrowing levels increased principally to fund capital expenditures. Interest expense during 2003 was favorably impacted by a reduction in the weighted cost of long-term debt from 6.56% at December 31, 2002 to 6.19% at December 31, 2003.

Allowance for Funds Used During Construction

The allowance for funds used during construction (AFUDC) was \$2,127 in 2003, \$1,389 in 2002 and \$1,222 in 2001 and has varied over the years as a result of changes in the average balance of utility plant construction work in progress (CWIP), to which AFUDC is applied, and to changes in the AFUDC rate. The increase in 2003 is due to an increase in the AFUDC rate as a result of tax-exempt borrowings for our multi-year infrastructure rehabilitation plan and an increase in the average balance of CWIP. The increase in 2002 is a result of an increase in the average balance of CWIP to which AFUDC is applied, offset in part by a decrease in the AFUDC rate which is based on short-term interest rates.

Gain on Sale of Water System

Gain on sale of water system represents the gain realized on the December 2002 sale of a portion of the Ashtabula, Ohio water system to the county government. The sale provided \$12,118 of net proceeds and resulted in a fourth quarter 2002 pre-tax gain of \$5,676.

Gain on Sale of Other Assets

Gain on sale of other assets totaled \$5,692 in 2003, \$2,079 in 2002 and \$3,384 in 2001 and consisted of gains on land and marketable securities sales. Gain on sale of land totaled \$5,153 in 2003, \$900 in 2002 and \$3,018 in 2001. Gain on sale of marketable securities totaled \$539 in 2003, \$1,179 in 2002 and \$366 in 2001.

Income Taxes

Our effective income tax rate was 39.3% in 2003, 38.5% in 2002 and 39.3% in 2001. The changes in the effective tax rates in 2003 and 2002 are due to differences between tax deductible expenses and book expenses.

Summary

Operating income was \$153,561 in 2003, \$140,504 in 2002 and \$134,340 in 2001 and net income available to common stock was \$70,785 in 2003, \$67,154 in 2002 and \$60,005 in 2001. Our operating results were affected by a non-recurring item in 2002. Net income for 2002 includes a gain of \$5,676 (\$3,690 after-tax or \$0.04 per share) on the sale of a portion of our Ashtabula, Ohio water system. Diluted net income per share was \$0.79 in 2003, \$0.78 in 2002 and \$0.70 in 2001. Diluted income per share exclusive of the aforementioned non-recurring items (for 2002, \$0.04 per share from the gain on the sale of water system), was \$0.79 in 2003, \$0.73 in 2002 and \$0.70 in 2001. Diluted income per share exclusive of non-recurring items is a measure that is not determined in accordance with GAAP and may not be comparable to similarly titled measures reported by other companies. This Non-GAAP measure should not be considered as an alternative to net income per share as determined in accordance with GAAP. We believe that this is useful as an indicator of operating performance, as we measure it for management purposes, because it provides a better understanding of our results of operations by highlighting our ongoing operations and the underlying profitability of our core business. The changes in the per share income in 2003 and 2002 over the previous years were due to the aforementioned changes in income and impacted by a 3.1% increase in the average number of common shares outstanding during 2003 and a 0.7% increase in the average number of shares outstanding during 2002, respectively. The increase in the number of shares outstanding in 2003 is primarily a result of the additional shares issued in common share offerings and through our dividend reinvestment plan and employee stock and incentive plan during 2003.

Although we have experienced increased income in the recent past, continued adequate rate increases reflecting increased operating costs and new capital investments are important to the future realization of improved profitability.

Fourth Quarter Results

Net income available to common stock was \$18,606 in the fourth quarter of 2003 and \$18,646 in the same period of 2002. The fourth quarter results of 2002 include a net gain of \$3,690 (\$5,676 pre-tax) or \$0.04 per share on the sale of a portion of our Ashtabula, Ohio water system. The change in net income is due to a \$19,386 increase in operating revenues, a gain on the sale of other assets of \$1,278 realized in the fourth quarter of 2003, and an increase in AFUDC, offset by increased operations and maintenance expense of \$11,740, depreciation expense of \$2,134, and the absence in 2003 of the aforementioned gain on the sale of water system of \$5,676 realized in 2002. The increase in operating revenues was a result of the additional revenues from the AquaSource acquisition and an increase in water rates. The gain on sale of other assets is a result of the sale of marketable securities. The increased AFUDC resulted from a higher AFUDC rate. The higher operations and maintenance expense is due primarily to the additional operating costs associated with acquisitions. Depreciation expense increased due to acquisitions and utility plant additions made since the fourth quarter of 2002.

Effects of Inflation

As a regulated enterprise, our rates are established to provide recovery of costs and a return on our investment. Recovery of the effects of inflation through higher water rates is dependent upon receiving adequate and timely rate increases. However, rate increases are not retroactive and often lag increases in costs caused by inflation. During periods of moderate to low inflation, as has been experienced for the past several years, the effects of inflation on our operating results are not significant.

Security

In light of concerns regarding security in the wake of the September 11, 2001 terrorist attacks, we have increased security measures at our facilities. These increased security measures were not made in response to any specific threat. We are in contact with federal, state and local authorities and industry trade associations regarding current information on possible threats and security measures for water utility operations. The cost of the increased security measures, including capital expenditures, is expected to be recoverable in water rates and is not expected to have a material impact on our results from operations or financial condition.

FINANCIAL CONDITION

Cash Flow and Capital Expenditures

Net operating cash flow, dividends paid on common stock, capital expenditures, including allowances for funds used during construction, and expenditures for acquiring water and wastewater systems for the five years ended December 31, 2003 were as follows:

	Net Operating Cash Flow	Common Dividends	Capital Expenditures	Acquisitions of Utility Systems
1999	\$ 74,103	\$ 29,217	\$ 96,383	\$ 39,164
2000	86,972	30,406	129,740	3,546
2001	102,165	34,234	124,088	9,517
2002	121,560	36,789	136,164	8,914
2003	143,373	39,917	163,320	192,331
	\$ 528,173	\$ 170,563	\$ 649,695	\$ 253,472

AQUA AMERICA, INC. AND SUBSIDIARIES

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

Included in capital expenditures for the five-year period are:
expenditures for the modernization and replacement of existing treatment plants,

new water mains and customer service lines, rehabilitation of existing water mains and hydrants, and water meters. During this five-year period, we received \$36,570 of customer advances and contributions in aid of construction to finance new water mains and related facilities which are not included in the capital expenditures presented in the above table. In addition, during this period, we have made sinking fund contributions and retired debt in the amount of \$110,799, retired \$3,220 of preferred stock, and have refunded \$22,697 of customer advances for construction. Common dividends increased during the past five years as a result of an annual increase in the common dividends declared and paid and an increase in the shares outstanding during the period.

Our planned 2004 capital program, exclusive of the costs of new mains financed by advances and contributions in aid of construction, is estimated to be \$178,900 of which \$49,345 is for infrastructure rehabilitation surcharge-qualified projects. We have increased our capital spending for infrastructure rehabilitation in response to the infrastructure rehabilitation surcharge mechanisms, and should these mechanisms be discontinued for any reason, which is not anticipated, we would re-evaluate the magnitude our capital program. Our 2004 capital program, along with \$39,386 of sinking fund obligations and debt maturities, and \$28,007 of other contractual cash obligations, as reported in the section captioned "Contractual Obligations", is expected to be financed through internally-generated funds, our revolving credit facilities, the issuance of equity and the issuance of new long-term debt.

Future utility construction in the period 2005 through 2008, including recurring programs, such as the ongoing replacement of water meters, water treatment plant upgrades, storage facility renovations, the rehabilitation of water mains and additional transmission mains to meet customer demands, exclusive of the costs of new mains financed by advances and contributions in aid of construction, is estimated to require aggregate expenditures of approximately \$600,000. We anticipate that less than one-half of these expenditures will require external financing of debt and the additional issuance of common stock through our dividend reinvestment plan and possible future public equity offerings. We expect to refinance \$90,339 of sinking fund obligations and debt maturities during this period as they become due with new issues of long-term debt. The estimates discussed above do not include any amounts for possible future acquisitions of water systems or the financing necessary to support them, including the planned Heater acquisition described below.

Our primary source of liquidity is cash flows from operations, borrowings under various short-term lines of credit and other credit facilities, and advances and contributions in aid of construction. Our cash flow from operations, or internally-generated funds, is impacted by the timing of rate relief and water consumption. We fund our capital and acquisition programs through internally-generated funds, supplemented by short-term borrowings. Over time, we refinance our short-term borrowings with long-term debt and proceeds from the issuance of common stock. The ability to finance our future construction programs, as well as our acquisition activities, depends on our ability to attract the necessary external financing and maintain internally-generated funds. Rate orders permitting compensatory rates of return on invested capital and timely rate adjustments will be required by our operating subsidiaries to achieve an adequate level of earnings to enable them to secure the capital they will need and to maintain satisfactory debt coverage ratios.

Acquisitions

During the past five years, we have expended cash of \$253,472 and issued 1,317,017 shares of common stock, valued at \$16,400 at the time of the acquisition, related to the acquisitions of utility systems, primarily water utilities and some wastewater utilities. On July 31, 2003, we completed the acquisition of four operating water and wastewater subsidiaries of AquaSource, Inc., a subsidiary of DQE, Inc., including selected, integrated operating and maintenance contracts and related assets (individually and collectively the acquisition is referred to as "AquaSource") for \$190,717 in cash, as adjusted pursuant to the purchase agreement and subject to further adjustment. The acquisition was initially funded by a portion of the proceeds from the July 2003 issuance of \$135,000 of unsecured notes due 2023, with an interest rate of 4.87%, and the issuance of a \$90,000 unsecured note by Aqua America. In August 2003, the \$90,000 unsecured note was repaid with the proceeds from the issuance of 5,000,000 shares of common stock through a shelf registration. Please refer to the section captioned "AquaSource Acquisition" which follows. These acquisitions were accounted for as purchases. In March 1999, we completed a merger with Consumers Water Company (CWC). On the date of the merger, we issued

25,417,998 shares of Common Stock in exchange for all of the outstanding shares of CWC and CWC became our wholly-owned subsidiary. The CWC merger has been accounted for as a pooling-of-interests.

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AQUA AMERICA, INC. AND SUBSIDIARIES

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

On November 21, 2003, we entered into a purchase agreement with ALLETE Water Services, Inc., a subsidiary of ALLETE, Inc., to acquire the capital stock of Heater Utilities, Inc., which owns water and wastewater systems located in North Carolina. The purchase agreement provides for a cash purchase price of \$48,000 and the assumption of approximately \$28,000 in debt, reflecting an acquisition premium of approximately \$18,000. We intend to seek the ability to recover a portion of this premium through customer rates via the North Carolina Utilities Commission approval process. The acquisition, which is subject to regulatory approval, is expected to close in mid-2004. This acquisition will add approximately 50,000 customers in the areas of suburban Raleigh, Charlotte, Gastonia and Fayetteville, North Carolina. It is our intention to fund the acquisition at closing with cash from a combination short-term debt, long-term debt and/or the issuance of our common stock.

We continue to hold acquisition discussions with several water systems. In general, acquisitions are expected to be financed through the issuance of equity (for the acquisition of some investor-owned systems) or funded initially with short-term debt with subsequent repayment from the proceeds of long-term debt or proceeds from equity offerings.

Dispositions

In May 2003, we announced agreements for the sale of the AquaSource regulated and nonregulated operations located in Connecticut and New York to a New England-based water company for an aggregate purchase price of \$5,000 and the assumption of approximately \$800 of debt. The sale of the Connecticut operations closed on October 31, 2003 and provided proceeds of \$4,000. The sale of the New York operations is expected to occur in mid-2004. The combined operations in New York and Connecticut represented approximately 2% of the operations acquired from AquaSource, Inc. We intend to sell other minor divisions of the acquired AquaSource operations as we will continue to review and evaluate our areas of business and operating divisions.

In December 2002, as a result of the settlement of a condemnation action, our Ohio operating subsidiary sold to Ashtabula County, Ohio the water utility assets in the unincorporated areas of Ashtabula County and the area within the Village of Geneva on the Lake for net proceeds of \$12,118, which was in excess of the book value for these assets. The proceeds were used to pay down short-term debt, and the sale resulted in the recognition in the fourth quarter of 2002 of a gain on the sale of these assets of \$5,676, or an after-tax gain of \$3,690 and \$0.04 per share. We continue to operate this water system for Ashtabula County, beginning after the closing of the sale, under a multi-year operating contract that was recently renewed and is expected to provide us with over \$300 in operating revenues annually. The water utility assets sold represented less than 1% of our total assets, and the total number of customers included in the water system sold represented less than 1% of our total customer base.

Despite these transactions, our strategy continues to be to acquire additional water and wastewater systems, maintain our existing systems, and actively oppose efforts by municipal governments to acquire any of our operations.

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AQUA AMERICA, INC. AND SUBSIDIARIES

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

Sources of Capital

Since net operating cash flow plus advances and contributions in aid of construction have not been sufficient to fully fund cash requirements, we issued approximately \$462,500 of long-term debt and obtained other short-term borrowings during the past five years. At December 31, 2003, we had short-term lines of credit and other credit facilities of \$178,000, of which \$81,541 was available. Our short-term lines of credit and other credit facilities are either payable on demand or have a 364-day term.

In April 2003, we filed a universal shelf registration with the SEC to allow for the sale, over time, of up to \$250,000 of various debt and equity securities, including common stock. To date, we have completed two issuances under the universal shelf registration:

- o In May 2003, we sold 1,868,750 shares of common stock in a public offering for proceeds of \$33,100, net of expenses. The net proceeds were used to repay short-term debt, including the repayment of \$22,000 of indebtedness incurred in connection with our repurchase of 1,513,275 shares of our common stock from affiliates of Veolia Environnement, S.A., formerly Vivendi Environnement, S.A., in October 2002.
- o In August 2003, we sold 5,000,000 shares of common stock in a public offering for proceeds of \$90,100, net of expenses. The net proceeds were used to repay an unsecured note of \$90,000. The indebtedness was incurred by Aqua America in connection with the acquisition of the operations that were purchased from AquaSource, Inc.

The balance remaining available for use under the universal shelf registration as of December 31, 2003 is \$121,895. In addition, we have a shelf registration statement filed with the SEC to permit the offering from time to time of shares of common stock and shares of preferred stock for acquisitions. During 2003, no shares were issued from the acquisition shelf registration. During 2002 and 2001, 178,664 and 414,638 shares of common stock totaling \$2,745 and \$5,361, were issued to acquire water and wastewater systems. The balance remaining available for use under the acquisition shelf registration as of December 31, 2003 is 2,218,947 shares. The form and terms of such securities shall be determined when and if these securities are issued under these shelf registrations.

In September 2000, we sold 2,583,008 shares of common stock in a public offering for net proceeds of \$29,689. The proceeds of this offering were used to make an equity contribution to our Pennsylvania operating subsidiary.

We offer a Dividend Reinvestment and Direct Stock Purchase Plan (Plan) that provides a convenient and economical way to purchase shares of Aqua America, Inc. Under the direct stock purchase portion of the Plan, shares are sold throughout the year and the shares are obtained by our transfer agent in the open market. The dividend reinvestment portion of the Plan offers a 5% discount on the purchase of original issue shares of common stock with reinvested dividends. As of the December 2003 dividend payment, holders of 17.0% of the common shares outstanding participated in the dividend reinvestment portion of the Plan. During the past five years, we have sold 2,150,474 original issue shares of common stock for net proceeds of \$29,913 through the dividend reinvestment portion of the Plan and the proceeds were used to invest in our operating subsidiaries, to repay short-term debt, and for general corporate purposes.

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AQUA AMERICA, INC. AND SUBSIDIARIES

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

Other Capital Transactions

In May 2002, Veolia Environnement, S.A., formerly Vivendi Environnement, S.A., which through its affiliates (collectively "VE") owned approximately 16.8% of our outstanding common stock, advised us of its decision to sell its investment in Aqua America. VE announced that its decision was part of its overall strategy to divest non-core assets and focus on other business strategies. In September 2002, in order to facilitate the orderly re-distribution of the shares held by VE into the market, we completed a secondary offering of 12,356,570 shares of Aqua America common stock held by VE.

The number of outstanding shares of common stock was not changed and we did not receive any proceeds as a result of this secondary offering. In addition, in October 2002 we repurchased 1,513,275 shares of Aqua America common stock representing the remainder of the shares of Aqua America common stock held by VE. The repurchase of shares was funded with proceeds of \$22,000 from a short-term credit facility. In May 2003, this \$22,000 short-term credit facility was repaid with funds from the issuance of 1,868,750 shares of common stock through a shelf registration, providing proceeds of approximately \$33,100, net of expenses. The balance of the net proceeds were used to repay other short-term debt.

The Board of Directors has authorized us to purchase our common stock, from time to time, in the open market or through privately negotiated transactions. We have not purchased any shares under this authorization since 2000. As of December 31, 2003, 411,209 shares remain available for repurchase. Funding for future stock purchases, if any, is not expected to have a material impact on our financial position.

Contractual Obligations

The following table summarizes our contractual cash obligations as of December 31, 2003:

	Payments Due By Period						Total
	2004	2005	2006	2007	2008	Thereafter	
Long-term debt (a)	\$ 39,386	\$ 40,418	\$ 16,088	\$ 14,395	\$ 19,438	\$606,327	\$736,052
Operating leases (b)	2,558	2,110	1,352	1,081	1,016	16,420	24,537
Unconditional purchase obligations (c)	7,573	7,403	7,403	7,403	7,238	68,485	105,505
Other purchase obligations (d)	7,400	--	--	--	--	--	7,400
Defined benefit plan obligations (e)	5,371	--	--	--	--	--	5,371
Other obligations (f)	5,105	200	200	200	200	--	5,905
Total	\$ 67,393	\$ 50,131	\$ 25,043	\$ 23,079	\$ 27,892	\$691,232	\$884,770

- (a) Represents sinking fund obligations and debt maturities.
- (b) Represents operating leases that are noncancelable, before expiration, for the lease of motor vehicles, buildings, land and other equipment.
- (c) Represents our commitment to purchase minimum quantities of water as stipulated in agreements with other water purveyors. We use purchased water to supplement our water supply, particularly during periods of peak customer demand.
- (d) Represents an approximation of the open purchase orders as of the period end for goods and services purchased in the ordinary course of business.
- (e) Represents contributions expected to be made to qualified defined benefit plan. The amount of required contributions in 2005 and thereafter is not determinable.
- (f) Represents capital expenditures estimated to be required under legal and binding contractual obligations.

AQUA AMERICA, INC. AND SUBSIDIARIES

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

In addition to these obligations, we make refunds on Customers' Advances for Construction over a specific period of time based on operating revenues related to developer-installed water mains or as new customers are connected to and take service from such mains. After all refunds are made, any remaining balance is transferred to Contributions in Aid of Construction. The refund amounts are not included in the above table because the refund amounts and timing 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 refund amounts are payable annually through 2017 and amounts not paid by the contract expiration dates become non-refundable.

These contractual obligations will be funded from cash flows from

operations and liquidity sources held by or available to Aqua America.

AquaSource Acquisition

Pursuant to our strategy to grow through acquisitions, on July 31, 2003, we completed the acquisition of four operating water and wastewater subsidiaries of AquaSource, Inc. (a subsidiary of DQE, Inc.), including selected, integrated operating and maintenance contracts and related assets (individually and collectively the acquisition is referred to as "AquaSource") for \$190,717 in cash, as adjusted pursuant to the purchase agreement for the completion of a closing balance sheet and the finalization of working capital (\$195,533 was paid at closing and refunds were subsequently received totaling \$4,816). There remains approximately \$12,000 of the above purchase price subject to an agreed-upon arbitration process. Accordingly, the final purchase price is expected to be within the range of \$178,700 to \$190,717. We expect the arbitration process to conclude by mid-year 2004. The results of AquaSource have been included in our consolidated financial statements beginning August 1, 2003. The acquired operations of AquaSource serve over 130,000 water and wastewater customer accounts in 11 states (including the Connecticut operations which we sold in October 2003). Please refer to the section captioned "Dispositions" for a discussion of the sale of the AquaSource operations located in Connecticut and the planned sale of the New York operations.

The AquaSource acquisition was initially funded by a portion of the proceeds from the July 2003 issuance of \$135,000 of unsecured notes due 2023, with an interest rate of 4.87%, and the issuance of a \$90,000 unsecured note by Aqua America. In August 2003, the \$90,000 unsecured note was repaid with the proceeds from the issuance of 5,000,000 shares of common stock through a shelf registration.

The acquired operations of AquaSource serve over 130,000 water and wastewater customer accounts in 11 states (including the Connecticut operations which we sold in October 2003). The acquisition provides an expanded platform from which to extend our growth-through-acquisition strategy of acquiring water and wastewater utility systems that are near or adjacent to our existing service territories. The AquaSource operations are comprised of approximately 600 small systems, which are generally clustered in regions to achieve some level of operating efficiency.

AQUA AMERICA, INC. AND SUBSIDIARIES

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

Market Risk

We are subject to market risks in the normal course of business, including changes in interest rates and equity prices. The exposure to changes in interest rates is a result of financings through the issuance of fixed-rate, long-term debt. Such exposure is typically related to financings between utility rate increases, because generally our rate increases provide a revenue level to allow recovery of our current cost of capital. Interest rate risk is managed through the use of a combination of long-term debt, which is at fixed interest rates and short-term debt, which is at floating interest rates. As of December 31, 2003, the debt maturities by period and the weighted average interest rate for fixed-rate, long-term debt are as follows:

	2004	2005	2006	2007	2008	Thereafter	Total	Fair Value
Long-term debt (fixed rate)	\$ 39,386	\$ 40,418	\$ 16,088	\$ 14,395	\$ 19,438	\$ 606,327	\$ 736,052	\$ 781,502
Weighted average interest rate	6.39%	7.26%	7.25%	6.94%	7.38%	6.02%	6.19%	

From time to time, we make investments in marketable equity securities. As a result, we are exposed to the risk of changes in equity prices for the "available for sale" marketable equity securities. As of December 31, 2003, our carrying value of marketable equity securities was \$1,019, which reflects the market value of such securities and is in excess of our original cost. The market risks to which we are exposed are consistent with the risks to which we were exposed in the prior year.

Capitalization

The following table summarizes our capitalization during the past five years:

December 31,	2003	2002	2001	2000	1999
Long-term debt*	52.8%	55.6%	52.9%	52.4%	53.8%
Preferred stock*	0.0%	0.0%	0.1%	0.2%	0.2%
Common stockholders' equity	47.2%	44.4%	47.0%	47.4%	46.0%
	100.0%	100.0%	100.0%	100.0%	100.0%

*Includes current portion.

The changes in the capitalization ratios primarily result from the issuance of common stock over the past five years, and the issuance of debt to finance our acquisitions and capital program and the previously mentioned repurchase of common stock from Veolia Environnement (formerly Vivendi, S.A.) in 2002. It is our goal to maintain an equity ratio adequate to support our current Standard and Poors corporate credit rating of "A+" and its senior secured debt rating of "AA-" for Aqua Pennsylvania, our largest operating subsidiary.

Dividends on Common Stock

We have paid common dividends consecutively for 59 years. Effective December 1, 2003, our Board of Directors authorized an increase of 7.1% in the dividend rate over the amount we paid in the previous quarter. As a result of this authorization, beginning with the dividend payment in December 2003, the annual dividend rate increased to \$0.48 per share. We presently intend to pay quarterly cash dividends in the future, on March 1, June 1, September 1 and December 1, subject to our earnings and financial condition, regulatory requirements and such other factors as our Board of Directors may deem relevant. During the past five years, our common dividends paid have averaged 59.4% of net income.

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AQUA AMERICA, INC. AND SUBSIDIARIES

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our financial condition and results of operations are impacted by the methods, assumptions, and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to our financial condition or results of operations, and require estimates or other judgements of matters of uncertainty. Changes in the estimates or other judgements included within these accounting policies could result in a significant change to the financial statements. We believe our most critical accounting policies include revenue recognition, the use of regulatory assets and liabilities as permitted by Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation," the review for impairment of our long-lived assets which consist primarily of Utility Plant in Service and regulatory assets, and our accounting for pensions and other postretirement benefits.

Our utility revenues recognized in an accounting period include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the last billing to the end of the accounting period. The estimated usage is based on our judgement and assumptions; our actual results could differ from these estimates which would result in operating revenues being adjusted in the period that the revision to our estimates are determined.

SFAS No. 71 stipulates generally accepted accounting principles for companies whose rates are established by or are subject to approval by an independent third-party regulator. In accordance with SFAS No. 71, we defer costs and credits on the balance sheet as regulatory assets and liabilities when

it is probable that these costs and credits will be recognized in the rate-making process in a period different from when the costs and credits were incurred. These deferred amounts, both assets and liabilities, are then recognized in the income statement in the same period that they are reflected in our rates charged for water and wastewater service. In the event that our assessment as to the probability of the inclusion in the rate-making process is incorrect, the associated regulatory asset or liability would be adjusted to reflect the change in our assessment or change in regulatory approval.

In accordance with the requirements of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", we review for impairment of our long-lived assets, including Utility Plant in Service. We also review regulatory assets for the continued application of SFAS No. 71. Our review determines whether there have been changes in circumstances or events that have occurred that require adjustments to the carrying value of these assets. In accordance with SFAS No. 71, adjustments to the carrying value of these assets would be made in instances where the inclusion in the rate-making process is unlikely.

We maintain a qualified defined benefit pension plan and plans that provide for certain postretirement benefits other than pensions. Accounting for pensions and other postretirement benefits requires an extensive use of assumptions about the discount rate, expected return on plan assets, the rate of future compensation increases received by our employees, mortality, turnover and medical costs. Each assumption is reviewed annually with assistance from our 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 postretirement benefit expense that we recognize.

Our discount rate is based on a market rate for a recognized-rating agency's high-quality long-term bond portfolio with durations matching the expected payouts under our retirement plans. Our pension expense and liability (benefit obligations) increases as the discount rate is reduced. A 25 basis-point reduction in this assumption would have increased 2003 pension expense by \$500 and the pension liabilities by \$5,500. The present values of Aqua America's future pension and other postretirement obligations were determined using discount rates of 6.25% at December 31, 2003 and 6.75% at December 31, 2002. Our expense under these plans is determined using the discount rate as of the beginning of the year, which was 6.75% for 2003, and will be 6.25% for 2004.

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AQUA AMERICA, INC. AND SUBSIDIARIES

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

Our expected return on assets is determined by evaluating the asset class return expectations with our advisors as well as actual, long-term, historical results of our asset returns. Our pension expense increases as the expected return on assets decreases. A 25 basis-point reduction in this assumption would have increased 2003 pension expense by \$230. For 2003, we used an 8.5% expected return on assets assumption which will remain unchanged for 2004. The expected return on assets is based on a targeted allocation of 65% equities and 35% fixed income. We believe that our actual long-term asset allocation on average will approximate the targeted allocation. Our targeted allocation is driven by the investment strategy to earn a reasonable rate of return while maintaining risk at acceptable levels through the diversification of investments across and with various asset categories.

As of December 31, 2003, we have an additional minimum liability of \$41 associated with our defined benefit pension plan. The additional minimum liability is a result of the accumulated benefit obligation exceeding the fair value of plan assets and results in the establishment of a regulatory asset, as we anticipate recovery of the future, increased pension expense through customer rates. An additional minimum liability of \$4,731 was initially recorded on December 31, 2002 as a result of the following events during 2002:

- o pension plan assets declined due to negative equity market performance, and
- o assumed discount rate decreased resulting in an increase in

pension liabilities.

The change in the additional minimum liability from December 31, 2002 to December 31, 2003 resulted from an increase in the pension plan assets during 2003 due to positive equity market performance, offset partially by the effect of a decreased discount rate. Although additional minimum liability does not directly impact net income or cash flow, in future years, our pension expense and cash funding requirements are anticipated to increase as a result of the decline in plan assets and the discount rate. Funding requirements for qualified defined benefit pension plans are determined by government regulations and not by accounting pronouncements. In accordance with funding rules, during 2004 our required pension contribution is expected to be approximately \$5,371. We expect future changes in the amount of contributions and expense recognized will be properly included in customer rates.

IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board ("FASB") approved Statement of Financial Accounting Standards ("SFAS") No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred. When the liability is initially recognized, the carrying amount of the related long-lived asset is increased by the same amount. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, we may settle the obligation for its recorded amount, or an alternative amount, thereby incurring a gain or loss upon settlement. We've adopted this statement as required on January 1, 2003 and it did not have an impact on our results of operations. We recover, through customer rates, retirement costs which do not meet the definition of an asset retirement obligation under SFAS No. 143. Our Pennsylvania operating subsidiary recovers retirement costs through an amortization process in customer rates after the costs are incurred. Generally, these costs are recovered over a five-year period. As a result, \$13,699 as of December 31, 2003 and \$11,089 as of December 31, 2002 has been reclassified and reported as a regulatory asset. Certain other of our operating subsidiaries recover retirement costs through the depreciation component of customer rates during the life of the associated asset. As a result, \$7,484 as of December 31, 2003 and \$6,951 as of December 31, 2002 has been reclassified and is reported as a regulatory liability. Prior to the adoption of this statement, these amounts were embedded within accumulated depreciation. All prior year amounts have been restated to remove the regulatory asset and liability from accumulated depreciation.

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AQUA AMERICA, INC. AND SUBSIDIARIES

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

In April 2002, the FASB approved SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145, among other things, rescinds SFAS No. 4, which required all gains and losses from the extinguishment of debt to be classified as an extraordinary item and amends SFAS No. 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. We adopted this statement in the first quarter of 2003 and it did not have a material impact on our results of operations or financial position.

In June 2002, the FASB approved SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires the recognition of costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. This statement replaces the previous accounting guidance provided in Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. We adopted this standard in the first quarter of 2003 and it did not have a material impact on our results of operations and financial position.

In November 2002, the FASB issued FASB Interpretation No. 45,

"Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," an interpretation of SFAS No. 5, 57 and 107 and rescission of SFAS No. 34. This interpretation clarifies the requirements of FASB Statement No. 5, "Accounting for Contingencies" relating to the guarantor's accounting for, and disclosure of, the issuance of certain types of guarantees. The disclosure provisions of the interpretation are effective for financial statements of periods ending after December 15, 2002. The provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002. We adopted the accounting provisions of this standard in the first quarter of 2003 and it did not have a material impact on our results of operations or financial position.

In April 2003, the FASB approved SFAS No. 149, "Amendment of Statement No. 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. The adoption of this standard had no effect on our results of operations or financial position. As of December 31, 2003, we had no derivative instruments or hedging activities.

In May 2003, the FASB approved SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes standards for classifying and measuring as liabilities certain financial instruments with characteristics of both liabilities and equity. The standard is effective for financial instruments entered into or modified after May 31, 2003, and is otherwise effective July 1, 2003. This statement did not have a material impact on our results of operations or financial position.

In December 2003, the FASB approved SFAS No. 132 (Revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits." SFAS No. 132 amends SFAS No. 87 "Employers' Accounting for Pensions," SFAS No. 88 "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits," and SFAS No. 106 "Employers' Accounting for Postretirement Benefits Other Than Pensions." This new statement does not change the recognition and measurement requirements of those amended statements, and retains the disclosure requirements contained in SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," which it replaces and requires additional disclosure. We adopted the provisions of this statement as required as of December 31, 2003.

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AQUA AMERICA, INC. AND SUBSIDIARIES

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

In January 2004, the FASB issued FASB Staff Position ("FSP") No. 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." FSP 106-1, which is effective for our consolidated financial statements for the year ended December 31, 2003, permits a sponsor of a postretirement health care plan that provides a prescription drug benefit to make a one-time election to defer accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act"). The Act was signed into law in December 2003 and establishes a prescription drug benefit under Medicare (Medicare Part D) and a federal subsidy to sponsors of postretirement health care plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Under FSP No. 106-1, sponsors must consider the two new features in measuring the accumulated postretirement benefit obligation ("APBO") and net periodic postretirement benefit costs. In accordance with FSP 106-1, we made a one-time election to defer the recognition of the impact on FSP No. 106 accounting. Any measures of APBO and net periodic postretirement benefit cost in the consolidated financial statements and footnotes for the year ended December 31, 2003 do not reflect the effects of the Act. Currently, specific authoritative accounting guidance for the federal subsidy is pending and that guidance when issued may require us to change previously reported information. We are currently investigating the impacts of the adoption of FSP 106-1's initial recognition, measurement and disclosure provisions on our consolidated financial statements.

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AQUA AMERICA, INC. AND SUBSIDIARIES

Report of Management

The consolidated financial statements and related information for the years ended December 31, 2003, 2002 and 2001 were prepared by management in accordance with accounting principles generally accepted in the United States of America and include management's best estimates and judgments, as required. Financial information included in other sections of this annual report is consistent with that in the consolidated financial statements.

The Company has an internal accounting control structure designed to provide reasonable assurance that assets are safeguarded and that transactions are properly authorized and recorded in accordance with established policies and procedures. The internal control structure is supported by the selection and training of qualified personnel, the delegation of management authority and responsibility, dissemination of policies and procedures and periodic reviews by our internal audit director.

The Company's independent accountants, PricewaterhouseCoopers LLP, provide an independent review of management's reporting of results of operations and financial condition. PricewaterhouseCoopers LLP has audited the financial statements by conducting tests as they deemed appropriate and their report follows.

The Audit Committee of the Board of Directors selects and evaluates the Company's independent accountants and reviews the scope and results of their audits. The Audit Committee also reviews the integrity of the Company's financial reporting process, system of internal controls and other significant financial matters. The Audit Committee meets regularly with management, our internal audit director and the independent accountants. The Audit Committee held six meetings in 2003.

NICHOLAS DEBENEDICTIS

DAVID P. SMELTZER

Nicholas DeBenedictis
Chairman &
President

David P. Smeltzer
Senior Vice President - Finance

Report of Independent Auditors

To the Board of Directors and Stockholders of
Aqua America, Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and comprehensive income, of capitalization and of cash flow present fairly, in all material respects, the financial position of Aqua America, Inc. (formerly Philadelphia Suburban Corporation) and its subsidiaries at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(In thousands, except per share amounts)
Years ended December 31, 2003, 2002 and 2001

	2003	2002	2001
Operating revenues	\$ 367,233	\$ 322,028	\$ 307,280
Costs and expenses:			
Operations and maintenance	140,602	117,735	111,885
Depreciation	48,522	41,424	37,979
Amortization	2,941	2,898	2,189
Taxes other than income taxes	21,607	19,467	20,887
	213,672	181,524	172,940
Operating income	153,561	140,504	134,340
Other expense (income):			
Interest expense, net	44,662	40,396	39,859
Allowance for funds used during construction	(2,127)	(1,389)	(1,222)
Gain on sale of water system	--	(5,676)	--
Gain on sale of other assets	(5,692)	(2,079)	(3,384)
Income before income taxes	116,718	109,252	99,087
Provision for income taxes	45,923	42,046	38,976
Net income	70,795	67,206	60,111
Dividends on preferred stock	10	52	106
Net income available to common stock	\$ 70,785	\$ 67,154	\$ 60,005
Net income	\$ 70,795	\$ 67,206	\$ 60,111
Other comprehensive income (loss), net of tax:			
Unrealized gains on securities	455	104	39
Reclassification adjustment for gains reported in net income	(347)	(767)	(239)
	108	(663)	(200)
Comprehensive income	\$ 70,903	\$ 66,543	\$ 59,911
Net income per common share:			
Basic	\$ 0.80	\$ 0.78	\$ 0.71
Diluted	\$ 0.79	\$ 0.78	\$ 0.70
Average common shares outstanding during the period:			
Basic	88,275	85,674	84,841
Diluted	89,244	86,538	85,943

See accompanying notes to consolidated financial statements.

AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands of dollars, except per share amounts)
December 31, 2003 and 2002

	2003	2002
Assets		
Property, plant and equipment, at cost	\$ 2,302,304	\$ 1,836,892
Less accumulated depreciation	478,013	350,189
Net property, plant and equipment	1,824,291	1,486,703
Current assets:		
Cash and cash equivalents	10,757	5,915
Accounts receivable and unbilled revenues, net	62,320	57,680
Inventory, materials and supplies	5,841	4,555

Prepayments and other current assets	5,051	2,758
Total current assets	83,969	70,908
Regulatory assets	98,761	92,313
Deferred charges and other assets, net	34,277	23,391
Funds restricted for construction activity	28,438	43,754
	\$ 2,069,736	\$ 1,717,069
Liabilities and Stockholders' Equity		
Stockholders' equity:		
Common stock at \$.50 par value, authorized 100,000,000 shares, issued 93,270,424 and 87,046,893 in 2003 and 2002	\$ 46,635	\$ 35,034
Capital in excess of par value	413,008	317,871
Retained earnings	210,915	180,047
Minority interest	912	503
Treasury stock, at cost, 681,384 and 2,151,350 shares in 2003 and 2002	(12,611)	(40,421)
Accumulated other comprehensive income	171	63
Total stockholders' equity	659,030	493,097
6.05% Series B cumulative preferred stock	--	172
Long-term debt, excluding current portion	696,666	582,910
Commitments	--	--
Current liabilities:		
Current portion of long-term debt	39,386	34,265
Loans payable	96,459	115,113
Accounts payable	32,321	31,058
Accrued interest	11,126	9,269
Accrued taxes	16,779	14,500
Other accrued liabilities	35,930	22,326
Total current liabilities	232,001	226,531
Deferred credits and other liabilities:		
Deferred income taxes and investment tax credits	190,395	187,300
Customers' advances for construction	72,500	69,790
Other	9,419	13,330
Total deferred credits and other liabilities	272,314	270,420
Contributions in aid of construction	209,725	143,939
	\$ 2,069,736	\$ 1,717,069

See accompanying notes to consolidated financial statements.

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AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CAPITALIZATION
(In thousands of dollars, except per share amounts)
December 31, 2003 and 2002

	2003	2002
Stockholders' equity:		
Common stock, \$.50 par value	\$ 46,635	\$ 35,034
Capital in excess of par value	413,008	317,871
Retained earnings	210,915	180,047
Minority interest	912	503
Treasury stock, at cost	(12,611)	(40,421)
Accumulated other comprehensive income	171	63
Total stockholders' equity	659,030	493,097
6.05% Series B cumulative preferred stock	--	172
Long-term debt:		
Long-term debt of subsidiaries (substantially secured by utility plant):		
Interest Rate Range		
0.00% to 2.49%	16,868	18,009
2.50% to 2.99%	18,913	14,052
3.00% to 3.49%	5,618	4,733
3.50% to 3.99%	2,800	3,200
4.00% to 4.99%	8,135	8,135
5.00% to 5.49%	110,875	90,955
5.50% to 5.99%	76,260	86,260
6.00% to 6.49%	119,360	126,360

6.50% to 6.99%	42,000	52,000
7.00% to 7.49%	46,716	58,000
7.50% to 7.99%	23,000	23,000
8.00% to 8.49%	17,500	17,497
8.50% to 8.99%	9,000	9,000
9.00% to 9.49%	53,805	54,359
9.50% to 9.99%	43,242	44,637
10.00% to 10.50%	6,000	6,000
	-----	-----
	600,092	616,197
Note payable, 6.05%, due 2006	960	978
Unsecured notes payable, 4.87%, due 2023	135,000	--
	-----	-----
	736,052	617,175
Current portion of long-term debt	39,386	34,265
	-----	-----
Long-term debt, excluding current portion	696,666	582,910
	-----	-----
Total capitalization	\$ 1,355,696	\$ 1,076,179
	=====	=====

See accompanying notes to consolidated financial statements.

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AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED CASH FLOW STATEMENTS
(In thousands of dollars)
Years ended December 31, 2003, 2002 and 2001

	2003	2002	2001
	-----	-----	-----
Cash flows from operating activities:			
Net income	\$ 70,795	\$ 67,206	\$ 60,111
Adjustments to reconcile net income to net cash flows from operating activities:			
Depreciation and amortization	51,463	44,322	40,168
Deferred income taxes	26,741	18,470	14,935
Gain on sale of water system	--	(5,676)	--
Gain on sale of other assets	(5,692)	(2,079)	(3,384)
Net increase in receivables, inventory and prepayments	(314)	(742)	(5,295)
Net increase in payables, accrued interest, accrued taxes and other accrued liabilities	7,777	1,346	7,045
Payment of Competitive Transition Charge	--	--	(11,465)
Other	(7,397)	(1,287)	50
Net cash flows from operating activities	-----	-----	-----
	143,373	121,560	102,165
Cash flows from investing activities:			
Property, plant and equipment additions, including allowance for funds used during construction of \$2,127 \$1,389 and \$1,222	(163,320)	(136,164)	(124,088)
Acquisitions of water and wastewater systems	(192,331)	(8,914)	(9,517)
Net decrease (increase) in funds restricted for construction activity	15,314	(23,986)	(15,806)
Net proceeds from the sale of water systems	4,000	12,118	--
Net proceeds from the sale of other assets	6,496	6,258	5,211
Other	(312)	(362)	(173)
Net cash flows used in investing activities	-----	-----	-----
	(330,153)	(151,050)	(144,373)
Cash flows from financing activities:			
Customers' advances and contributions in aid of construction	8,181	10,266	5,175
Repayments of customers' advances	(4,257)	(5,070)	(4,652)
Net proceeds (repayments) of short-term debt	(18,654)	5,445	8,385
Proceeds from long-term debt	154,537	119,350	64,024
Repayments of long-term debt	(44,204)	(43,279)	(8,498)
Redemption of preferred stock	(172)	(944)	(644)
Proceeds from issuing common stock	134,826	10,611	13,522
Repurchase of common stock	(1,353)	(24,109)	(2,493)
Dividends paid on preferred stock	(10)	(52)	(106)
Dividends paid on common stock	(39,917)	(36,789)	(34,234)
Other	2,645	(1,034)	(1,348)
Net cash flows from financing activities	-----	-----	-----
	191,622	34,395	39,131
Net increase (decrease) in cash and cash equivalents	4,842	4,905	(3,077)
Cash and cash equivalents at beginning of year	5,915	1,010	4,087
Cash and cash equivalents at end of year	-----	-----	-----
	\$ 10,757	\$ 5,915	\$ 1,010
Cash paid during the year for:			
Interest, net of amounts capitalized	\$ 40,572	\$ 38,040	\$ 38,637
Income taxes	\$ 19,168	\$ 24,165	\$ 19,388
	=====	=====	=====

See Summary of Significant Accounting Policies-Customers' Advances for Construction, Acquisitions and Employee Stock and Incentive Plans footnotes for description of non-cash activities.

See accompanying notes to consolidated financial statements.

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
(In thousands of dollars, except per share amounts)

Summary of Significant Accounting Policies

Name Change - On January 16, 2004, Philadelphia Suburban Corporation changed its corporate name to Aqua America, Inc. In addition, we have changed our ticker symbol from PSC to WTR on the New York Stock Exchange and Philadelphia Stock Exchange effective as of the opening of trading on January 20, 2004.

Nature of Operations - Aqua America, Inc. ("Aqua America" or the "Company") is the holding company for regulated utilities providing water or wastewater services in Pennsylvania, Ohio, Illinois, Texas, New Jersey, Indiana, Virginia, Florida, North Carolina, Maine, Missouri, New York, South Carolina and Kentucky. Our largest operating subsidiary, Aqua Pennsylvania, Inc. - formerly Pennsylvania Suburban Water Company, accounts for approximately 60% of our operating revenues and provides water or wastewater service to customers in the suburban areas north and west of the City of Philadelphia and in 19 other counties in Pennsylvania. The Company's other subsidiaries provide similar services in 13 other states. In addition, the Company provides water and wastewater service through operating and maintenance contracts with municipal authorities and other parties close to our operating companies' service territories.

Regulation - Most of the operating companies that are regulated public utilities are subject to regulation by the public utility commissions of the states in which they operate. The respective public 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 Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation." SFAS No. 71 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.

Consolidation - The consolidated financial statements include the accounts of the Company and its subsidiaries. All material intercompany accounts and transactions have been eliminated where appropriate.

Recognition of Revenues - Revenues 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. Nonregulated revenues are recognized when services are performed and are primarily associated with operating and maintenance contracts and data processing service fees. Nonregulated revenues totaled \$11,806 in 2003, \$7,190 in 2002 and \$7,092 in 2001.

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 certain utility plant, allowance for funds used during construction. Water systems acquired are 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 an acquisition adjustment within utility plant. At December 31, 2003, utility plant includes a net credit acquisition adjustment of \$48,054, which is generally being amortized from 0 to 20 years. Amortization of the acquisition adjustments totaled \$1,649 during 2003, \$633 during 2002 and \$545 during 2001.

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 public utility commissions of the states in which the company operates. The cost of new units of property and betterments are capitalized.

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 recovers cost of removal or other retirement costs through rates after the retirement costs are incurred, a regulatory asset is recorded. 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. All prior year amounts have been restated to remove the regulatory asset and liability from accumulated depreciation where it had been previously reported.

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.

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AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

In accordance with the requirements of Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the long-lived assets of the Company, which consist primarily of Utility Plant in Service and regulatory assets, are reviewed for impairment when changes in circumstances or events occur. There has been no change in circumstances or events that have occurred that require adjustments to the carrying values of these assets.

Allowance for Funds Used During Construction - The allowance for funds used during construction ("AFUDC") is a non-cash credit which represents the estimated 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 or contributions in aid of construction. 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 2003, 2002 and 2001 was \$0, \$9 and \$0 respectively. No interest was capitalized by our nonregulated 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.

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 by the straight-line method 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. Other costs, for which the Company has received or expects to receive prospective rate recovery, are deferred and amortized over the period of rate recovery in accordance with SFAS No. 71.

Marketable securities are considered "available-for-sale" and accordingly, are carried on the balance sheet at fair market value. Unrecognized gains are included in other comprehensive income.

Income Taxes - The Company accounts for certain income and expense items in different time periods for financial reporting than for tax reporting purposes. Deferred income taxes are provided on the 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 allowed currently 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. Investment tax credits are deferred and amortized over the estimated useful lives of the related properties.

Customers' Advances for Construction - Water mains or, in some instances, cash advances to reimburse the Company for its costs to construct water mains, are contributed to the Company by customers, real estate developers and builders in order to extend water service to their properties. The value of these contributions is recorded as Customers' Advances for Construction. The Company makes refunds on these advances over a specific period of time based on operating revenues related to the main or as new customers are connected to and take service from the main. After all refunds are made, any remaining balance is transferred to Contributions in Aid of Construction. Non-cash property, in the form of water mains, has been received, generally from developers, as advances or contributions of \$9,991, 17,271 and \$10,196 in 2003, 2002 and 2001, respectively.

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

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.

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

Stock-Based Compensation - The Company accounts for stock-based compensation using the intrinsic value method in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees". Accordingly, no compensation expense related to granting of stock options has been recognized in the financial statements for stock options that have been granted. Pursuant to the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, pro forma net income available to common stock and earnings per share are presented in the following table as if compensation cost for stock options was determined as of the grant date under the fair value method:

	Years Ended December 31,		
	2003	2002	2001
Net income available to common stock, as reported	\$ 70,785	\$ 67,154	\$ 60,005
Add: stock-based employee compensation expense included in reported net income, net of tax	224	473	194
Less: pro forma expense related to stock options granted, net of tax effects	(1,793)	(1,741)	(1,125)
Pro forma	\$ 69,216	\$ 65,886	\$ 59,074
Basic net income per share:			
As reported	\$ 0.80	\$ 0.78	\$ 0.71
Pro forma	0.78	0.77	0.70
Diluted net income per share:			
As reported	\$ 0.79	\$ 0.78	\$ 0.70
Pro forma	0.78	0.76	0.69

The per share weighted-average fair value at the date of grant for stock options granted during 2003, 2002 and 2001 was \$4.67, \$5.15 and \$4.47 per option, respectively. The fair value of options at the date of grant was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2003	2002	2001
Expected life (years)	5.6	5.5	5.2
Interest rate	3.7%	4.9%	5.0%
Volatility	32.4%	34.2%	32.7%
Dividend yield	2.6%	2.6%	2.6%

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.

Reclassifications - Certain prior year amounts have been reclassified to conform with current year's presentation.

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

Recent Accounting Pronouncements -In July 2001, the Financial Accounting Standards Board ("FASB") approved Statement of Financial Accounting Standards ("SFAS") No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred. When the liability is initially recognized, the carrying amount of the related long-lived asset is increased by the same amount. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, the Company may settle the obligation for its recorded amount, or an alternative amount, thereby incurring a gain or loss upon settlement. The Company adopted this statement as required on January 1, 2003 and it did not have an impact on the Company's results of operations. The Company recovers, through customer rates, retirement costs which do not meet the definition of an asset retirement obligation under SFAS No. 143. The Company's Pennsylvania operating subsidiary recovers retirement costs through an amortization process in customer rates after the costs are incurred. Generally, these costs are recovered over a five-year period. As a result, \$13,699 and \$11,089 have been reclassified and reported as a regulatory asset as of December 31, 2003 and 2002. Certain other of the Company's operating subsidiaries recover retirement costs through the depreciation component of customer rates during the life of the associated asset. As a result, \$7,484 and \$6,951 have been reclassified as of December 31, 2003 and 2002, and is reported as a regulatory liability. Prior to the adoption of this statement, these amounts were embedded within accumulated depreciation. All prior year amounts have been restated to remove the regulatory asset and liability from accumulated depreciation.

In April 2002, the FASB approved SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145, among other things, rescinds SFAS No. 4, which required all gains and losses from the extinguishment of debt to be classified as an extraordinary item and amends SFAS No. 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. The Company adopted this statement in the first quarter of 2003 and it did not have a material impact on the Company's results of operations or financial position.

In June 2002, the FASB approved SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires the recognition of costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. This statement replaces the previous accounting guidance provided in Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The Company adopted this standard in the first quarter of 2003 and it did not have a material impact on the Company's results of operations or financial position.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," an interpretation of SFAS No. 5, 57 and 107 and rescission of SFAS No. 34. This interpretation clarifies the requirements of FASB Statement No. 5, "Accounting for Contingencies" relating to the guarantor's accounting for, and disclosure of, the issuance of certain types of guarantees. The disclosure provisions of the interpretation are effective for financial statements of periods ending after December 15, 2002. The provisions

for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002. The Company adopted the accounting provisions of this standard in the first quarter of 2003 and it did not have a material impact on the Company's results of operations or financial position.

In April 2003, the FASB approved SFAS No. 149, "Amendment of Statement No. 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. The adoption of this standard had no effect on the Company's results of operations or financial position. As of December 31, 2003, the Company had no derivative instruments or hedging activities.

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

In May 2003, the FASB approved SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes standards for classifying and measuring as liabilities certain financial instruments with characteristics of both liabilities and equity. The standard is effective for financial instruments entered into or modified after May 31, 2003, and is otherwise effective July 1, 2003. This statement did not have a material impact on the Company's results of operations or financial position.

In December 2003, the FASB approved SFAS No. 132 (Revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits." SFAS No. 132 amends SFAS No. 87 "Employers' Accounting for Pensions," SFAS No. 88 "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits," and SFAS No. 106 "Employers' Accounting for Postretirement Benefits Other Than Pensions." This new statement does not change the recognition and measurement requirements of those amended statements, and retains the disclosure requirements contained in SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," which it replaces and requires additional disclosure. The Company adopted the provisions of this statement as required as of December 31, 2003.

In January 2004, the FASB issued FASB Staff Position ("FSP") No. 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." FSP 106-1, which is effective for the Company's consolidated financial statements for the year ended December 31, 2003, permits a sponsor of a postretirement health care plan that provides a prescription drug benefit to make a one-time election to defer accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act"). The Act was signed into law in December 2003 and establishes a prescription drug benefit under Medicare (Medicare Part D) and a federal subsidy to sponsors of postretirement health care plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Under FSP No. 106-1, sponsors must consider the two new features in measuring the accumulated postretirement benefit obligation ("APBO") and net periodic postretirement benefit costs. In accordance with FSP 106-1, the Company made a one-time election to defer the recognition of the impact on FSP No. 106 accounting. Any measures of APBO and net periodic postretirement benefit cost in the consolidated financial statements and footnotes for the year ended December 31, 2003 do not reflect the effects of the Act. Currently, specific authoritative accounting guidance for the federal subsidy is pending and that guidance when issued may require the Company to change previously reported information. The Company is currently investigating the impacts of the adoption of FSP 106-1's initial recognition, measurement and disclosure provisions on its consolidated financial statements.

Acquisitions

AquaSource Acquisition - Pursuant to our strategy to grow through acquisitions, on July 31, 2003, the Company completed its acquisition of four operating water and wastewater subsidiaries of AquaSource, Inc. (a subsidiary of DQE, Inc.), including selected, integrated operating and maintenance contracts and related assets (individually and collectively the acquisition is referred to as

"AquaSource") for \$190,717 in cash, as adjusted pursuant to the purchase agreement for the completion of a closing balance sheet and the finalization of working capital (\$195,533 was paid at closing and refunds were subsequently received totaling \$4,816). There remains approximately \$12,000 of the above purchase price in dispute subject to an arbitration process under the terms of the purchase agreement. Accordingly, the final purchase price is expected to be within the range of \$178,700 to \$190,717. We expect the arbitration process to conclude by mid-2004.

The results of AquaSource have been included in the Company's consolidated financial statements beginning August 1, 2003. The acquired operations of AquaSource serve over 130,000 water and wastewater customer accounts in 11 states (including the Connecticut operations which were sold in October 2003). Please refer to the Dispositions footnote for a discussion of the sale of the AquaSource operations located in Connecticut and the planned sale of the New York operations. The AquaSource acquisition was initially funded by a portion of the proceeds from the July 2003 issuance of \$135,000 of unsecured notes due 2023, with an interest rate of 4.87%, and the issuance of a \$90,000 unsecured note by Aqua America. In August 2003, the \$90,000 unsecured note was repaid with the proceeds from the issuance of 5,000,000 shares of common stock through a shelf registration.

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AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

Under the purchase method of accounting, the purchase price is allocated to AquaSource's net tangible and intangible assets based upon their estimated fair values at the date of the acquisition. The preliminary purchase price allocation, which does not reflect the effects of the purchase price arbitration proceeding, is as follows:

	July 31, 2003
Property, plant and equipment, net	\$ 210,008
Current assets	9,687
Other long-term assets	14,204
Assets held for sale, net	4,096
Total assets acquired	237,995
Current liabilities	8,214
Long-term debt	7,170
Other long-term liabilities	31,894
Total liabilities assumed	47,278
Net assets acquired	\$ 190,717

The net property, plant and equipment balance includes accumulated depreciation of \$91,296. The following supplemental pro forma information is presented to illustrate the effects of the AquaSource acquisition, which was completed on July 31, 2003, on the historical operating results for the year ended December 31, 2003 and 2002 as if the acquisition had occurred at the beginning of the respective periods (unaudited):

	Years Ended December 31,	
	2003	2002
Operating revenues	\$ 407,628	\$ 391,569
Net income	\$ 74,436	\$ 72,420
Net income per common share:		
Basic	\$ 0.81	\$ 0.80
Diluted	\$ 0.81	\$ 0.79

The supplemental information is not necessarily representative of the actual results that may have occurred for these periods or of the results that may occur in the future. This information does not reflect the effects of recent rate increases or cost savings that may result from the acquisition, such as the effects of a reduction in administrative costs. This information is based upon the historical operating results of AquaSource for periods prior to the acquisition date of July 31, 2003 as provided to the Company by AquaSource, Inc. and DQE, Inc. management.

Other Acquisitions - On November 21, 2003, Aqua America entered into a purchase agreement with ALLETE Water Services, Inc., a subsidiary of ALLETE, Inc., to acquire the capital stock of Heater Utilities, Inc., which owns water and wastewater systems located in North Carolina. The purchase agreement provides for a cash purchase price of \$48,000 and the assumption of approximately \$28,000 in debt, reflecting an acquisition premium of approximately \$18,000. The Company intends to seek the ability to recover a portion of this premium through customer rates via the North Carolina Utilities Commission approval process. The acquisition, which is subject to regulatory approval, is expected to close in mid-2004. This acquisition will add approximately 50,000 customers in the areas of suburban Raleigh, Charlotte, Gastonia and Fayetteville, North Carolina.

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AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

During 2003, in addition to the AquaSource acquisition, the Company completed 17 acquisitions or other growth ventures in the various states in which the Company operates for an aggregate purchase price of \$1,614 in cash. The operating revenues included in the consolidated financial statements during the period owned by the Company was \$312.

During 2002, the Company completed 25 acquisitions or other growth ventures in various states. The total purchase price of \$11,659 for the systems acquired in 2002 consisted of \$8,914 in cash and the issuance of 178,864 shares of the Company's common stock. Operating revenues included in the consolidated financial statements related to the systems acquired in 2002 were \$2,920 in 2003 and \$1,341 in 2002.

During 2001, the Company completed 20 acquisitions or other growth ventures including the Company's entry into North Carolina. The total purchase price of \$14,878 for the systems acquired in 2001 consisted of \$9,517 in cash and the issuance of 414,638 shares of the Company's common stock. Operating revenues included in the consolidated financial statements related to the systems acquired in 2001 were \$4,647 in 2003, \$4,736 in 2002 and \$3,432 in 2001.

On February 4, 2003, the Company entered into a mutual termination agreement with Pennichuck Corporation terminating Aqua America's planned acquisition of Pennichuck Corporation, which was originally announced in April 2002. The mutual decision to terminate the merger agreement was primarily in response to a referendum of the City of Nashua, New Hampshire, authorizing Nashua to pursue the acquisition, by an eminent domain proceeding or otherwise, of all or a portion of Pennichuck Corporation's water works system, and was considered to be in the best interests of both companies.

Dispositions

In May 2003, the Company announced agreements for the sale of the AquaSource regulated and nonregulated operations located in Connecticut and New York to a New England-based water company for an aggregate purchase price of \$5,000 and the assumption of approximately \$800 of debt. The sale of the Connecticut operations closed on October 31, 2003 and provided proceeds of \$4,000. The sale of the New York operations is expected to occur in mid-2004. The combined operations in New York and Connecticut represented approximately 2% of the operations acquired from AquaSource, Inc.

In December 2002, as a result of the settlement of a condemnation action, the Company's Ohio operating subsidiary sold to Ashtabula County, Ohio the water utility assets in the unincorporated areas of Ashtabula County and the area within the Village of Geneva on the Lake for \$12,118, net of certain closing costs. The sale was in excess of the book value for these assets and the sale generated a gain of \$5,676 (or an after-tax gain of \$3,690 and \$0.04 per share) recorded in the fourth quarter of 2002. We continue to operate this water

system for Ashtabula County, beginning after the closing of the sale, under a multi-year operating contract that was recently renewed. The water utility assets sold represent less than 1% of our total assets, and the total number of customers included in the water system sold represents less than 1% of our total customer base.

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

Property, Plant and Equipment

	December 31,		Approximate range of remaining lives
	2003	2002	
Utility plant and equipment:			
Mains and accessories	\$ 962,439	\$ 815,066	33 to 85 years
Services, hydrants, treatment plants and reservoirs	547,622	432,564	5 to 68 years
Operations structures and water tanks	175,663	140,796	18 to 61 years
Miscellaneous pumping and purification equipment	259,468	182,415	12 to 50 years
Meters, data processing, transportation and operating equipment	251,721	194,073	5 to 50 years
Land and other non-depreciable assets	58,223	51,317	--
	-----	-----	
Utility Plant and equipment	2,255,136	1,816,231	
Utility construction work in progress	92,106	23,964	--
Net utility plant acquisition adjustment	(48,054)	(6,210)	0 to 20 years
Non-utility plant and equipment	3,116	2,907	2 to 40 years
	-----	-----	
Total property, plant and equipment	\$ 2,302,304	\$ 1,836,892	
	=====	=====	

Accounts Receivable

	December 31,	
	2003	2002
Billed utility revenue	\$ 41,843	\$ 34,733
Unbilled utility revenue	23,876	26,007
Other	2,452	520
	-----	-----
	68,171	61,260
Less allowance for doubtful accounts	5,851	3,580
	-----	-----
Net accounts receivable	\$ 62,320	\$ 57,680
	=====	=====

The Company's customers are located principally in the following states: 54% in Pennsylvania, 11% in Ohio, 8% in Illinois, 7% in Texas, 6% in New Jersey and 4% in Indiana. No single customer accounted for more than one percent of the Company's operating revenues during the years ended December 31, 2003, 2002 or 2001. The following table summarizes the changes in the Company's allowance for doubtful accounts:

	2003	2002	2001
	-----	-----	-----
Balance at January 1,	\$ 3,580	\$ 2,482	\$ 1,907
Amounts charged to expense	2,643	3,182	2,557
Accounts written off	(2,715)	(2,375)	(2,179)
Recoveries of accounts written off	253	291	197
Allowance acquired through acquisitions	2,090	--	--
	-----	-----	-----
Balance at December 31,	\$ 5,851	\$ 3,580	\$ 2,482
	=====	=====	=====

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

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 and the competitive transition charge payment, 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 (liabilities) are as follows:

	December 31,	
	2003	2002
Income taxes, asset	\$ 68,917	\$ 67,658
Income taxes, liability	(3,434)	(3,574)
CTC payment	8,026	9,172
Postretirement benefits	6,698	8,334
Merger Costs	2,700	3,229
Water tank painting	3,240	2,114
Utility plant retirement costs, asset	13,699	11,089
Utility plant retirement costs, liability	(7,484)	(6,951)
Rate case filing expenses & other	6,399	1,242
	\$ 98,761	\$ 92,313

Items giving rise to deferred state income taxes, as well as a portion of deferred Federal income taxes related to certain differences between tax and book depreciation expense, are recognized in the rate setting process on a cash or flow-through basis and will be recovered as they reverse. The regulatory asset associated with the Competitive Transition Charge ("CTC") payment represents the full payoff in 2001, net of amortization, of the allocable share of a CTC as negotiated by Aqua Pennsylvania, Inc. from its electric distribution company, PECO Energy Company. The Pennsylvania Electricity Generation Customer Choice and Competition Act permitted electric distribution utilities to recover their stranded costs from its customers in the form of a CTC. Rate recovery of the \$11,465 CTC payment began in 2000 and is expected to conclude in 2010.

Postretirement benefits include pension and other postretirement benefits. The pension costs include deferred net pension expense in excess of amounts funded which the Company believes will be recoverable in future years as pension funding is required, and in addition includes an additional minimum liability for pensions as a result of a decline in the fair market value of plan assets and a decline in the discount rate assumed for pension obligations. The additional minimum liability equals the excess of the accumulated benefit obligation over the fair value of plan assets. The regulatory asset related to postretirement benefits other than pensions represents costs that were deferred between the time that the accrual method of accounting for these benefits was adopted in 1993 and the recognition of the accrual method in the Company's rates as prescribed in subsequent rate filings. Amortization of the amount deferred for postretirement benefits other than pensions began in 1994 and is currently being recovered in rates.

The regulatory asset related to the recovery of merger costs represents the portion of the Consumers Water Company merger costs that will be recovered in rates as a result of a rate settlement in 2000 and is being amortized over the recovery period. Expenses associated with water tank painting are deferred and amortized over a period of time as approved in the regulatory process. 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 related to rate case filing expenses represents the costs associated with filing for rate increases that are deferred and amortized over periods that generally range from one to three years.

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

Income Taxes

The provision for income taxes consists of:

	Years Ended December 31,		
	2003	2002	2001
Current:			
Federal	\$ 11,933	\$ 16,619	\$ 18,935
State	7,249	6,647	5,106
	19,182	23,266	24,041
Deferred:			
Federal	25,521	17,921	13,048
State	1,220	859	1,887
	26,741	18,780	14,935
Total tax expense	\$ 45,923	\$ 42,046	\$ 38,976

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 5.50% to 9.99% for all years presented. The Company's Federal income tax returns for all years through 1999 have been closed.

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

	Years Ended December 31,		
	2003	2002	2001
Computed Federal tax expense at statutory rate	\$ 40,852	\$ 38,238	\$ 34,680
Increase in tax expense for depreciation expense to be recovered in future rates	1,125	558	452
Merger transaction costs	(96)	(680)	--
Charitable contribution	(424)	(98)	--
Deduction for Aqua America common dividends paid under employee benefit plan	(241)	(207)	--
Amortization of deferred investment tax credits	(285)	(283)	(276)
Prior year rate reductions	(431)	(315)	(322)
State income taxes, net of federal tax benefit	5,505	4,879	4,545
Other, net	(82)	(46)	(103)
Actual income tax expense	\$ 45,923	\$ 42,046	\$ 38,976

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

The tax effects of temporary differences between book and tax accounting that give rise to the deferred tax assets and deferred tax liabilities are as follows:

	December 31,	
	2003	2002
Deferred tax assets:		
Customers' advances for construction	\$ 17,133	\$ 17,787

Costs expensed for book not deducted for tax, principally accrued expenses	6,525	4,015
Utility plant acquisition adjustment basis differences	21,784	--
	-----	-----
Total gross deferred tax assets	45,442	21,802
	-----	-----
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	203,706	177,620
Deferred taxes associated with the gross-up of revenues necessary to recover, in rates, the effect of temporary differences	24,634	23,972
Deferred investment tax credit	6,618	6,903
Unrealized gain on marketable securities	141	83
Other	738	524
	-----	-----
Total gross deferred tax liabilities	235,837	209,102
	-----	-----
Net deferred tax liability	\$ 190,395	\$ 187,300
	=====	=====
Commitments		

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 are expected to approximate \$7,404 through 2008. The Company purchased approximately \$8,014, \$7,079 and \$5,807 of water under these agreements during the years ended December 31, 2003, 2002 and 2001, respectively.

The Company leases motor vehicles, buildings and other equipment under operating leases that are noncancelable. During the next five years, \$5,797 of future minimum lease payments are due: \$2,098 in 2004, \$1,647 in 2005, \$888 in 2006, \$615 in 2007 and \$549 in 2008. 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 2012 and 2052 and contain certain renewal provisions. Certain leases are subject to an adjustment every five years based on changes in the Consumer Price Index. During each of the next five years, approximately \$464 of lease payments for land, subject to the aforesaid adjustment, are due. The Company leases treatment plants to other parties under lease agreements that require payments to the Company of \$567 in 2004, \$567 in 2005, \$567 in 2006, \$267 in 2007 and \$308 in 2008.

Rent expense was \$2,993, \$2,182 and \$2,281 for the years ended December 31, 2003, 2002 and 2001, respectively.

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AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

Long-term Debt and Loans Payable

The Consolidated Statements of Capitalization provides a summary of long-term debt and loans outstanding as of December 31, 2003 and 2002. The supplemental indentures with respect to certain issues of the First Mortgage Bonds restrict the ability of Aqua Pennsylvania, Inc. and certain other operating subsidiaries of the Company to declare dividends, in cash or property, or repurchase or otherwise acquire the stock of these companies. As of December 31, 2003, approximately \$245,000 of Aqua Pennsylvania's retained earnings and \$52,000 of the retained earnings of certain other subsidiaries were free of these restrictions. Certain supplemental indentures also prohibit Aqua Pennsylvania and certain other subsidiaries of the Company from making loans to, or purchasing the stock of, the Company.

Annual sinking fund payments are required for certain issues of First Mortgage Bonds by the supplemental indentures. The future sinking fund payments and debt maturities of the Company's long-term debt are as follows:

Interest Rate Range	2004	2005	2006	2007	2008	Thereafter
0.00% to 2.49%	\$ 147	\$ 164	\$ 136	\$ 135	\$ 135	\$ 16,151
2.50% to 2.99%	13	21	22	22	22	18,813
3.00% to 3.49%	--	--	--	--	--	5,618
3.50% to 3.99%	400	400	400	400	400	800
4.00% to 4.99%	--	--	--	--	--	143,135
5.00% to 5.49%	70	70	75	75	80	110,505
5.50% to 5.99%	10,000	--	--	--	--	66,260
6.00% to 6.49%	15,000	--	644	144	10,172	94,360
6.50% to 6.99%	--	10,000	10,000	10,000	--	12,000
7.00% to 7.49%	12,040	28,040	2,040	2,040	2,040	516
7.50% to 7.99%	--	--	--	--	--	23,000
8.00% to 8.49%	--	--	--	--	--	17,500
8.50% to 8.99%	--	--	--	--	--	9,000
9.00% to 9.49%	561	568	576	584	594	50,922
9.50% to 9.99%	1,155	1,155	2,195	995	5,995	31,747
10.00% to 10.50%	--	--	--	--	--	6,000
Total	\$ 39,386	\$ 40,418	\$ 16,088	\$14,395	\$19,438	\$ 606,327

Aqua Pennsylvania has a five-year \$300,000 medium-term note program through December 2004 that provides for the issuance of long-term debt with maturities ranging between one and 35 years at fixed rates of interest, as determined at the time of issuance. The notes issued under this program are secured by the Thirty-Third Supplement to the trust indenture relating to Aqua Pennsylvania's First Mortgage Bonds. In June 2002, Aqua Pennsylvania issued First Mortgage Bonds through the program of \$25,000 5.93% Series due 2012. The proceeds from this issuance was used to fund acquisitions, to reduce the balance of Aqua Pennsylvania's short-term debt and for Aqua Pennsylvania's ongoing capital program.

In July 2003, the Company issued \$135,000 of unsecured notes due 2023 and with an interest rate of 4.87%. The proceeds of this financing was used to fund the acquisition of the AquaSource operations and to refinance existing debt. In July 2003, the Company also issued a \$90,000 unsecured note payable and the proceeds were also used to fund the acquisition of the AquaSource operations. In August 2003, the \$90,000 note payable was repaid with the proceeds from an equity offering. At various times during 2003, Aqua Pennsylvania, other operating subsidiaries and the Company issued other notes payable, first mortgage bonds and tax-exempt bonds in aggregate of \$27,894 at a weighted average interest rate of 4.50% due at various times ranging from 2013 to 2032. The proceeds from these issuances were used to reduce a portion of the balance of the short-term debt at each of the respective operating subsidiaries, to redeem \$7,000 of first mortgage bonds of operating subsidiaries with a weighted average interest rate of 6.35% and redeem the Company's preferred stock of \$172. As of December 31, 2003, the Trustees for four issues held \$28,438 pending completion of the projects financed with the issues and are reported in the consolidated balance sheet as funds restricted for construction activity. In connection with the acquisition of the AquaSource operations in July 2003, the Company assumed \$8,131 of long-term debt of which \$7,415 was retired during 2003.

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

In June 2002, Aqua Pennsylvania issued \$25,000 tax-exempt bonds due in 2032 at a rate of 5.55%. In December 2002, Aqua Pennsylvania issued \$25,000 tax-exempt bonds due in 2032 at a rate of 5.15%. The proceeds from the bonds issued are restricted to funding the costs of certain capital projects. At various times during 2002, Aqua Pennsylvania and other operating subsidiaries issued notes payable and tax-exempt bonds in aggregate of \$47,765 at a weighted average interest rate of 4.32% due at various times ranging from 2007 to 2032. The proceeds from these issuances were used to reduce a portion of the balance of the short-term debt at each of the respective operating subsidiaries, to redeem \$26,835 of First Mortgage Bonds of operating subsidiaries ranging from 3.75% to 5.6% and redeem Aqua America preferred stock of \$944. In connection with acquisitions completed in 2002, \$6,313 of long-term debt was assumed as a result of acquisitions at an interest rate of 1% due in various years. The

weighted average cost of long-term debt at December 31, 2003 and 2002 was 6.19% and 6.56%, respectively.

In October 2002, a 364-day note payable of \$22,000 was issued by the Company, the proceeds of which were used to repurchase shares of Aqua America common stock from Veolia Environnement, S.A. (formerly Vivendi Environnement, S.A.) Interest under this facility was based, at the borrower's option, on either a defined base rate or an adjusted London Interbank Offered Rate corresponding to the interest period selected. This note payable was redeemed in May 2003 with a portion of the proceeds from a common stock offering.

Aqua Pennsylvania has a \$70,000 364-day revolving credit facility with four banks and the Company has a \$20,000 364-day bank revolving credit facility. Funds borrowed under these agreements are classified as loans payable and are used to provide working capital. As of December 31, 2003 and 2002, funds borrowed under the Aqua Pennsylvania revolving credit agreements were \$52,068 and \$35,664, respectively, and \$19,801 and \$12,902 were borrowed under the Company's revolving credit agreement, respectively. Interest under these facilities 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. These agreements restrict the total amount of short-term borrowings of Aqua Pennsylvania and the Company. A commitment fee ranging from 1/4 to 1/10 of 1% is charged on the unused portion of the revolving credit agreements. The average cost of borrowing under these facilities was 1.6% and 2.3%, and the average borrowing was \$62,528 and \$63,529, during 2003 and 2002, respectively. The maximum amount outstanding at the end of any one month was \$73,079 in 2003 and \$83,836 in 2002.

At December 31, 2003 and 2002, the Company had combined short-term lines of credit of \$88,000 and \$90,000, respectively. Funds borrowed under these lines are classified as loans payable and are used to provide working capital. The average borrowing under the lines was \$50,353 and \$48,527 during 2003 and 2002, respectively. The maximum amount outstanding at the end of any one month was \$73,700 in 2003 and \$75,575 in 2002. 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 2003 and 2002 was 2.4% and 2.8%, respectively.

Interest income of \$395, \$287 and \$367 was netted against interest expense on the consolidated statements of income for the years ended December 31, 2003, 2002 and 2001, respectively. The total interest cost was \$45,057, \$40,683 and \$40,226 in 2003, 2002 and 2001, including amounts capitalized of \$2,127, \$1,389 and \$1,222, respectively.

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

Fair Value of Financial Instruments

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

	December 31,	
	2003	2002
Carrying amount	\$736,052	\$617,175
Estimated fair value	781,502	660,436

The fair value of long-term debt has been determined by discounting the future cash flows using current market interest rates for similar financial instruments of the same duration. The Company's customers' advances for construction and related tax deposits have a carrying value of \$72,500 and \$69,790 at December 31, 2003 and 2002, 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 2017 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.

Preferred Stock

At December 31, 2003, the Company had 1,770,819 shares of Series Preferred Stock with a \$1.00 par value authorized, of which 100,000 shares are designated as Series A Preferred Stock. During 1996, the Company designated and issued in connection with an acquisition 32,200 shares as Series B Preferred Stock, \$1.00 par value. The Series A Preferred Stock, as well as the undesignated shares of Series Preferred Stock, remains unissued. The Series B Preferred Stock was recorded on the consolidated balance sheet at its liquidation value of \$100 per share. All but 172 shares were liquidated during 2002, and in December 2003, the remaining 172 shares of Series B Preferred Stock were redeemed as provided under the provisions of the issue through the issuance of debt with a five-year maturity at an interest rate of 6.05% per annum. As of December 31, 2003, the Company did not have any preferred stock outstanding and has provided for all dividends accrued on the Series B Preferred Stock.

Stockholders' Equity

At December 31, 2003, the Company had 100,000,000 shares of common stock authorized; par value \$0.50. Shares outstanding at December 31, 2003, 2002 and 2001 were 92,589,040, 84,895,543 and 85,483,086, respectively. Treasury shares held at December 31, 2003, 2002 and 2001 were 681,384, 2,151,350 and 913,877, respectively.

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AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued) (In thousands of dollars, except per share amounts)

The following table summarizes the activity of common stockholders' equity:

	Common stock	Treasury stock	Capital in excess of par value	Retained earnings	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2000	\$ 27,260	\$ (15,346)	\$291,013	\$123,911	\$ 926	\$427,764
Net income	--	--	--	60,005	--	60,005
Other comprehensive income, net of income tax of \$19	--	--	--	--	39	39
Reclassification adjustment for gains reported in net income, net of income tax of \$127	--	--	--	--	(239)	(239)
Dividends	--	--	--	(34,234)	--	(34,234)
Stock split	6,829	--	(6,829)	--	--	--
Stock issued for acquisitions	133	--	5,228	--	--	5,361
Sale of stock	128	672	5,783	--	--	6,583
Repurchase of stock	--	(2,493)	--	--	--	(2,493)
Equity Compensation Plan	3	--	141	--	--	144
Exercise of stock options	297	--	6,642	--	--	6,939
Employee stock plans tax benefits	--	--	2,061	--	--	2,061
Balance at December 31, 2001	34,650	(17,167)	304,039	149,682	726	471,930
Net income	--	--	--	67,154	--	67,154
Other comprehensive income, net of income tax of \$56	--	--	--	--	104	104
Reclassification adjustment for gains reported in net income, net of income tax of \$412	--	--	--	--	(767)	(767)
Dividends	--	--	--	(36,789)	--	(36,789)
Stock issued for acquisitions	71	--	2,674	--	--	2,745
Sale of stock	161	855	6,220	--	--	7,236
Repurchase of stock	--	(24,109)	--	--	--	(24,109)
Equity Compensation Plan	15	--	598	--	--	613
Exercise of stock options	137	--	3,237	--	--	3,374
Employee stock plans tax benefits	--	--	1,103	--	--	1,103
Balance at December 31, 2002	35,034	(40,421)	317,871	180,047	63	492,594
Net income	--	--	--	70,785	--	70,785
Other comprehensive income, net of income tax of \$244	--	--	--	--	455	455
Reclassification adjustment for gains reported in net income, net of income tax of \$186	--	--	--	--	(347)	(347)
Dividends	--	--	--	(39,917)	--	(39,917)
Stock split	9,244	--	(9,244)	--	--	--
Sale of stock	2,168	29,163	99,031	--	--	130,362
Repurchase of stock	--	(1,353)	--	--	--	(1,353)
Equity Compensation Plan	8	--	344	--	--	352
Exercise of stock options	181	--	4,283	--	--	4,464
Employee stock plans tax benefits	--	--	723	--	--	723

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

In August 2003, the Company's Board of Directors declared a 5-for-4 common stock split to be effected in the form of a 25% stock distribution for all common shares outstanding, to shareholders of record on November 14, 2003. Common shares outstanding do not include shares held by the Company in treasury. The new shares were distributed on December 1, 2003. The Company's par value of \$0.50 per share remained unchanged and \$9,244 was transferred from Capital in Excess of Par Value to Common Stock to record the split. All share and per share data for all periods presented have been restated to give effect to the stock split.

In April 2003, the Company filed a universal shelf registration with the Securities and Exchange Commission to allow for the sale, over time, of up to \$250,000 of various debt and equity securities, including common stock. To date, the Company has issued common stock in two transactions under the universal shelf registration:

- o In May 2003, the Company issued 1,868,750 shares of common stock in a public offering for proceeds of \$33,100, net of expenses. The net proceeds were used to repay short-term debt, including the repayment of \$22,000 of indebtedness incurred in connection with the Company's repurchase of 1,513,275 shares of common stock from affiliates of Veolia Environnement, S.A. (formerly Vivendi Environnement, S.A.) in October 2002.
- o In August 2003, the Company issued 5,000,000 shares of common stock in a public offering for proceeds of \$90,100, net of expenses. The net proceeds were used to repay an unsecured note of \$90,000. The indebtedness was incurred by Aqua America in connection with the acquisition of the operations that were purchased from AquaSource, Inc.

The balance remaining available for use under the universal shelf registration as of December 31, 2003 is \$121,895. In addition, the Company has a shelf registration statement filed with the Securities and Exchange Commission to permit the offering from time to time of shares of common stock and shares of preferred stock for acquisitions. During 2002 and 2001, 178,664 and 414,638 shares of common stock totaling \$2,745 and \$5,361, respectively, were issued by the Company to acquire water and wastewater systems. The balance remaining available for use under the acquisition shelf registration as of December 31, 2003 is 2,218,947 shares. The form and terms of such securities shall be determined when and if these securities are issued under these shelf registrations.

In May 2002, Veolia Environnement, S.A. which through its affiliates (collectively "VE") owned approximately 16.8% of our outstanding common stock, advised the Company of their decision to sell its investment in Aqua America, Inc. VE announced that its decision was part of its overall strategy to divest non-core assets and focus on other business strategies. In September 2002, in order to facilitate the orderly re-distribution of the shares held by VE into the market, the Company completed a secondary offering of 12,356,570 shares of Aqua America common stock held by VE. The number of outstanding shares of common stock was not changed and the Company did not receive any proceeds as a result of this secondary offering. In addition, in October 2002 the Company repurchased 1,513,275 shares of Aqua America, Inc. common stock representing the remainder of the shares of Aqua America, Inc. common stock held by VE. The repurchase of shares was funded with proceeds of \$22,000 from a short-term credit facility. In May 2003, this \$22,000 short-term credit facility was repaid with a portion of the funds from the issuance of 1,868,750 shares of common stock through a shelf registration as described above.

In addition, the Board of Directors has authorized the Company to purchase its common stock, from time to time, in the open market or through privately negotiated transactions. The Company has not repurchased any shares under this authorization since 2000. As of December 31, 2003, 411,209 shares

remain available for purchase by the Company.

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

The Company has a Dividend Reinvestment and Direct Stock Purchase Plan ("Plan") that allows reinvested dividends to be used to purchase original issue 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 and the shares are purchased by the Company's transfer agent in the open-market at least weekly. During 2003, 2002 and 2001, under the dividend reinvestment portion of the Plan, 395,605, 402,084 and 379,883 original issue shares of common stock were sold providing the Company with proceeds of \$7,000, \$6,407 and \$5,980, respectively.

The Company reports comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income." Accordingly, the Company's accumulated other comprehensive income for unrealized gains on securities is reported in the Stockholders' Equity section of the Consolidated Balance Sheets and the related other comprehensive income is reported in the Consolidated Statements of Income and Comprehensive Income.

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 options is included in the computation of Diluted net income per share. The following table summarizes the shares, in thousands, used in computing Basic and Diluted net income per share:

	Years ended December 31,		
	2003	2002	2001
Average common shares outstanding during the period for Basic computation	88,275	85,674	84,841
Dilutive effect of employee stock options	969	864	1,102
Average common shares outstanding during the period for Diluted computation	89,244	86,538	85,943

Equity per common share was \$7.11 and \$5.80 at December 31, 2003 and 2002, respectively. These amounts were computed by dividing common stockholders' equity by the number of shares of common stock outstanding at the end of each year.

Shareholder Rights Plan

The Company has a Shareholder Rights Plan designed to protect the Company's shareholders in the event of an unsolicited unfair offer to acquire the Company. Each outstanding common share is entitled to one Right which is evidenced by the common share certificate. In the event that any person acquires 20% or more of the outstanding common shares or commences a tender or exchange offer which, if consummated, would result in a person or corporation owning at least 20% of the outstanding common shares of the Company, the Rights will begin to trade independently from the common shares and, if certain circumstances occur, including the acquisition by a person of 20% or more of the outstanding common shares, each Right would then entitle its holder to purchase a number of common shares of the Company at a substantial discount. If the Company is involved in a merger or other business combination at any time after the Rights become exercisable, the Rights will entitle the holder to acquire a certain number of shares of common stock of the acquiring company at a substantial discount. The Rights are redeemable by the Company at a redemption price of \$.01 per Right at any time before the Rights become exercisable. The Rights will expire on March 1, 2008, unless previously redeemed.

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

Employee Stock and Incentive Plan

Under the 1994 Equity Compensation Plan ("Plan"), the Company may grant qualified and non-qualified stock options to officers, key employees and consultants. Officers and key employees may also be granted dividend equivalents and restricted stock. Restricted stock may also be granted to non-employee members of the Board of Directors ("Board"). In May 2003, the Shareholders authorized a 3,500,000 share increase in the shares available for issuance under the Plan. The maximum number of shares that may be subject to grants under the Plan to any one individual in any one year is 150,000. Awards under this plan are made by a committee of the Board of Directors.

Options under the plan were issued at the 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 following table summarizes stock option transactions for the plan:

As of or For the Years Ended December 31,						
2003		2002		2001		
Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	
Options:						
Outstanding, beginning of year	2,830,133	\$ 12.06	2,559,763	\$ 10.66	2,829,754	\$ 8.55
Granted	613,654	16.98	617,813	16.64	669,599	15.28
Terminated	(15,533)	14.78	(8,265)	12.99	(22,729)	9.70
Exercised	(434,833)	10.28	(339,178)	9.82	(916,861)	7.51
Outstanding, end of year	2,993,421	\$ 13.31	2,830,133	\$ 12.06	2,559,763	\$ 10.66
Exercisable, end of year	1,756,300	\$ 11.01	1,555,483	\$ 9.70	1,269,635	\$ 8.63

Options exercised during 2003 ranged in price from \$4.38 per share to \$16.65 per share. At December 31, 2003, 4,984,151 options under the Plan were still available for grant. The following table summarizes the price ranges of the options outstanding and options exercisable as of December 31, 2003:

Range of prices:	Options Outstanding			Options Exercisable	
	Shares	Weighted Average Remaining Life (years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
\$ 4.56 - 7.99	419,291	2.3	\$ 6.18	419,291	\$ 6.18
\$ 8.00 - 9.99	320,558	6.3	9.39	320,558	9.39
\$10.00 - 12.99	489,839	4.9	11.10	489,839	11.10
\$13.00 - 15.99	556,918	7.3	15.28	338,294	15.28
\$16.00 - 16.99	1,084,944	8.8	16.65	188,318	16.65
\$17.00 - 18.34	121,871	9.4	18.32	--	--
	2,993,421	6.7	\$ 13.31	1,756,300	\$ 11.01

Under SFAS No. 123 "Accounting for Stock-Based Compensation" and SFAS No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure", the Company elects to continue to apply the provisions of APB Opinion No. 25 and to provide the pro forma disclosure provisions of this statement. Accordingly, no compensation cost has been recognized in the financial statements for stock options that have been granted. Pursuant to the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, pro forma net income available to common stock and earnings per share are presented in the Summary of Significant Accounting Policies - Stock-Based

Compensation as if compensation cost for stock options was determined as of the grant date under the fair value method.

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AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

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. During 2003, 2002 and 2001, 20,156, 37,031 and 9,844 shares of restricted stock were granted with a restriction period ranging from six to 36 months. The value of restricted stock awards, which are "compensatory", is equal to the fair market value of the stock on the date of the grant and is amortized ratably over the restriction period.

Pension Plans and Other Postretirement Benefits

The Company maintains a qualified, defined benefit pension plan that covers a majority of 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. To offset certain limitations imposed by the Internal Revenue Code with respect to payments under qualified plans, the Company has a non-qualified Excess Benefit Plan for Salaried Employees in order to prevent certain employees from being penalized by these limitations. The Company also has non-qualified Supplemental Executive Retirement Plans for certain 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 addition to providing pension benefits, the Company offers certain Postretirement Benefits other than Pensions ("PBOPs") to employees hired before April 1, 2003 and retiring with a minimum level of service. These PBOPs include continuation of medical and prescription drug benefits for eligible retirees and life insurance benefits for certain eligible retirees. The Company funds its gross PBOP cost through various trust accounts. The benefits of retired officers and certain other retirees are paid by the Company and not from plan assets due to limitations imposed by the Internal Revenue Code.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") was signed into law which would provide plan sponsors a federal subsidy for certain qualifying prescription drug benefits covered under the sponsor's postretirement health care plans. The Company is currently reviewing the impact of the Act and has elected to defer recognition of the benefit to its postretirement health care plans in accordance with FASB Staff Position No. 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." Any measures of accumulated postretirement benefit obligation and net periodic PBOP cost for the year ended December 31, 2003 do not reflect the effects of the Act. Currently, specific authoritative accounting guidance for the federal subsidy is pending and that guidance when issued may require the Company to change previously reported information.

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AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

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:

Other

	Pension Benefits		Postretirement Benefits	
	2003	2002	2003	2002
Change in benefit obligation:				
Benefit obligation at January 1,	\$131,059	\$119,667	\$ 25,436	\$ 22,317
Service cost	3,627	3,205	987	840
Interest cost	8,999	8,501	1,703	1,620
Plan amendments	--	170	--	--
Actuarial loss	12,222	5,104	1,978	1,574
Plan participants' contributions	--	--	513	342
Benefits paid	(5,809)	(5,588)	(1,483)	(1,257)
Benefit obligation at December 31,	150,098	131,059	29,134	25,436
Change in plan assets:				
Fair value of plan assets at January 1,	94,438	113,330	12,200	12,216
Actual return on plan assets	20,021	(13,369)	816	(1,168)
Employer contributions	81	65	2,345	2,067
Benefits paid	(5,809)	(5,588)	(970)	(915)
Fair value of plan assets at December 31,	108,731	94,438	14,391	12,200
Funded status of plan:				
Funded status at December 31,	41,367	36,621	14,743	13,236
Unrecognized actuarial loss	(29,164)	(30,471)	(4,857)	(2,839)
Unrecognized prior service cost	(1,942)	(2,337)	590	647
Unrecognized net transition obligation	1,227	1,436	(7,231)	(8,034)
Accrued benefit costs	\$ 11,488	\$ 5,249	\$ 3,245	\$ 3,010

The Company's pension plans had an accumulated benefit obligation of \$121,521 and \$106,053 at December 31, 2003 and 2002, respectively. The following table provides the net liability recognized on the Consolidated Balance Sheets at December 31,:

	Pension Benefits		Other Postretirement Benefits	
	2003	2002	2003	2002
Prepaid benefits cost	\$ --	\$ 1,919	\$ 937	\$ 1,225
Accrued benefit cost	(11,488)	(7,168)	(4,182)	(4,235)
Additional minimum liability	(2,003)	(5,989)	--	--
Intangible assets	1,962	1,258	--	--
Accumulated other comprehensive income	41	4,731	--	--
Net liability recognized	\$ (11,488)	\$ (5,249)	\$ (3,245)	\$ (3,010)

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

At December 31, 2003 and 2002, 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	
	2003	2002
Projected benefit obligation	\$ 150,098	\$ 131,059
Fair value of plan assets	108,731	94,438

Accumulated Benefit
Obligation Exceeds
the Fair Value of
Plan Assets

	2003	2002
Accumulated benefit obligation	\$ 121,521	\$ 84,756
Fair value of plan assets	108,731	72,551

*2002 data in this table excludes pension plan with plan assets in excess of accumulated benefit obligation.

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

	Pension Benefits			Other Postretirement Benefits		
	2003	2002	2001	2003	2002	2001
Service cost	\$ 3,627	\$ 3,205	\$ 2,986	\$ 987	\$ 840	\$ 705
Interest cost	8,999	8,501	8,261	1,703	1,620	1,427
Expected return on plan assets	(7,775)	(9,945)	(10,891)	(917)	(953)	(947)
Amortization of transition obligation (asset)	(209)	(209)	(110)	803	803	803
Amortization of prior service cost	395	414	432	(57)	(57)	(57)
Amortization of actuarial (gain) loss	1,282	(2)	(528)	62	(5)	(179)
Amortization of regulatory asset	--	--	-	136	136	136
Capitalized costs	(205)	(66)	(49)	(598)	(520)	(475)
Rate-regulated adjustment	--	--	(553)	--	--	--
Net periodic benefit cost	\$ 6,114	\$ 1,898	\$ (452)	\$ 2,119	\$ 1,864	\$ 1,413

The rate-regulated adjustment set forth above is required for 2001 in order to reflect pension expense (credit) for the Company in accordance with the method used in establishing water rates.

Accounting for pensions and other postretirement 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 postretirement benefit expense that the Company recognizes.

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AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

The significant assumptions related to the Company's pension and other postretirement benefit plans are as follows:

	Pension Benefits		Other Postretirement Benefits	
	2003	2002	2003	2002
Weighted-average Assumptions Used to Determine Benefit Obligations as of December 31,				
Discount rate	6.25%	6.75%	6.25%	6.75%
Rate of compensation increase	4.0-5.0%	4.0-5.0%	4.0%	4.0%
Assumed Health Care Cost Trend Rates Used to Determine Benefit Obligations as of December 31,				
Health care cost trend rate	n/a	n/a	10%	10%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	n/a	n/a	5%	5%
Year that the rate reaches the ultimate trend rate	n/a	n/a	2009	2006
Weighted-average Assumptions Used to Determine Net Periodic Benefit				

Costs for Years Ended December 31,				
Discount rate	6.75%	7.25%	6.75%	7.25%
Expected return on plan assets	8.50%	9.00%	6.0-9.0%	6.0-9.0%
Rate of compensation increase	4.0-5.0%	4.0-5.0%	4.0%	4.0%
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	10%	12%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	n/a	n/a	5%	5%
Year that the rate reaches the ultimate trend rate	n/a	n/a	2006	2006

n/a - Assumption is not applicable to pension benefits.

Assumed health-care trend rates have a significant effect on the expense and liabilities for other postretirement benefit plans. The health care trend rate is based on historical rates and expected market conditions. A one-percentage point change in the expected 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 postretirement benefit obligation	\$ 949 =====	\$ (860) =====
Effect on total service and interest cost components of net periodic postretirement health-care benefit cost	\$ 103 =====	\$ (95) =====

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AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

The discount rate is based on a market rate for a recognized-rating agency's high-quality long-term bond portfolio with durations matching the expected payouts under our retirement plans. The Company's pension expense and liability (benefit obligations) increases as the discount rate is reduced.

The Company's expected return on 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 pension expense increases as the expected return on assets decreases. 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 Lehman Brothers Intermediate Government/Credit Index, and a combination of the two indices. The Pension Committee of the Board of Directors 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 category are as follows:

	2004 Target Allocation	Percentage of Plan Assets at December 31,	
		-----	-----
	-----	2003	2002
	-----	-----	-----
Asset Category:			
Equity securities	65%	66%	63%
Debt securities	35%	32%	35%
Cash	0%	2%	2%
	-----	-----	-----
Total	100%	100%	100%
	=====	=====	=====

Equity securities include Aqua America, Inc. common stock in the amounts of \$6,469 or 5.9% of total plan assets and \$4,701 or 5.0% of total plan assets as of December 31, 2003 and 2002, respectively.

The asset allocation for the Company's other postretirement benefit plans and the target allocation by asset category are as follows:

Asset Category:	2004 Target Allocation -----	Percentage of Plan Assets at December 31, -----	
		2003 -----	2002 -----
Cash	65%	64%	64%
Equity securities	35%	36%	36%
	-----	-----	-----
Total	100%	100%	100%
	=====	=====	=====

Funding requirements for qualified defined benefit pension plans are determined by government regulations and not by accounting pronouncements. In accordance with funding rules, during 2004 our pension contribution is expected to be \$5,371.

As of December 31, 2003, the Company has an additional minimum liability of \$41 associated with our defined benefit plan. The additional minimum liability is a result of the accumulated benefit obligation exceeding the fair value of plan assets and results in the establishment of a regulatory asset, as the Company anticipates recovery of the future, increased pension expense through customer rates. An additional minimum liability of \$4,731 was initially recorded on December 31, 2002 as a result of a decline in pension plan assets and a decrease in the assumed discount rate which resulted in an increase in pension liabilities. The change in the additional minimum liability from December 31, 2002 to December 31, 2003 resulted from an increase in the pension plan assets during 2003 due to positive equity market performance, offset partially by the effect of a decreased discount rate.

AQUA AMERICA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)
(In thousands of dollars, except per share amounts)

The Company has 401(k) savings plans that cover substantially all employees. The Company makes matching contributions that are invested in Aqua America, Inc. common stock based on a percentage of an employee's contribution, subject to certain limitations. The Company's matching contribution, recorded as compensation expense, was \$921, \$859 and \$798 for the years ended December 31, 2003, 2002 and 2001, respectively.

Water and Wastewater Rates

In November 2003, the Company's Pennsylvania operating subsidiary, Aqua Pennsylvania, Inc., filed an application with the Pennsylvania Public Utility Commission ("PAPUC") requesting a \$25,300 or 10.2% increase in annual revenues. The application is currently pending before the PAPUC and a final determination is anticipated by August 2004.

On August 1, 2002, the PAPUC granted Aqua Pennsylvania, Inc. a \$21,226 or 10.2% base rate increase. The rates in effect at the time of the filing included \$9,400 in Distribution System Improvement Charges ("DSIC") at 5.0%. Consequently, the total base rates increased by \$30,626 and the DSIC was reset to zero.

The Company's other operating subsidiaries were allowed annual rate increases of \$1,275 in 2003, \$3,024 in 2002 and \$4,799 in 2001, represented by eight, thirteen and nine rate decisions, respectively. Revenues from these increases realized in the year of grant were approximately \$839, \$1,403 and \$4,200 in 2003, 2002 and 2001, respectively.

Four states in which the Company operates permit water utilities, and in some 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 and Indiana allow for the use of infrastructure rehabilitation surcharges. These mechanisms typically adjust periodically based on additional qualified capital expenditures completed or anticipated in a future period. The infrastructure rehabilitation surcharge is capped as a percentage of base rates, generally 5% of base rates, 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. Infrastructure rehabilitation surcharges provided revenues in 2003, 2002 and 2001 of \$8,147, \$5,518 and \$6,672, respectively.

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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
2003					
Operating revenues	\$ 80,489	\$ 83,379	\$102,153	\$101,212	\$367,233
Operations and maintenance expense	30,664	31,029	36,777	42,132	140,602
Net income available to common stock	13,324	15,235	23,620	18,606	70,785
Basic net income per common share	0.16	0.18	0.26	0.20	0.80
Diluted net income per common share	0.16	0.18	0.26	0.20	0.79
Dividend paid per common share	0.112	0.112	0.112	0.120	0.456
Dividend declared per common share	0.112	0.112	0.232	--	0.456
Price range of common stock					
- high	17.83	19.85	20.07	22.40	22.40
- low	15.77	17.22	18.28	18.71	15.77
2002					
Operating revenues	\$ 71,669	\$ 76,615	\$ 91,918	\$ 81,826	\$322,028
Operations and maintenance expense	27,285	28,915	31,143	30,392	117,735
Net income available to common stock	11,875	14,818	21,815	18,646	67,154
Basic net income per common share	0.14	0.17	0.25	0.22	0.78
Diluted net income per common share	0.14	0.17	0.25	0.22	0.78
Dividend paid per common share	0.106	0.106	0.106	0.112	0.430
Dividend declared per common share	0.106	0.106	0.218	--	0.430
Price range of common stock					
- high	19.69	20.00	16.24	17.50	20.00
- low	16.88	14.79	12.82	15.44	12.82

All per share data as presented has been adjusted for the 2003 5-for-4 common stock split effected in the form of a 25% stock distribution. High and low prices of the Company's common stock are as reported on the New York Stock Exchange Composite Tape. The cash dividends paid in December 2003 of \$0.12 and December 2002 of \$0.112 were declared in August 2003 and August 2002, respectively.

Beginning August 1, 2003, the financial results for the operations acquired in the AquaSource acquisition have been included in the Company's consolidated financial statements.

Net income available to common stock and net income per share for the fourth quarter of 2002 includes a net gain of \$3,690 (\$5,676 pre-tax) or \$0.04 per share on the sale of a portion of our Ashtabula, Ohio water system.

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Summary of Selected Financial Data

Aqua America, Inc. and Subsidiaries

(in thousands of dollars, except per share amounts)

Years ended December 31,	2003 (a)	2002*	2001*	2000*	1999*
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PER COMMON SHARE:

Income from operations before non-recurring items: (b)					
Basic	\$0.80	\$0.74	\$0.71	\$0.62	\$0.56
Diluted	0.79	0.73	0.70	0.62	0.56
Net income (b)					
Basic	0.80	0.78	0.71	0.65	0.45
Diluted	0.79	0.78	0.70	0.65	0.45
Cash dividends paid	0.46	0.43	0.40	0.38	0.36
Cash dividends declared	0.46	0.43	0.40	0.38	0.36
Return on average stockholders' equity (b)	12.3%	13.9%	13.3%	13.2%	10.1%
Book value at year end	\$7.11	\$5.80	\$5.52	\$5.10	\$4.55
Market value at year end	22.10	16.48	18.04	15.68	10.59

INCOME STATEMENT HIGHLIGHTS:

Operating revenues	\$367,233	\$322,028	\$307,280	\$274,014	\$256,546
Depreciation and amortization	51,463	44,322	40,168	34,100	31,903
Interest expense, net (c)	42,535	39,007	38,637	37,775	31,796
Income before income taxes	116,718	109,252	99,087	86,995	62,915
Provision for income taxes	45,923	42,046	38,976	34,105	26,531
Net income available to common stock (b)	70,785	67,154	60,005	52,784	36,275

BALANCE SHEET HIGHLIGHTS:

Total assets	\$2,069,736	\$1,717,069	\$1,555,108	\$1,413,723	\$1,280,805
Property, plant and equipment, net	1,824,291	1,486,703	1,364,282	1,249,652	1,135,230
Stockholders' equity	659,030	493,097	472,717	430,587	367,141
Long-term debt, including current portion	736,052	617,175	531,455	472,712	425,946
Total debt	832,511	732,288	641,123	573,706	529,015

ADDITIONAL INFORMATION:

Net cash flows from operating activities	\$143,373	\$121,560	\$102,165	\$86,972	\$74,103
Capital additions	163,320	136,164	124,088	129,740	96,383
Cash expended for acquisitions of utility systems	192,331	8,914	9,517	3,546	39,164
Dividends on common stock	39,917	36,789	34,234	30,406	29,217
Number of customers served	749,491	605,474	587,537	565,146	548,937
Number of shareholders of common stock	22,726	21,389	20,920	20,978	21,187
Common shares outstanding (000)	92,589	84,896	85,483	83,869	80,103
Employees (full-time)	1,260	971	951	943	945

*Share and per share data has been restated for the 2003 5-for-4 stock split.

- (a) Beginning August 1, 2003, the financial results for the operations acquired in the AquaSource acquisition have been included in Aqua America's consolidated financial statements.
- (b) Income per share from operations before non-recurring items is a measure that is not determined in accordance with GAAP and may not be comparable to similarly titled measures reported by other companies. This Non-GAAP measure should not be considered as an alternative to net income per share as determined in accordance with GAAP. We believe that this is useful as an indicator of operating performance, as we measure it for management purposes, because it provides a better understanding of our results of operations by highlighting our ongoing operations and the underlying profitability of our core business. Non-recurring items include the following: the 2002 amounts include a net gain of \$3,690 (\$5,676 pre-tax) or \$0.04 per share on the sale of a portion of our Ashtabula, Ohio water system; the 2000 amounts include a net gain of \$2,236 (\$4,041 pre-tax) or \$0.03 per share for the partial recovery of the merger costs related to the merger with Consumers Water Company; and the 1999 amounts include a net charge of \$8,596 (\$10,121 pre-tax) or \$0.11 per share for the merger transaction costs and related restructuring costs.
- (c) Includes dividends on preferred stock of subsidiary and minority interest; net of allowance for funds used during construction.

AQUA AMERICA, INC. AND SUBSIDIARIES

The following table lists the significant subsidiaries and other active subsidiaries of Aqua America, Inc. at December 31, 2003:

Aqua Pennsylvania, Inc. (Pennsylvania)
Aqua Resources, Inc. (Pennsylvania)
Aqua Services, Inc. (Delaware)
Consumers Oho Water Company (Ohio)
Aqua Illinois, Inc. (Illinois)
Aqua New Jersey, Inc. (New Jersey)
Aqua Maine, Inc. (Maine)
Aqua North Carolina, Inc. (North Carolina)
Aqua Texas, Inc. (Texas)
Aqua Indiana, Inc. (Indiana)
Aqua Utilities, Inc. (Texas)
Aqua Virginia, Inc. (Virginia)
Aqua Utilities Florida, Inc. (Florida)
Aqua Missouri, Inc. (Missouri)
Aqua South Carolina, Inc. (South Carolina)

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 333-61772, 333-42275 and 333-104290), on Form S-4 (No. 333-93243), and on Form S-8 (Nos. 333-61768, 333-70859, 033-52557, 33-27032, 2-81757, 333-81085, 333-107673 and 333-113502) of Aqua America, Inc. of our report dated January 28, 2004 relating to the consolidated financial statements, which appears in the Annual Report to Shareholders, which is incorporated in this Annual Report on Form 10-K.

PRICEWATERHOUSECOOPERS LLP

PricewaterhouseCoopers LLP

Philadelphia, Pennsylvania
March 12, 2004

CERTIFICATION

I, Nicholas DeBenedictis, Chairman, President and Chief Executive Officer of Aqua America, Inc., certify that:

1. I have reviewed this annual report on Form 10-K of Aqua America, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) [Paragraph omitted in accordance with SEC transition instructions contained in SEC Release 34-47986.]
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures, and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting, and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 12, 2004

NICHOLAS DEBENEDICTIS

Nicholas DeBenedictis
Chairman, President and Chief Executive Officer

CERTIFICATION

I, David P. Smeltzer, Senior Vice President - Finance and Chief Financial Officer of Aqua America, Inc., certify that:

1. I have reviewed this annual report on Form 10-K of Aqua America, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) [Paragraph omitted in accordance with SEC transition instructions contained in SEC Release 34-47986.]
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures, and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting, and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 12, 2004

DAVID P. SMELTZER

David P. Smeltzer

Senior Vice President - Finance and Chief Financial Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350

In connection with the Annual Report on Form 10-K for the year ended December 31, 2003 of Aqua America, Inc. (the "Company") as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Nicholas DeBenedictis, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78m(a) or Section 78o(d)); and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

NICHOLAS DEBENEDICTIS

Nicholas DeBenedictis
Chairman, President and Chief Executive Officer
March 12, 2004

The foregoing certification shall not be deemed to be filed for purposes of Section 18 of the Securities and Exchange Act of 1934 or otherwise subject to liability under that section. This certification shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Exchange Act except to the extent this Exhibit 32.1 is expressly and specifically incorporated by reference in any such filing.

A signed original of this written statement required by 18 U.S.C. Section 1350 has been provided to Aqua America, Inc. and will be retained by Aqua America, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350

In connection with the Annual Report on Form 10-K for the year ended December 31, 2003 of Aqua America, Inc. (the "Company") as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David P. Smeltzer, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78m(a) or Section 78o(d)); and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

DAVID P. SMELTZER

David P. Smeltzer
Senior Vice President - Finance and Chief Financial Officer
March 12, 2004

The foregoing certification shall not be deemed to be filed for purposes of Section 18 of the Securities and Exchange Act of 1934 or otherwise subject to liability under that section. This certification shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Exchange Act except to the extent this Exhibit 32.2 is expressly and specifically incorporated by reference in any such filing.

A signed original of this written statement required by 18 U.S.C. Section 1350 has been provided to Aqua America, Inc. and will be retained by Aqua America, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.