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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, 2006

Commission File number 1-6659

AQUA AMERICA, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania	23-1702594
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
762 W. Lancaster Avenue, Bryn Mawr, Pennsylvania	19010-3489
(Address of principal executive offices)	(Zip Code)
Registrant's telephone number, including area code:	(610) 527-8000

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 if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ☑ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes ☐ No ☑

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

Indicate by check mark 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 amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12(b)-2 of the Exchange Act.:
Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2006:
$2,973,777,262

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, 2006, 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 the registrant's common stock as of February 9, 2007:
132,344,394

DOCUMENTS INCORPORATED BY REFERENCE

(1) Portions of registrant's 2006 Annual Report to Shareholders have been incorporated by reference into Parts I and II of this Form 10-K.

(2) Portions of the Proxy Statement, relative to the May 24, 2007 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.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Annual Report on Form 10-K ("10-K"), or incorporated by reference into 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 that are 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," "probably," "predictions," "continue" or the negative of such terms or similar expressions. Forward-looking statements in this 10-K, or incorporated by reference into this 10-K, include, but are not limited to, statements regarding:

- projected capital expenditures and related funding requirements;
- developments, trends and consolidation in the water and wastewater utility industries;
- dividend payment projections;
- opportunities for future acquisitions, the success of pending acquisitions and the impact of future acquisitions;
- the capacity of our water supplies, water facilities and wastewater facilities;
- the impact of geographic diversity on our exposure to unusual weather;
- our capability to pursue timely rate increase requests;
- our authority to carry on our business without unduly burdensome restrictions;
- our ability to obtain fair market value for condemned assets;
- the impact of fines and penalties;
- the development of new services and technologies by us or our competitors;
- the availability of qualified personnel;
- the condition of our assets;
- the impact of legal proceedings;
- general economic conditions;
- acquisition-related costs and synergies; and
- 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 2006 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:

- changes in general economic, business and financial market conditions;
- changes in government regulations and policies, including environmental and public utility regulations and policies;
- changes in environmental conditions, including those that result in water use restrictions;
- abnormal weather conditions;

- changes in, or unanticipated, capital requirements;
- changes in our credit rating or the market price of our common stock;
- our ability to integrate businesses, technologies or services which we may acquire;
- our ability to manage the expansion of our business;
- the extent to which we are able to develop and market new and improved services;
- the effect of the loss of major customers;
- our ability to retain the services of key personnel and to hire qualified personnel as we expand;
- labor disputes;
- increasing difficulties in obtaining insurance and increased cost of insurance;
- cost overruns relating to improvements or the expansion of our operations;
- increases in the costs of goods and services;
- civil disturbance or terroristic threats or acts; and
- changes in accounting policies.

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 into 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, and assume no obligation, to update these forward-looking statements, even though our situation may change in the future. For further information or other factors which could affect our financial results and such forward-looking statements, see "Risk Factors." We qualify all of our forward-looking statements by these cautionary statements.

PART I

Item 1. Business

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 what we estimate to be approximately 2.8 million people in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, New York, Florida, Indiana, Virginia, Maine, Missouri and South Carolina. Our largest operating subsidiary, Aqua Pennsylvania, Inc., accounted for approximately 55% of our operating revenues for 2006 and as of December 31, 2006, provided water or wastewater services to approximately one-half of the total number of people we serve, and is located in the suburban areas north and west of the City of Philadelphia and in 23 other counties in Pennsylvania. Our other subsidiaries provide similar services in 12 other states. In addition, we provide water and wastewater services through operating and maintenance contracts with municipal authorities and other parties, and septage hauling services, close to our utility companies’ service territories.

The following table reports our operating revenues by principal state for the year ended December 31, 2006:

	Operating Revenues (000's)	Operating Revenues (%)
Pennsylvania	$ 291,580	54.7%
Texas	46,293	8.7%
Ohio	39,670	7.4%
Illinois	37,792	7.1%
North Carolina	32,140	6.0%
New Jersey	23,879	4.5%
Florida	16,756	3.1%
Indiana	16,640	3.1%
Virginia	10,347	1.9%
Maine	9,798	1.8%
Other states	1,398	0.4%
Regulated segment total	526,293	98.7%
Other	7,198	
Consolidated	$ 533,491	

The following table summarizes our operating revenues, by utility customer class, for the year ended December 31, 2006:

	Operating Revenues (000's)	Operating Revenues (%)
Residential water	$ 317,770	59.6%
Commercial water	76,076	14.3%
Fire protection	23,831	4.5%
Industrial water	18,752	3.5%
Other water	27,432	5.1%
Water	463,861	87.0%
Wastewater	48,907	9.2%
Other	13,525	2.5%
Regulated segment total	526,293	98.7%
Other	7,198	1.3%
Consolidated	$ 533,491	100.0%

Our utility customer base is diversified among residential, commercial, fire protection, industrial, other water, wastewater customers and certain operating contracts that are integral and closely associated with the utility operations. Residential customers make up the largest component of our utility customer base, with these customers representing 69% of our 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 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 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, Water Facilities and Wastewater Facilities" for a discussion of water use restrictions that may impact water consumption during abnormally dry weather. The geographic diversity of our utility customer base reduces our exposure to extreme or unusual weather conditions in any one area of our service territory.

Our growth in revenues over the past three years is primarily a result of increases in our utility customer base and in water and wastewater rates. The majority of the increase in utility customer base is due to customers added through acquisitions. During the three-year period of 2000 through 2002, our utility customer base increased at an annual compound rate of 3.3%. The utility customer growth rate in 2003 was 23.8%, and reflects the additional customers obtained in the AquaSource acquisition on July 31, 2003. In 2004, the utility customer growth rate was 11.5% and reflects the additional customers added through the Heater and Florida Water Services acquisitions. In 2005, the utility customer growth rate was 3.5%. In 2006, the utility customer growth rate was 7.2%, including 44,792 customers associated with the New York Water Service Corporation acquisition which was completed on January 1, 2007. Overall, for the five-year period of 2002 through 2006, our utility customer base increased at an annual compound rate of 9.6% including the customers associated with the New York Water Service Corporation acquisition which was completed on January 1, 2007.

Acquisitions and Water Sale Agreements

With approximately 53,000 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 approximately 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 (government-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 13 states where we operate. In 2006 and 2005, we acquired six businesses providing on-site septic tank pumping and other wastewater-related services. These businesses presently serve customers in eastern Pennsylvania, New Jersey, Delaware, New York and Maryland, and accounted for $5,424,000 of our operating revenues for the year ended December 31, 2006.

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:

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

We are actively exploring opportunities to expand our utility operations through acquisitions or other growth ventures. During the five-year period ended December 31, 2006, we completed 131 acquisitions or other growth ventures, including the New York Water Service Corporation acquisition.

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 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 prospective sellers, performing analyses and investigations of acquisition candidates, making preliminary acquisition proposals and negotiating the terms of potential acquisitions.

Water Supplies, Water Facilities and Wastewater 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 by principal service area are as follows:

- Pennsylvania — The principal supply of water is surface water from streams, rivers and reservoirs. Wells and interconnections with adjacent municipal authorities supplement these surface supplies. There are 11 surface water treatment plants.

- 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 obtained through an interconnection with an adjacent water utility. Water supply is obtained for customers in Stark, Williams, Richland and Summit counties from wells. In Trumbull County, customers are served from surface water sources, including an interconnection from our Pennsylvania division.

- North Carolina — Water supply in approximately 700 non-contiguous divisions is obtained principally from wells, with several divisions purchasing water from neighboring municipalities.

- 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 and groundwater sources. In Will, Lee, Boone, Lake and Knox counties, our customers are served from wells. In some areas, water supply is supplemented with purchased water obtained through interconnections with adjacent water utilities.

- Texas — Water supply in 295 non-contiguous water systems is obtained principally from wells, supplemented in some cases by purchased water from adjacent water systems.

- Florida — Water supply in the majority of the 70 non-contiguous divisions is obtained principally from wells, supplemented in some cases by purchased water from adjacent water systems.

- New Jersey — Water supply is obtained principally from wells and the supply is supplemented with purchased water obtained through interconnections with adjacent water systems.

- New York — Water supply for five systems is obtained from wells.

- Indiana — Water supply in three water systems is obtained principally from wells.

- Virginia — Water supply in 127 non-contiguous divisions is obtained from wells, one division's supply is from surface water, and four divisions supplement their supply with purchased water from a nearby water system.

- Maine — Eleven non-contiguous water systems obtain their water supply as follows: six systems use groundwater, four 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 under normal conditions. We plan 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.

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 2006, portions of central and northern Texas experienced severe drought conditions. This necessitated the imposition of water use restrictions on approximately a dozen of our water systems in Texas, and at times required supplemental water to be trucked into a small number of systems in the Fort Worth area. In other parts of the state, dry weather increased water sales.

We believe that our wastewater treatment facilities are generally adequate to meet the present requirements of our customers. In addition, we own several sewer collection systems where the wastewater is treated at a municipally-owned facility. Capital funds are included in our capital plans to address inflow and infiltration in the collection systems, wet weather flows at our lift stations and treatment plants, and other conditions and requirements that can affect compliance. Changes in regulatory requirements may be reflected in revised permit limits and conditions when National Pollution Discharge Elimination System ("NPDES") permits are renewed, typically on a five-year cycle. Capital improvements are planned and budgeted to meet anticipated changes in regulations and needs for increased capacity related to projected growth. The various state public utility commissions have generally recognized the operating and capital costs associated with these improvements in setting wastewater rates for current customers and capacity charges for new customers.

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. 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 other financings, and the franchise areas that we serve. A small number of our operations are subject to rate regulation by county or city governments. The profitability of our utility operations is influenced to a great extent by the timeliness and adequacy of rate allowances we are granted by the respective regulatory commissions or authorities 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. We file rate increase requests to recover the capital investments that we make in improving or replacing our facilities and to recover expenses. In the states in which we operate, we are subject to economic regulation by the following state regulatory commissions:

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

All of the states in which we acquired operations in 2004 and 2003 permit some form of consolidated rates in varying degrees, but none currently permits us to fully consolidate rate filings state-wide. Between August 2003 and December 2006, we have filed rate filings for over 121 operating divisions. Due to the length of time since the last rate increase for some acquired systems and the large amount of capital improvements relative to the number of customers in some smaller systems, the proposed rate increase in some of these systems may be substantial. While each of these rate filings will proceed through the applicable regulatory process, we can provide no assurance that the rate increases will be granted in a timely or sufficient manner to cover the investments and expenses for which we initially sought the rate increases. Further, there remain 20 divisions within these acquired operations where we have not yet filed a rate request.

Six states in which we operate permit water utilities, and in two 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 surcharge 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 changes in certain costs, such as changes in state tax rates, other taxes and purchased water, until such time as the costs are incorporated into base rates.

Currently, Pennsylvania, Illinois, Ohio, New York, Indiana and Missouri 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 at a percentage of base rates, generally at 5% to 9% 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 $7,873,000 in 2006, $10,186,000 in 2005 and $7,817,000 in 2004.

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 regulated 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:

- eminent domain;
- the right of purchase given or reserved by a municipality or political subdivision when the original franchise was granted; and
- 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. 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.

In December 2004, as a result of the settlement of a condemnation action, our Ohio operating subsidiary sold its water utility assets within the municipal boundaries of the City of Geneva in Ashtabula County, Ohio for net proceeds of approximately $4,716,000, which was in excess of the book value for these assets. The sale resulted in the recognition in 2004 of a pre-tax gain on the sale of these assets, net of expenses, of $2,342,000. We continue to operate this water system for the City of Geneva under a multi-year operating contract that expires in December 2008. These water utility assets represented less than 1% of Aqua America's total assets, and the total number of customers included in the water system sold represented less than 1% of our total customer base. The increase in earnings associated with reinvesting the sale's proceeds and the operating income generated by the operating contract have offset the loss of this water system's historic contribution to income.

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 2003. We have challenged whether the City is following the correct legal procedures in connection with the City's attempted condemnation and we have challenged the City's valuation of this portion of our system. The portion of the system under consideration represents approximately 1% of our total customer base. While we continue to discuss this matter with officials from the City of Fort Wayne, we continue to legally protect our interests in this proceeding.

A sanitary district in Illinois and a city in Texas have also indicated interest in the acquisition, by eminent domain or otherwise, of all or a portion of the utility assets of two of our operations. Together, the systems represent approximately 3,000 customers or less than 0.5% of our total customer base. We believe that our operating subsidiaries are entitled to fair market value for these assets.

Despite the sales and possible condemnations referred to above, 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, Health and Safety 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.

Environmental compliance issues remain at various water and wastewater facilities associated with acquired systems, including facilities acquired in connection with the AquaSource acquisition completed in 2003, the Heater and Florida Water Service acquisitions completed in 2004 and the acquisitions of small utilities in Northeastern Pennsylvania over the past several years. We believe that the capital expenditures required to address these compliance issues have been budgeted in our capital program and represent less than 10% of our expected total capital expenditures over the next five years. We are parties to agreements with regulatory agencies in Texas, Florida, Indiana, Virginia and North Carolina under which we have committed to make certain improvements for environmental compliance. These agreements are intended to provide the regulators with assurance that problems covered by these agreements will be addressed, and the agreements generally provide protection to us from fines, penalties and other actions while corrective measures are being implemented. We are actively working directly with state environmental officials to implement or amend these agreements as necessary.

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 made and are making 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.

The EPA's issuance of a rule regulating radon in tap water has been postponed repeatedly since originally proposed in 1991. Limits for radon in tap water, if promulgated, would probably become effective 4 or 5 years after promulgation. The most likely scenario is that the rule might contain two standards and states would be encouraged to adopt Multi-Media Mitigation radon reduction programs to achieve cost-effective reductions in indoor air radon levels to qualify for the higher drinking water standard. Under this scenario, a small percentage of our wells, primarily in North Carolina, Pennsylvania and Virginia could require treatment, and the total cost of compliance could approximate $5,000,000 over a five year period. The likelihood of other scenarios developing in the near term is remote, and it is not possible at this time to estimate the costs of compliance.

The Safe Drinking Water Act provides for the regulation of radionuclides other than radon, such as radium and uranium. The Radionuclides Rule that became effective in 2003 left unchanged the existing standards for gross alpha and radium, but changed the monitoring protocol. The rule also added a maximum contaminant level for uranium. Under the new testing protocols, some of our smaller groundwater facilities have exceeded one or more of the radionuclide standards and require treatment by January 2008. Treatment processes have already been installed at 27 facilities, and approximately 17 additional facilities will require the installation of a treatment process, replacement or modification of a well, or other remedy. In most cases where remedies are yet to be implemented, other wells supplying the systems are in compliance, and the wells that exceed a maximum contaminant level have either been temporarily taken out of service or their use has been minimized. The future capital cost of compliance is expected to be less than $5,000,000. The impact of the rulemaking is not expected to have a material impact on our results of operations or financial condition.

In order to remove or inactivate microbial organisms, rules were issued by the EPA to improve disinfection and filtration of potable water and reduce consumers' exposure to disinfectants and by-products of the disinfection process. In the future, we may be required to install filtration or other treatment, for one currently unfiltered surface water supply. The cost of this treatment, should it be required, is not expected to exceed $6,000,000. 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 a total of $1,000,000. In addition, four systems in Florida and potentially eight systems in North Carolina have levels of disinfection by-products above the current maximum contaminant level requiring a compliance response which possibly will change the type of treatment. At least one-half of these systems purchase water from an adjacent supplier, and the resolution of the problem may depend upon supplier co-operation. Treatment modifications, if necessary, may require capital costs of approximately $1,500,000 over the next two years.

The EPA promulgated the Long Term 2 Enhanced Surface Water Treatment Rule and a Stage 2 Disinfection/Disinfection By-product Rule in January 2006. These rules will result in additional one-time special monitoring costs of approximately $600,000 over a four-year period from 2007 to 2011. Monitoring began for our larger systems in September 2006. The results of the monitoring might require modification of treatment, including capital improvements, in year 2008 and beyond. It is not possible at this time to reasonably project the potential impact on the capital budget, if any, from these rules, but the effect is not expected to have a material impact on our results of operations or financial condition.

A rule lowering the limit on arsenic was promulgated in 2001 by the EPA and became effective in January 2006, with a provision for further time extensions for small systems. One well system in Pennsylvania was equipped with a treatment system in 2004, and one small system in Maine was equipped with a treatment system in 2005. An existing treatment system has been replaced at one system in Ohio, and possibly two very small systems in Texas will be treated in 2007 or 2008. One system in North Carolina will require a treatment system at a back-up well that is currently unused. The cost of these remaining capital improvements to fully achieve compliance with this regulation is not expected to exceed $500,000.

Clean Water Act — The Clean Water Act regulates discharges from drinking water and wastewater treatment facilities into lakes, rivers, streams, and groundwater. It is our policy to obtain and maintain all required permits and approvals for the discharges from our 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, discharge violations may occur which may result in fines. We are also parties to compliance agreements with regulatory agencies in several states where we operate while improvements are being made to address wastewater discharge compliance issues. These fines and penalties, if any, are not expected to have a material impact on our results of operations or financial condition. The required costs to comply with the agreements previously cited are included in our capital program, are not expected to be significant, and are expected to be recoverable in rates.

Recent changes in wastewater regulations in the state of Missouri will require improvements at certain of the 52 small wastewater systems we operate in that state. We presently estimate the cost of these improvements to be approximately $1,500,000 over the next three years.

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 are not aware of any significant environmental remediation costs necessary from our handling and disposal of waste material from our water and wastewater operations. However, we do anticipate capital expenditures, that have been included within our five-year capital budget, related to the expansion and/or replacement of some of our current waste disposal facilities in Pennsylvania and Ohio, to support our large surface water treatment facilities in these states.

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.

We continue to study our dams to determine what improvements may be needed as a result of the adoption of revised formulas in Pennsylvania, by the Department of Environmental Protection, and in Ohio, by the Department of Natural Resources, for determining the magnitude of a probable maximum flood. Studies of our dams identified two dams in Pennsylvania and three dams in Ohio that require capital improvements, which have been included in our capital budget, of approximately $17,500,000 in the aggregate during the four year period 2007 to 2010. Construction began in 2005 on one of these dams in Ohio, and one dam upgrade in Pennsylvania began in 2006 with $1,800,000 of capital expenditures incurred to date. Design is underway for improvements to the other dams.

Safety Standards — Our facilities and operations may be subject to inspections by representatives of the Occupational Safety and Health Administration from time to time. We maintain safety policies and procedures to comply with the Occupational Safety and Health Administration’s rules and regulations, but violations may occur from time to time, which may result in fines and penalties, which are not expected to be material. We endeavor to correct such violations promptly after they are brought to our attention.

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 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 of operations or financial condition.

Employee Relations

As of December 31, 2006, we employed a total of 1,540 full-time employees. Our subsidiaries are parties to 11 agreements with labor unions covering 451 employees that expire at various times between August 2007 and December 2009. The employees in our New Jersey operation voted to be represented by a union. There are 33 employees in the bargaining unit in New Jersey and negotiations with that union have been on-going since mid-2005. The employees represented by this union continue to work under their existing terms of employment while negotiations continue with the union.

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 with the SEC at the SEC’s public reference room at 100 F. Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. You may also obtain our SEC filings from the SEC’s Web site at www.sec.gov.

Our Internet Web site address is www.aquaamerica.com. We make available free of charge through our Web site’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 with 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 these committees 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 Web site, www.aquaamerica.com. The references to our Web site and the SEC’s Web site are intended to be inactive textual references only, and the contents of those Web sites are not incorporated by reference herein.

In addition, you may request a copy of the foregoing filings, 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:

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

Item 1A. Risk Factors

In addition to the other information included or incorporated by reference in this 10-K, the following factors should be considered in evaluating our business and future prospects. Any of the following risks, either alone or taken together, could materially and adversely affect our business, financial position or results of operations. If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, our actual results may vary materially from what we projected. There may be additional risks about which we do not presently know or that we currently believe are immaterial which could also impair our business or financial position.

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

The water utility business is capital intensive. In addition to the capital required to fund our growth through acquisition strategy, 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 availability of adequate capital and the recovery of our capital investments through the rates we charge our customers. There is no guarantee that we will be able to obtain sufficient capital in the future on reasonable terms and conditions for expansion, construction and maintenance. In the event we are unable to obtain sufficient capital, our expansion efforts could be curtailed, which may affect our growth and may affect our future results of operations. The rates we charge our customers 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.

Federal and state environmental laws and regulations impose substantial compliance requirements on our operations. 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 federal and state 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 impacted by weather conditions and is subject to seasonal fluctuations, which could adversely 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, rainfall levels and rainfall frequency. In the event that temperatures during the typically warmer months are cooler than normal, if there is more rainfall than normal, or rainfall is more frequent than normal, the demand for our water may decrease and adversely affect our revenues.

Drought conditions and government imposed water use restrictions 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 supplies 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:

- dilutive issuances of our equity securities;
- incurrence of debt and contingent liabilities;
- failure to have effective internal control over financial reporting;
- fluctuations in quarterly results; and
- 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 and comply with regulatory requirements. The businesses we acquire in the future may not achieve sales and profitability that would justify our investment, and any difficulties we encounter in the integration process, including in the integration of controls necessary for internal control and financial reporting, could interfere with our operations, reduce our operating margins and adversely affect our internal controls. 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 naturally-occurring compounds, chemicals in groundwater systems, pollution resulting from man-made sources, such as man-made organic chemicals, and possible terrorist attacks. In the event that a 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, operating results and financial condition and may not 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. Despite these tightened security measures, we may not be in a position to control the outcome of terrorist events should they occur.

Wastewater operations may entail significant risks.

Wastewater collection and treatment and septage pumping and hauling involve various risks associated with damage to the surrounding environment. If collection or treatment systems fail or do not operate properly, or if there is a septage spill, untreated or partially treated wastewater could discharge onto property or into nearby streams and rivers, causing property or environmental damage. Liabilities resulting from such damage could materially and adversely affect the Company’s results of operations and financial condition.

Work stoppages and other labor relations matters could adversely affect our operating results.

Approximately 30% of our workforce are unionized under 11 labor contracts (or contracts under negotiation) with labor unions, which expire over several years. We believe our labor relations are good, but in light of rising costs for healthcare and pensions, contract negotiations in the future may be difficult. We are subject to a risk of work stoppages and other labor relations matters as we negotiate with the unions to address these issues, which could affect our results of operations and financial condition. We cannot assure you that issues with our labor forces will be resolved favorably to us in the future or that we will not experience work stoppages.

We depend significantly on the services of the members of our 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 management team. The loss of the services of any member of our management team or the inability to hire and retain experienced management personnel could harm our operating results.

Settlement provisions contained in the forward equity sale agreement between us and the forward purchaser subject us to certain risks.

In August 2006, we entered into a forward stock agreement for 3,525,000 shares of common stock with a third party (the "forward purchaser"). In connection with the forward equity sale agreement, the forward purchaser borrowed 3,525,000 shares of common stock from stock lenders and sold the borrowed shares to the public to meet its obligations under the forward equity sale agreement. The forward purchaser has the right to require us to physically settle the forward sale agreement on a date specified by the forward purchaser in certain events, including (a) if the average of the closing bid and offer price or, if available, the closing sale price of our common stock is less than or equal to $10.00 per share on any trading day, (b) if our board of directors votes to approve, or there is a public announcement of, in either case, an action that, if consummated, would result in a merger or other takeover event of our company, (c) if we declare any cash dividend or distribution above a specified threshold, or any non-cash dividend or distribution (other than a dividend or distribution of shares of our common stock), in either case, on shares of our common stock and set a record date for payment for such dividend or distribution on or prior to the final settlement date, (d) if the forward purchaser is unable to continue to borrow a number of shares of our common stock equal to the number of shares underlying the forward sale agreement, (e) if the cost of borrowing the common stock has increased above a specified amount, (f) if a nationalization, delisting or change in law occurs, each as defined in the forward sale agreement or (g) in connection with certain events of default and termination events under the deemed master agreement governing such forward sale agreement. In the event that early settlement of the forward sale agreement occurs as a result of any of the foregoing events, we will be required to physically settle the forward sale agreement by delivering shares of our common stock and receiving applicable proceeds. The forward purchaser's decision to exercise its right to require us to settle the forward sale agreement will be made irrespective of our need for capital. In the event that we elect, or are required, to settle the forward sale agreement with shares of our common stock, delivery of such shares would likely result in dilution to our earnings per share and return on equity.

In addition, upon certain events of bankruptcy, insolvency or reorganization relating to us, the forward sale agreement will terminate without further liability of either party. Following any such termination, we would not issue any shares, and we would not receive any proceeds pursuant to the forward sale agreement.

Except under the circumstances described above, we have the right to elect physical, cash or net stock settlement under the forward sale agreement. If we elect cash or net stock settlement, we would expect the forward purchaser to purchase in the open market the applicable number of shares necessary, based upon the portion of the forward sale agreement that we have elected to so settle, to return to stock lenders the shares of our common stock that the forward purchaser has borrowed in connection with the sale of our common stock under the prospectus supplement and, if applicable in connection with net stock settlement, to deliver shares to us. If the market value of our common stock at the time of these purchases is above the forward price at that time, we would pay, or deliver, as the case may be, to the forward purchaser under the forward sale agreement an amount of cash, or common stock with a value, equal to this difference. Any such difference could be significant. If the market value of our common stock at the time of these purchases is below the forward price at that time, we would be paid this difference in cash by, or we would receive the value of this difference in common stock from, the forward purchaser under the forward sale agreement, as the case may be.

Item 1B. Unresolved Staff Comments.

None.

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 and the collection and treatment of wastewater. Substantially all of our properties are owned by our subsidiaries, and a substantial portion of our property is 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, surface water treatment plants, and many well treatment stations and wastewater treatment plants. Some properties are leased under long-term leases. The following table indicates our net property, plant and equipment, in thousands of dollars, as of December 31, 2006 in the principal states where we operate:

	Net Property, Plant and Equipment
Pennsylvania	$ 1,447,590
Illinois	191,385
Ohio	190,347
North Carolina	164,463
Texas	159,685
New Jersey	132,331
Indiana	104,586
Florida	66,498
Virginia	42,678
Maine	40,970
Inter-company eliminations and other states	(34,538)
	$ 2,505,995

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 our subsidiary, Aqua Pennsylvania, Inc., and are 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 material or are expected to have a material effect on our financial position, results of operations or cash flows.

In May 2004, our subsidiaries in Texas filed an application with the Texas Commission on Environmental Quality to increase rates over a multi-year period. In accordance with authorization from the Texas Commission on Environmental Quality, our subsidiaries commenced billing for the requested rates and deferred recognition of certain expenses for financial statement purposes. Several customers and municipalities have joined the proceeding and challenged the requested rate structure, including our request to regionalize rates, and the amount of our requested rate increase. In the event our request is denied completely or in part, we could be required to refund some or all of the revenue billed to-date, and write-off some or all of the regulatory asset for the expense deferral. For more information, see the description under the section captioned "Management's Discussion and Analysis" and refer to the footnote titled "Water and Wastewater Rates" in the "Notes to Consolidated Financial Statements" from the portions of our 2006 Annual Report to Shareholders filed as Exhibit 13.1 to this 10-K.

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 2006.

PART II

Item 5. Market for the Registrant's Common Stock, Related Stockholder Matters and Purchases of Equity Securities

Our common stock is traded on the New York Stock Exchange and the Philadelphia Stock Exchange under the ticker symbol WTR. As of February 9, 2007, there were approximately 28,344 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 2005 4-for-3 common stock split effected in the form of a stock distribution):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
2006					
Dividend paid per common share	$ 0.1069	$ 0.1069	0.115	0.115	$ 0.4438
Dividend declared per common share	0.1069	0.1069	0.230	—	0.4438
Price range of common stock					
- high	29.79	27.82	23.93	24.94	29.79
- low	26.50	20.13	21.13	21.54	20.13
2005					
Dividend paid per common share	$ 0.0975	$ 0.0975	$ 0.0975	$ 0.1069	$ 0.3994
Dividend declared per common share	0.0975	0.0975	0.2044	—	0.3994
Price range of common stock					
- high	19.37	23.24	29.15	29.22	29.22
- low	17.49	18.03	21.61	22.88	17.49

We have paid common dividends consecutively for 62 years. Effective September 1, 2006, our Board of Directors authorized an increase of 7.6% 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 September 2006, the annualized dividend rate increased to $0.46 per share. This is the 16th dividend increase in the past 15 years and the eighth consecutive year that we have increased our dividend in excess of five percent. 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, restrictions set forth in our debt instruments, 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 57.8% of net income.

In August 2005, our Board of Directors declared a 4-for-3 common stock split effected in the form of a 33 1/3 % stock distribution for all common shares outstanding, to shareholders of record on November 17, 2005. The new shares were distributed on December 1, 2005. All share and per share data for all periods presented have been restated to give effect to the stock split. At the time, this was the 6th stock split within the past nine years.

The following table summarizes the Company's purchases of its common stock for the quarter ending December 31, 2006:

	Issuer Purchases of Equity Securities			
Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plan or Programs (2)
October 1-31, 2006	919	$ 22.08	—	548,278
November 1-30, 2006	4,390	$ 23.33	—	548,278
December 1-31, 2006	1,877	$ 22.88	—	548,278
Total	7,186	$ 23.05	—	548,278

(1) These amounts consist of shares we purchased from our employees who elected to pay the exercise price of their stock options (and then hold shares of the stock) upon exercise by delivering to us (and, thus, selling) shares of Aqua America common stock in accordance with the terms of our equity compensation plans that were previously approved by our shareholders and disclosed in our proxy statements. This feature of our equity compensation plan is available to all employees who receive option grants under the plan. We purchased these shares at their fair market value, as determined by reference to the closing price of our common stock on the day prior to the option exercise.

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

Item 6. Selected Financial Data

The information appearing in the section captioned "Summary of Selected Financial Data" from the portions of our 2006 Annual Report to Shareholders filed as Exhibit 13.1 to this Form 10-K 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 2006 Annual Report to Shareholders filed as Exhibit 13.1 to this Form 10-K 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, 2006, the debt maturities by period, in thousands of dollars, and the weighted average interest rate for fixed-rate, long-term debt are as follows:

	2007	2008	2009	2010	2011	Thereafter	Total	Fair Value
Long-term debt (fixed rate)	$31,155	$23,961	$ 7,004	$54,192	$26,998	$ 839,505	$982,815	$986,487
Weighted average interest rate	5.10%	6.63%	4.81%	6.43%	6.42%	5.65%	5.72%	

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, 2006, our carrying value of certain investments was $499, which reflects the market value of such investments and is in excess of our original cost. As of December 31, 2005, we owned no marketable equity securities.

Item 8. Financial Statements and Supplementary Data

Information appearing under the captions "Consolidated Statements of Income and Comprehensive Income," "Consolidated Balance Sheets," "Consolidated Statements of Cash Flows," "Consolidated Statements of Capitalization," "Consolidated Statements of Common Stockholders' Equity" and "Notes to Consolidated Financial Statements" from the portions of our 2006 Annual Report to Shareholders filed as Exhibit 13.1 to this Form 10-K is incorporated by reference herein. Also, the information appearing in the sections captioned "Management's Report on Internal Control Over Financial Reporting" and "Report of Independent Registered Public Accounting Firm" from the portions of our 2006 Annual Report to Shareholders filed as Exhibit 13.1 to this Form 10-K is incorporated by reference herein.

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

None.

Item 9A. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures — Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report are effective to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure. A controls system cannot provide absolute assurance, however, 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.

(b) Management's Report on Internal Control Over Financial Reporting — The information appearing in the section captioned "Management's Report on Internal Control Over Financial Reporting" from the portions of our 2006 Annual Report to Shareholders filed as Exhibit 13.1 to this Form 10-K is incorporated by reference herein.

(c) 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.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

We make available free of charge within the "Investor Relations / Corporate Governance" section of our Internet Web site, 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 Investor Relations Department, Aqua America, Inc., 762 W. Lancaster Avenue, Bryn Mawr, PA 19010-3489. Amendments to the Code, and any grant of a waiver from a provision of the Code requiring disclosure under applicable SEC rules will be disclosed on the Company's Web site. The information contained on our Web site 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, Audit Committee, Audit Committee Financial Expert and Filings under Section 16(a)

The information appearing in the sections captioned "Information Regarding Nominees and Directors," "Corporate Governance" and "Section 16(a) Beneficial Ownership Reporting Compliance" of the Proxy Statement relating to our May 24, 2007, annual meeting of shareholders, to be filed within 120 days after the end of the fiscal year covered by this Form 10-K, 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	61	Chairman, President and Chief Executive Officer (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	54	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	48	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	60	Vice President — Engineering and Environmental Affairs (May 2006 to present); Senior Vice President - Engineering and Environmental Affairs (January 1999 to May 2006) (5)
Karl M. Kyriss	56	President — Aqua Pennsylvania (March 2003 to present) and President, Mid-Atlantic Operations (May 2005 to present) (6)
Robert G. Liptak, Jr.	59	President, Northern Operations (March 1999 to present); President, Consumers Pennsylvania Water Company (1980 to March 1999) (7)
Robert A. Rubin	44	Vice President, Controller and Chief Accounting Officer (May 2005 to present); Controller and Chief Accounting Officer (March 2004 to May 2005); Controller (March 1999 to March 2004) (8)

(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 Senior Vice President — Operations, Philadelphia Suburban Water Company (April 1989 to January 1999), and from 1982 to 1984 he was Chief Engineer of Philadelphia Suburban Water Company. He then served as Vice President and Chief Engineer from 1984 to 1986 and Vice President of Operations from 1986 to 1989.

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(6) Mr. Kyriss was Vice President — Northeast Region of American Water Works Services Company from 1997 to 2003.

(7) Mr. Liptak was President of Consumers Pennsylvania Water Company from 1980 to March 1999.

(8) Mr. Rubin was Accounting Manager with Aqua America, Inc. from June 1989 to June 1994. He then served from June 1994 to March 1999 as Assistant Controller of Philadelphia Suburban Water Company.

Item 11. Executive Compensation

The information appearing in the sections captioned "Executive Compensation" of the Proxy Statement relating to our May 24, 2007, annual meeting of shareholders, to be filed within 120 days after the end of the fiscal year covered by this Form 10-K, 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 24, 2007, annual meeting of shareholders, to be filed within 120 days after the end of the fiscal year covered by this Form 10-K, is incorporated herein by reference.

Securities Authorized for Issuance under Equity Compensation Plans — The following table provides information for our equity compensation plan as of December 31, 2006:

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	3,364,778	$ 16.72	3,521,136
Equity compensation plans not approved by security holders	0	0	0
Total	3,364,778	$ 16.72	3,521,136

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information appearing in the sections captioned "Corporate Governance — Director Independence" and " — Policies and Procedures of Related Person Transactions" of the Proxy Statement relating to our May 24, 2007, annual meeting of shareholders, to be filed within 120 days after the end of the fiscal year covered by this Form 10-K, is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information appearing in the section captioned "Independent Registered Public Accounting Firm — Services and Fees" of the Proxy Statement relating to our May 24, 2007, annual meeting of shareholders, to be filed within 120 days after the end of the fiscal year covered by this Form 10-K, is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

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

Management's Report on Internal Control Over Financial Reporting

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets — December 31, 2006 and 2005

Consolidated Statements of Income and Comprehensive Income — 2006, 2005 and 2004

Consolidated Statements of Cash Flows — 2006, 2005 and 2004

Consolidated Statements of Capitalization — December 31, 2006 and 2005

Consolidated Statements of Common Stockholders' Equity — December 31, 2006, 2005 and 2004

Notes to Consolidated Financial Statements

Financial Statement Schedules. All schedules to our consolidated financial statements 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.

Exhibits, Including Those Incorporated by Reference. A list of exhibits filed as part of this Form 10-K is set forth in the Exhibit Index hereto which is incorporated herein by reference. 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.

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
Chairman, President and Chief Executive Officer

Date: February 27, 2007

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Roy H. Stahl, Executive Vice President and General Counsel, and David P. Smeltzer, Senior Vice President — Finance and Chief Financial Officer, as true and lawful attorneys-in-fact and agents with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities to sign this Report filed herewith and any or all amendments to said Report, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission granting unto said attorneys-in-fact and agents the full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the foregoing, as to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or any of them, or his or her substitute, may lawfully do or cause to be done by virtue hereof.

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.

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NICHOLAS DEBENEDICTIS
Nicholas DeBenedictis
Chairman, President, Chief Executive Officer and Director (Principal Executive Officer)

DAVID P. SMELTZER
David P. Smeltzer
Senior Vice President — Finance and Chief Financial Officer (Principal Financial Officer)

ROBERT A. RUBIN
Robert A. Rubin
Vice President, Controller and Chief Accounting Officer (Principal Accounting Officer)

MARY C. CARROLL
Mary C. Carroll
Director

RICHARD H. GLANTON
Richard H. Glanton
Director

LON R. GREENBERG
Lon R. Greenberg
Director

WILLIAM P. HANKOWSKY
William P. Hankowsky
Director

DR. CONSTANTINE PAPADAKIS
Dr. Constantine Papadakis
Director

ELLEN T. RUFF
Ellen T. Ruff
Director

RICHARD L. SMOOT
Richard L. Smoot
Director

ANDREW J. SORDONI III
Andrew J. Sordoni III
Director

EXHIBIT INDEX

Exhibit No.	Description
3.1	Restated Articles of Incorporation (as of December 9, 2004) (20) (Exhibit 3.1)
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. (22) (Exhibit 4.10)
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) (Exhibit 4.20)

EXHIBIT INDEX

Exhibit No.	Description
4.16	Thirty-fourth Supplemental Indenture, dated as of October 15, 2001. (15) (Exhibit 4.21)
4.17	Thirty-fifth Supplemental Indenture, dated as of January 1, 2002. (15) (Exhibit 4.22)
4.18	Thirty-sixth Supplemental Indenture, dated as of June 1, 2002. (17) (Exhibit 4.23)
4.19	Thirty-seventh Supplemental Indenture, dated as of December 15, 2002. (18) (Exhibit 4.23)
4.20	Credit Agreement dated as of October 25, 2002, between Philadelphia Suburban Corporation and PNC Bank, National Association. (18) (Exhibit 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) (Exhibit 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) (Exhibit 4.26)
4.23	Note Purchase Agreement among the note purchasers and Philadelphia Suburban Corporation, dated July 31, 2003 (19) (Exhibit 4.27)
4.24	Credit Agreement dated as of July 31, 2003, between Philadelphia Suburban Corporation and PNC Bank, National Association (19) (Exhibit 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. (22) (Exhibit 4.25)
4.26	Credit Agreement dated as of May 28, 2004, between Aqua America, Inc. and PNC Bank, National Association (21) (Exhibit 4.26)
4.27	Sixth Amendment to Revolving Credit Agreement dated as of December 12, 2004 between Aqua Pennsylvania, Inc. (formerly known as Pennsylvania Suburban Water Company, successor by merger to Philadelphia Suburban Water Company) and PNC Bank, National Association, Citizens Bank of Pennsylvania, Fleet National Bank, National City Bank dated as of December 22, 1999. (25) (Exhibit 4.27)
4.28	Thirty-eighth Supplemental Indenture, dated as of November 15, 2004. (25) (Exhibit 4.28)
4.29	Thirty-ninth Supplemental Indenture, dated as of May 1, 2005. (24) (Exhibit 4.29)
4.30	Seventh Amendment to Revolving Credit Agreement dated as of December 6, 2005 between Aqua Pennsylvania, Inc. (formerly known as Pennsylvania Suburban Water Company, successor by merger to Philadelphia Suburban Water Company) and PNC Bank, National Association, Citizens Bank of Pennsylvania, Bank of America, N.A. (formerly Fleet National Bank), National City Bank dated as of December 22, 1999. (16) (Exhibit 4.30)
4.31	Fortieth Supplemental Indenture, dated as of December 15, 2005. (16) (Exhibit 4.31)
4.32	Eighth Amendment to Revolving Credit Agreement dated as of December 1, 2006 between Aqua Pennsylvania, Inc. (formerly known as Pennsylvania Suburban Water Company, successor by merger to Philadelphia Suburban Water Company) and PNC Bank, National Association, Citizens Bank of Pennsylvania, Bank of America, N.A. (formerly 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)

EXHIBIT INDEX

Exhibit No.	Description
10.3	Supplemental Executive Retirement Plan, effective March 15, 1992* (1) (Exhibit 10.6)
10.4	Employment letter agreement with Mr. Nicholas DeBenedictis, dated May 20, 1992* (1) (Exhibit 10.8)
10.5	1994 Equity Compensation Plan, as amended by Amendment effective August 5, 2003* (22) (Exhibit 10.5)
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)
10.9	Philadelphia Suburban Corporation Amended and Restated Executive Deferral Plan* (22) (Exhibit 10.9)
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* (22) (Exhibit 10.13)
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) (Exhibit 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) (Exhibit 10.36)
10.19	Agreement among Philadelphia Suburban Corporation, Philadelphia Suburban Water Company and Nicholas DeBenedictis, dated August 7, 2001* (15) (Exhibit 10.37)

EXHIBIT INDEX

Exhibit No.	Description
10.20	Agreement among Philadelphia Suburban Corporation, Philadelphia Suburban Water Company and Roy H. Stahl, dated August 7, 2001* (15) (Exhibit 10.38)
10.21	Agreement among Philadelphia Suburban Corporation, Philadelphia Suburban Water Company and Richard R. Riegler, dated August 7, 2001* (15) (Exhibit 10.39)
10.22	Agreement among Philadelphia Suburban Corporation, Philadelphia Suburban Water Company and David P. Smeltzer, dated August 7, 2001* (15) (Exhibit 10.40)
10.23	Agreement among Philadelphia Suburban Corporation, Philadelphia Suburban Water Company and Richard D. Hugus, dated August 7, 2001* (22) (Exhibit 10.23)
10.24	2007 Annual Cash Incentive Compensation Plan*
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	Aqua America, Inc. 2004 Equity Compensation Plan as amended by Amendment effective February 22, 2007*
10.30	2006 Annual Cash Incentive Compensation Plan* (16) (Exhibit 10.30)
10.31	Bond Purchase Agreement among the Northumberland County Industrial Development Authority, Aqua Pennsylvania, Inc., and Sovereign Securities Corporation, LLC, dated November 16, 2004. (25) (Exhibit 10.31)
10.32	Aqua America, Inc. 2004 Equity Compensation Plan* (23)
10.33	2005 Executive Deferral Plan* (25) (Exhibit 10.33)
10.34	2005 Director Deferral Plan* (25) (Exhibit 10.34)
10.35	Non-Employee Directors' Compensation for 2006* (26) (Exhibit 10.1)
10.36	Bond Purchase Agreement among the Delaware County Industrial Development Authority, Aqua Pennsylvania, Inc. and Sovereign Securities Corporation, LLC, dated May 10, 2005. (24) (Exhibit 10.36)
10.37	Bond Purchase Agreement among the Delaware County Industrial Development Authority, Aqua Pennsylvania, Inc. and Sovereign Securities Corporation, LLC, dated December 21, 2005. (16) (Exhibit 10.37)
10.38	Aqua America, Inc. Dividend Reinvestment and Direct Stock Purchase Plan* (29)
10.39	Aqua America, Inc. Amended and Restated Employee Stock Purchase Plan* (16) (Exhibit 10.39)
10.40	Form of Stock Option Agreement* (16) (Exhibit 10.40)

EXHIBIT INDEX

Exhibit No.	Description
10.41	Acceleration of Payout of 2004 and 2005 Dividend Equivalent Awards; Grants of 2006 Dividend Equivalent Awards; Performance Criteria for Acceleration of Payout of Dividend Equivalent Awards* (28) (Exhibit 10.2)
10.42	Vesting of Restricted Stock Granted in 2005; Grants of Restricted Stock* (28) (Exhibit 10.3)
10.43	2006 Salaries; Annual Incentive Compensation Earned in 2005* (28) (Exhibit 10.1)
10.44	Non-Employee Directors' Compensation for 2007*
13.1	Selected portions of Annual Report to Shareholders for the year ended December 31, 2006 incorporated by reference in Annual Report on Form 10-K for the year ended December 31, 2006.
21.1	Subsidiaries of Aqua America, Inc.
23.1	Consent of Independent Registered Public Accounting Firm — PricewaterhouseCoopers LLP
24.1	Power of Attorney (included on signature page)
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

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 an Exhibit to Annual Report on Form 10-K for the year ended December 31, 1999.

(14) Filed as an Exhibit to Annual Report on Form 10-K for the year ended December 31, 2000.

(15) Filed as an Exhibit to Annual Report on Form 10-K for the year ended December 31, 2001.

(16) Filed as an Exhibit to Annual Report on Form 10-K for the year ended December 31, 2005.

(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

(20) Filed as an Exhibit to Form 8-K filed December 9, 2004.

(21) Filed as an Exhibit to Quarterly Report on Form 10-Q for the quarter ended June 30, 2004.

(22) Filed as an Exhibit to Annual Report on Form 10-K for the year ended December 31, 2003.

(23) Filed as Appendix C to definitive Proxy Statement dated April 2, 2004.

(24) Filed as an Exhibit to Quarterly Report on Form 10-Q for the quarter ended June 30, 2005.

(25) Filed as an Exhibit to Annual Report on Form 10-K for the year ended December 31, 2004.

(26) Filed as an Exhibit to Form 8-K filed December 12, 2005.

(27) Filed as an Exhibit to Form 8-K filed March 7, 2005.

(28) Filed as an Exhibit to Form 8-K filed March 13, 2006.

(29) Filed as a Registration Statement on Form S-3 on February 18, 2005.

*Indicates management contract or compensatory plan or arrangement.

EXHIBIT 4.32

EIGHTH AMENDMENT TO CREDIT AGREEMENT

THIS EIGHTH AMENDMENT TO CREDIT AGREEMENT is made as of this 1st day of December, 2006, by and among AQUA PENNSYLVANIA, INC., a Pennsylvania corporation (formerly known as Pennsylvania Suburban Water Company, 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, a Fourth Amendment dated as of December 24, 2002, a Fifth Amendment to Credit Agreement dated as of December 14, 2003, a Sixth Amendment to Credit Agreement dated as of December 12, 2004 and a Seventh Amendment to Credit Agreement dated as of December 6, 2005 (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 8, 2006 (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 6, 2007 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.

AQUA PENNSYLVANIA, INC.

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: Leslie Broderick
Title: Senior Vice President

BANK OF AMERICA, N.A. (formerly Fleet National Bank)

By: Katherine Osele
Title: Assistant Vice President

NATIONAL CITY BANK

By: David Dobstaff
Title: Senior Vice President

EXHIBIT 10.24

AQUA AMERICA, INC.
and SUBSIDIARIES
2007 ANNUAL CASH INCENTIVE COMPENSATION PLAN

BACKGROUND

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.

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).

The Plan has two components — a Management Incentive Program and an Employee Recognition ("Chairman's Award") Program.

The Plan is designed to provide an appropriate incentive to the officers, managers and certain other key employees of the Company. The **2007** Management Incentive Program will cover officers, managers and certain key employees of Aqua America, Inc., and its subsidiaries.

All incentive awards under the Plan shall be paid by March 15 of the calendar year following the calendar year in which such awards are earned, or as soon as administratively practicable thereafter.

MANAGEMENT INCENTIVE PROGRAM

Performance Measures

- Annual incentive bonus awards are calculated by multiplying an individual's Target Bonus by a Company Factor based on the applicable company's performance and an Individual 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 (financial factor, thresholds and weighting by applicable business unit) for each participant will be established by the Chairman of the Company and, for the senior executives of the Company, approved individually by the Executive Compensation and Employee Benefits Committee. Each year a "Target Net Income or EBITD" level will be established. Portions of the Company Rating Factor may be tied to the financial targets of more than one company for some participants whose responsibilities involve more than one company. For purposes of the Plan, the Target Net Income or EBITD may differ from the budgeted net income or EBITD level. For 2007, 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 Net Income 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 each year and are primarily directed toward customer growth, improving customer service, controlling costs and improving efficiencies and productivity. 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 up to 110 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.

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 70 percent depending on duties and responsibilities. The Executive Compensation and Employee Benefits Committee will approve the Target Bonus Percentage for the CEO and the senior executives designated by the Committee each year.

- The Target Bonus Percentage for each participant will be applied to their base salary.

- Actual bonuses may range from 0, if the company's financial results falls 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, prior to the end of the Company's fiscal year 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 Factor, but pro-rated for the number of full calendar months the employee completed before his or her death.

Company Factor

- Company performance will be measured on the following schedule:

	Percent of Target	Company Factor
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 Factor for purposes of this Plan.

Individual Factor

- Individual performance will be measured on the following scale:

Performance Measure Points	Individual 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

- Example 1

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

Calculation:

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

- 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 x 0 x 90% = 0

- 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 x 100% x 0 = 0

- Example 4

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

    Calculation:

Target Bonus	x	Company Factor	x	Company Allocation	x	Individual Factor	=	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

- 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 Factory	x	Company Allocation	x	Individual Factor	=	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 who are 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 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 EBITD 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 EBITD 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.

7. Employees who would otherwise be eligible to participate in the Chairman's Award program, but who leave employment with the company, either voluntarily, involuntarily or as a result of retirement, prior to the end of the Company's fiscal year will not receive a Chairman's Award for the year in which their employment terminates.

EXHIBIT 10.29

AQUA AMERICA, INC
2004 EQUITY COMPENSATION PLAN
(as amended February 22, 2007)

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. The Plan is a successor plan to the Corporation’s existing Amended and Restated 1994 Equity Compensation Plan (the “1994 Plan.”)

2. Administration

This Plan shall be administered by a Committee (the “Committee”) of the Board of Directors of the Corporation. Each of the members of the Committee 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 Corporation 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 3,675,000 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, subject to adjustment as provided in Section 15. 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. Additionally, if and to the extent options granted under the 1994 Plan terminate or expire without being exercised, or if any shares of restricted stock are forfeited, or shares of Common Stock otherwise issuable under the 1994 Plan are withheld by the Corporation in satisfaction of withholding taxes incurred in connection with the exercise of a stock option or vesting of a restricted stock award, the shares subject to such awards 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 closing price 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 closing price 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 Corporation 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 regular full-time 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 as a regular full-time employee 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 or a subsidiary. whose employment with the Corporation or subsidiary 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 as a regular full-time employee 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 a grantee's 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) and 7(g), 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 by the Committee (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 regular full-time 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 1,500 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.

(g) (1) *Restricted Stock Awards Subject to Performance Goals.* From time to time the Committee may issues shares of Common Stock of the Corporation pursuant to restricted stock grants, which, in addition to the terms and restrictions of Sections 7(a)–(f) above, will be subject to certain pre-established performance goals. In setting the performance goals for grants designated as "qualified performance-based compensation" pursuant to this Section 7, the Committee may establish that the Restriction Period of such restricted stock grants will lapse only upon the achievement of certain pre-established corporate performance goals that shall be objectively determinable. The performance goals may be based on one or more of the following criteria: (1) total return to shareholders; (2) dividends; (3) earnings per share; (4) customer growth; (5) cost reduction goals; (6) the achievement of specified operational goals, including water quality and the reliability of water supply; (7) measures of customer satisfaction; (8) net income (before or after taxes) or operating income; (9) earnings before interest, taxes, depreciation and amortization or operating income before depreciation and amortization; (10) revenue targets; (11) return on assets, capital or investment; (12) cash flow; (13) budget comparisons; (14) implementation or completion of projects or processes strategic or critical to the Company's business operations; and (15) any combination of, or a specified increase in, any of the foregoing. In addition, such performance goals may be based upon the attainment of specified levels of the Corporation's performance under one or more of the measures described above relative to the performance of other entities and may also be based on the performance of any of the Corporation's business units or divisions or any parent or subsidiary. Performance goals may be based upon the attainment of specified levels of the Company's performance under one or more of the measures described above during a specified time period, which may differ from the Restriction Period. Performance goals may include a minimum threshold level of performance below which no award will be earned, levels of performance at which specified portions of an award will be earned and a maximum level of performance at which an award will be fully earned. These performance goals shall satisfy the requirements for "qualified performance-based compensation," including the requirement that the achievement of the goals be substantially uncertain at the time they are established and that the performance goals be established in such a way that a third party with knowledge of the relevant facts could determine whether and to what extent the performance goals have been met. The Committee shall not have discretion to increase the amount of compensation that is payable upon achievement of the designated performance goals, but the Committee may reduce the amount of compensation that is payable upon achievement of the designated performance goals.

(2) *Timing of Establishment of Goals*. The Committee shall establish the performance goals in writing either before the beginning of the commencement of the period during which the specified performance goals are to be measured or during a period ending no later than the earlier of (i) 90 days after the beginning of the period during which the specified performance goals are to be measured or (ii) the date on which 25% of the period during which the specified performance goals are to be measured has been completed, or such other date as may be required or permitted under applicable regulations under Code section 162(m).

(3) *Announcement of Results*. The Committee shall certify and announce the results for the Restriction Period to all grantees after the Company announces the Company's financial results for the Restriction Period. If and to the extent that the Committee does not certify that the performance goals have been met, the applicable grants for the Restriction Period shall be forfeited or shall not be paid, as applicable.

(4) *Death, Disability or Other Circumstances*. The Committee may provide that grants shall be payable or restrictions shall lapse, in whole or in part, in the event of the grantee's death or disability during the Restriction Period, a Change of Control or under other circumstances consistent with the Treasury regulations and rulings under Code section 162(m).

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 with respect to 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 regular full-time 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 for the applicable Performance Period exceeds the targets for such criteria established by the Committee .

(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 for the applicable Performance Period is less than the targets for such criteria established by the Committee.

(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 regular full-time 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 regular full-time 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 then 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 will 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 March 17, 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 shall be effective on March 18, 2004, but subject to the approval of the Corporation’s stockholders at the May 20, 2004 meeting of the Corporation’s stockholders or any resumption thereof.

Exhibit 10.44

Non-Employee Directors' Compensation for 2007

At its regularly scheduled meeting on December 6, 2006, the Board of Directors of Aqua America, Inc., upon the recommendation of its Executive Compensation and Employee Benefits Committee, approved the following directors' compensation for 2007 for the non-employee directors of Aqua America, Inc.: (1) an annual cash retainer of $17,500; (2) an annual cash retainer for the Chair of the Executive Compensation and Employee Benefits Committee and Corporate Governance Committee of $5,000; (3) an annual cash retainer for the Chair of the Audit Committee of $7,500; (4) a meeting fee of $1,500 for each meeting of the Board of Directors; (5) a meeting fee of $1,250 per meeting for meetings of the Audit Committee and a meeting fee of $1,000 per meeting for meetings of the other Committees; and (6) an annual stock grant to directors of 1,500 shares payable on the first of the month following the Annual Meeting of Shareholders. All directors are reimbursed for reasonable expenses incurred in connection with attendance at Board or Committee meetings. Directors are eligible to defer part or all of their fees under the Company's Director Deferral Plan. Amounts deferred accrue interest at the prime interest rate plus 1.0%.

Exhibit 13.1

SELECTED PORTIONS OF ANNUAL REPORT TO SHAREHOLDERS

FOR THE YEAR ENDED DECEMBER 31, 2006

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, that may be outside our control and 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:

- recovery of capital expenditures and expenses in rates;
- projected capital expenditures;
- availability of capital financing;
- dividend payment projections;
- future financing plans;
- future pension contributions;
- opportunities for future acquisitions, the success of pending acquisitions and the impact of future acquisitions;
- acquisition-related costs and synergies;
- the capacity of our water supplies, water facilities and wastewater facilities;
- the availability and cost of key production necessities, including power, chemicals and purchased water or wastewater services;
- the availability of qualified personnel;
- the return performance of our defined benefit pension plan assets;
- general economic conditions;
- the impact of geographic diversity on our exposure to unusual weather; and
- the impact of accounting pronouncements.

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:

- changes in general economic, business and financial market conditions;
- changes in government regulations and policies, including environmental and public utility regulations and policies;
- changes in environmental conditions, including those that result in water use restrictions;
- abnormal weather conditions;
- changes in, or unanticipated, capital requirements;
- changes in our credit rating or the market price of our common stock;
- our ability to integrate businesses, technologies or services which we may acquire;
- our ability to manage the expansion of our business;
- the extent to which we are able to develop and market new and improved services;
- the effect of the loss of major customers;
- our ability to retain the services of key personnel and to hire qualified personnel as we expand;
- increasing difficulties in obtaining insurance and increased cost of insurance;
- cost overruns relating to improvements or the expansion of our operations;
- changes in accounting pronouncements; and
- 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. As you read this report, you should pay particular attention to the "Risk Factors" included in our Annual Report on Form 10-K.

OVERVIEW

The Company

Aqua America, Inc. is the holding company for regulated utilities providing water or wastewater services to what we estimate to be approximately 2.8 million people in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, New York, Florida, Indiana, Virginia, Maine, Missouri and South Carolina. Our largest operating subsidiary, Aqua Pennsylvania, Inc., accounted for approximately 55% of our operating revenues for 2006 and, as of December 31, 2006, provided water or wastewater services to approximately one-half of the total number of people we serve, is located in the suburban areas north and west of the City of Philadelphia and in 23 other counties in Pennsylvania. Our other subsidiaries provide similar services in 12 other states. In addition, we provide water and wastewater service through operating and maintenance contracts with municipal authorities and other parties, and septage hauling services, close to our utility companies' service territories.

Industry Mission

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

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

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. 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 other financings, and the franchise areas that we serve. A small number of our operations are subject to rate regulation by county or city government. The profitability of our utility operations is influenced to a great extent by the timeliness and adequacy of rate allowances in the various states in which we operate.

Rate Case Management Capability**—**We strive to achieve the industry mission by effective planning and efficient use of our resources. We maintain a rate case management capability to pursue timely and adequate returns on the capital investments that we make in improving or replacing water mains, treatment plants and other infrastructure. This capability 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. Accordingly, we execute a rate case management strategy to provide that the rates 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 or local regulatory authorities. In general, as a regulated enterprise, our water and wastewater rates are established to provide recovery of utility costs, taxes, interest on debt used to finance facilities and a return on equity used to finance facilities. Our ability to recover our expenses in a timely manner and earn a return on equity employed in the business determines the profitability of the Company.

All of the states in which we acquired operations in 2004 and 2003 permit some form of consolidated rates in varying degrees, but none currently permits us to fully consolidate rate filings state-wide. Between August 2003 and December 2006, we have filed rate filings in over 121 operating divisions. Due to the length of time since the last rate increase for some acquired systems and the large amount of capital improvements relative to the number of customers in some smaller systems, the proposed rate increase in some of these systems may be substantial. While each of these rate filings will proceed through the applicable regulatory process, we can provide no assurance that the rate increases will be granted in a timely or sufficient manner to cover the investments and expenses for which we initially sought the rate increases. Further, there remain 20 divisions within these acquired operations where we have not yet filed a rate request.

***Revenue Surcharges*—**Six states in which we operate permit water utilities, and in two 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. In all other states, water and wastewater utilities absorb 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 acts as a disincentive to water and wastewater utilities to rehabilitate their infrastructure. In addition, certain states permit our subsidiaries to use a surcharge or credit on their bill to reflect certain allowable changes in costs, such as changes in state tax rates, other taxes and purchased water, until such time as these costs are fully incorporated in base rates.

***Effects of Inflation*—**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 inflation, as has been experienced in 2006, the effects of inflation on our operating results are noticeable and partly responsible for lower than expected earnings growth.

Growth-Through-Acquisition Strategy

Part of our strategy to meet the industry 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, and to explore acquiring non-regulated businesses that are complementary to our regulated water and wastewater operations. This growth-through-acquisition strategy allows us to operate more efficiently by sharing operating expenses over more utility customers and provides new locations for possible future growth. The ability to successfully execute this strategy 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.

During 2006 we completed 28 acquisitions, growing our number of customers served by 62,341 or 7.2%, including the customers acquired with the New York Water Services Corporation acquisition. On January 1, 2007, we completed the acquisition of the capital stock of New York Water Service Corporation for $28,866 in cash, as adjusted pursuant to the purchase agreement primarily based on working capital at closing, and the assumption of $23,460 of long-term debt. The operating results of New York Water Service Corporation will be included in our consolidated financial statements beginning January 1, 2007. The acquired operation provides water service to 44,792 customers in several water systems located in Nassau County, Long Island, New York. The acquisition was funded through the issuance of long-term debt that was issued in 2006.

During 2005 and 2006, we completed six acquisitions of non-regulated companies that provide on-site septic tank pumping, sludge hauling and other wastewater-related services to customers in eastern Pennsylvania, New Jersey, Delaware, New York and Maryland. The operating revenues of these businesses for the year ended December 31, 2006 were $5,424 and are excluded from our Regulated segment. In total during 2006, $7,897 in cash was invested in these non-regulated wastewater and septage acquisitions on which we believe we will earn an appropriate return. Please refer to the section captioned "Acquisitions" for an additional discussion of acquisitions.

We believe that utility acquisitions will continue to be the primary source of growth for us. With approximately 53,000 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 approximately 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 13 states where we operate. We also intend to explore opportunities in the non-regulated wastewater and septage businesses when they complement our utility companies.

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:

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

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. We continue to explore opportunities for the acquisition of other non-regulated wastewater service and septage businesses that are located near our existing markets, growing our existing revenue base in this business by offering the wastewater services to nearby residents with on-site sewer systems, adding new customers to this business and expanding the services that are provided to them.

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.

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.

The geographic diversity of our utility customer base helps reduce our exposure to extreme or unusual weather conditions in any one area of our service territory. Our geographic diversity has continued to increase as a result of the Heater and Florida Water acquisitions which closed in mid-year 2004 and the AquaSource acquisition which closed in 2003. During the year ended December 31, 2006, our operating revenues were derived principally from the following states: 55% in Pennsylvania, 9% in Texas, 7% in Ohio, 7% in Illinois, and 6% in North Carolina.

(In thousands of dollars, except per share amounts)

Consolidated Selected Financial and Operating Statistics

Our selected five-year consolidated financial and operating statistics follow:

Years ended December 31,	2006 (a)	2005	2004 (b)	2003 (c)	2002 (d)
Utility customers:					
Residential water	780,828	724,954	702,367	624,355	535,506
Commercial water	36,280	33,975	33,720	33,015	30,355
Industrial water	1,337	1,356	1,365	1,397	1,423
Other water	15,587	15,584	15,700	20,483	16,466
Wastewater	93,203	89,025	82,360	70,241	21,724
Total	927,235	864,894	835,512	749,491	605,474
Operating revenues:					
Residential water	$ 317,770	$ 295,473	$ 264,910	$ 218,487	$ 197,190
Commercial water	76,076	73,455	65,605	61,343	55,962
Industrial water	18,752	18,364	17,377	17,675	17,221
Other water	51,263	50,827	44,593	40,048	36,255
Wastewater	48,907	42,176	35,931	17,874	8,210
Other	13,525	13,161	11,556	9,821	5,861
Regulated segment total	526,293	493,456	439,972	365,248	320,699
Other	7,198	3,323	2,067	1,985	1,329
Consolidated	$ 533,491	$ 496,779	$ 442,039	$ 367,233	$ 322,028
Operations and maintenance expense	$ 219,560	$ 203,088	$ 178,345	$ 140,602	$ 117,735
Net income available to common stock	$ 92,004	$ 91,156	$ 80,007	$ 70,785	$ 67,154
Capital expenditures	$ 271,706	$ 237,462	$ 195,736	$ 163,320	$ 136,164
Operating Statistics					
Selected operating results as a percentage of operating revenues:					
Operations and maintenance	41.2%	40.9%	40.3%	38.3%	36.6%
Depreciation and amortization	14.1%	13.2%	13.3%	14.0%	13.8%
Taxes other than income taxes	6.2%	6.4%	6.2%	5.9%	6.0%
Interest expense, net	10.9%	10.4%	11.0%	12.2%	12.5%
Net income available to common stock	17.2%	18.3%	18.1%	19.3%	20.9%
Return on average stockholders' equity	10.6%	11.7%	11.4%	12.3%	13.9%
Effective tax rates	39.6%	38.4%	39.4%	39.3%	38.5%

(a) 2006 includes 44,792 customers associated with the New York Water Service Corporation acquisition which was completed on January 1, 2007. The operating results of this acquisition will be reported in our consolidated financial statements beginning January 1, 2007.

(b) Net income available to common stock includes the gain of $1,522 ($2,342 pre-tax) realized on the sale of our Geneva, Ohio water system. The gain is reported in the 2004 consolidated statement of income as a reduction to operations and maintenance expense. 2004 includes a partial year of financial results for the mid-year acquisition of Heater Utilities, Inc. and certain utility assets of Florida Water Services Corporation.

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

(d) Net income available to common stock and net income includes the gain of $3,690 ($5,676 pre-tax) realized on the sale of a portion of our Ashtabula, Ohio water system.

Performance Measures Considered by Management

We consider the following financial measures to be the fundamental basis by which we evaluate our operating results: earnings per share, operating revenues, net income and dividend rate on common stock. In addition, we consider other key measures in evaluating our utility business performance within our Regulated segment: our number of utility customers, the ratio of operations and maintenance expense compared to operating revenues (this percentage is termed "operating expense ratio" or "efficiency ratio"); return on revenues (net income divided by operating revenues); and return on equity (net income divided by common stockholders' equity). We review these measurements regularly and compare them to historical periods, to our operating budget as approved by the Aqua America, Inc. Board of Directors, and to similar measurements at other publicly-traded water utilities.

Our operating expense ratio is one measure that we use to evaluate our operating efficiency and management effectiveness in light of the changing nature of our company. During the past five years, our operating expense ratio has been effected over time due to a number of factors, including the following:

- ***Acquisitions*—**The AquaSource, Heater Utilities, Inc. and Florida Water Services acquisitions increased our operating expense ratio due to the operating revenues generated by these operations being accompanied by a higher ratio of operations and maintenance expenses as compared to the rest of the pre-existing, more densely-populated and integrated Aqua America operations. The Aqua South operations can be characterized as having relatively higher fixed operating costs, in contrast to the rest of the Aqua America operations which generally consist of larger, interconnected systems, with higher fixed capital costs (utility plant investment) and lower operating costs per customer. In addition, we completed several acquisitions of companies that provide on-site septic tank pumping and sludge hauling services during 2006. The cost-structure of these businesses differs from our utility companies in that these businesses have a higher ratio of operations and maintenance expenses to operating revenues and a lower-degree of capital investment and consequently a lower ratio of fixed capital costs (plant investment requirements are lower) versus operating revenues. As a result, the ratio of operating income compared to operating revenues is comparable between the businesses. The non-regulated wastewater and septage hauling service business is not a component of our Regulated segment.

- ***Regulatory lag*—**The efficiency ratio is influenced by regulatory lag, i.e., increases in operations and maintenance expenses without an immediate corresponding increase in operating revenues, decreases in operating revenues without a commensurate decrease in operations and maintenance expense, such as changes in water consumption as impacted by weather conditions, or a gap between the time that a capital project is completed and the recovery of its costs in rates.

- ***New accounting pronouncements*—**Our 2006 results reflect the effects of the adoption of SFAS No. 123R, "Share-Based Payment." As required, we began to record compensation expense for the fair value of stock options granted and the adoption of this accounting standard increased our 2006 operations and maintenance expense by $2,894. Prior to 2006, no compensation expense related to granting of stock options had been recognized in the financial statements.

We continue to evaluate initiatives to help control operating costs and improve efficiencies.

RESULTS OF OPERATIONS

Our net income has grown at an annual compound rate of approximately 8.9% during the five-year period ended December 31, 2006. During the past five years, operating revenues grew at a compound rate of 11.7% and total expenses, exclusive of income taxes, grew at a compound rate of 12.9%.

Operating Segments

We have identified fourteen operating segments and we have one reportable segment based on the following:

- Thirteen segments are comprised of our water and wastewater regulated utility operations in the thirteen states where we provide these services. These operating segments are aggregated into one reportable segment since each of these operating segments has the following similarities: economic characteristics, nature of services, production processes, customers, water distribution or wastewater collection methods, and the nature of the regulatory environment. Our single reportable segment is named the Regulated segment.

- One segment is not quantitatively significant to be reportable and is comprised of the businesses that provide on-site septic tank pumping, sludge hauling services, data processing service fees and certain other non-regulated water and wastewater services. This segment is included as a component of "other," in addition to corporate costs that have not been allocated to the Regulated segment and intersegment eliminations. Corporate costs include certain general and administrative expenses, and interest expense for certain of our utility companies that do not have their own credit facilities.

(In thousands of dollars, except per share amounts)

Prior to the acquisition in 2006 of companies that provide on-site septic tank pumping and sludge hauling services, our non-regulated operations were limited in scope and impact on our financial results. As a result we previously operated them as part of our regulated operating segments. We made this determination based on an evaluation of our operating segments during the fourth quarter of 2006. Unless specifically noted, the following discussion and analysis provides information on our consolidated result of operations. The following table provides the Regulated segment and Consolidated information for the years ended December 31, 2006, 2005 and 2004:

	2006			2005		
	Regulated	Other	Consolidated	Regulated	Other	Consolidated
Operating revenues	$ 526,293	$ 7,198	$ 533,491	$ 493,456	$ 3,323	$ 496,779
Operations and maintenance expense	216,919	2,641	219,560	202,662	426	203,088
Taxes other than income taxes	32,273	1,070	33,343	30,820	876	31,696
Earnings before interest, taxes, depreciation and amortization	$ 277,101	$ 3,487	280,588	$ 259,974	$ 2,021	261,995
Depreciation and amortization			75,041			65,488
Operating income			205,547			196,507
Interest expense, net of AFUDC			54,491			49,615
Gain on sale of other assets			(1,194)			(1,177)
Provision for income taxes			60,246			56,913
Net income			$ 92,004			$ 91,156

	2004		
	Regulated	Other	Consolidated
Operating revenues	$ 439,972	$ 2,067	$ 442,039
Operations and maintenance expense	179,332	(987)	178,345
Taxes other than income taxes	26,963	633	27,596
Earnings before interest, taxes, depreciation and amortization	$ 233,677	$ 2,421	236,098
Depreciation and amortization			58,864
Operating income			177,234
Interest expense, net of AFUDC			46,375
Gain on sale of other assets			(1,272)
Provision for income taxes			52,124
Net income			$ 80,007

Consolidated Results

Operating Revenues—The growth in revenues over the past five years is a result of increases in the customer base, water rates and the acquisition of non-regulated operations. The number of customers increased at an annual compound rate of 9.6% in the past five years primarily as a result of acquisitions of water and wastewater systems, including the January 1, 2007 acquisition of New York Water Service Corporation, the mid-year 2004 Heater and Florida Water Services acquisitions, and the AquaSource acquisition completed July 2003. The operating revenues and financial results of New York Water Service Corporation will be included in our consolidated financial statements beginning January 1, 2007. Acquisitions in our Regulated segment have provided additional water and wastewater revenues of approximately $4,715 in 2006, $12,630 in 2005 and $54,900 in 2004. Excluding the effect of acquisitions, our customer base increased at a five-year annual compound rate of 1.8%. Rate increases implemented during the past three years have provided additional operating revenues of approximately $32,000 in 2006, $26,800 in 2005 and $15,800 in 2004.

On June 22, 2006, the Pennsylvania Public Utility Commission (PAPUC) granted our Pennsylvania operating subsidiary a $24,900 base water rate increase, on an annualized basis. The rates in effect at the time of the filing included $12,397 in Distribution System Improvement Charges ("DSIC") or 5% above the prior base rates. Consequently, the total base rates increased by $37,297 and the DSIC was reset to zero.

On August 5, 2004, the PAPUC granted our Pennsylvania operating subsidiary a $13,800 base rate increase. The rates in effect at the time of the filing included $11,200 in DSIC or 5.0% above the prior base rates. Consequently, the total base rates increased by $25,000 and the DSIC was reset to zero.

In May 2004, our operating subsidiary in Texas filed an application with the Texas Commission on Environmental Quality (TCEQ) to increase rates, on an annualized basis, by $11,920 over a multi-year period. The application seeks to increase annual revenues in phases and is accompanied by a plan to defer and amortize a portion of our depreciation, operating and other tax expense over a similar multi-year period, such that the impact on operating income approximates the requested amount during the first years that the new rates are in effect. The application is currently pending before the TCEQ and several parties have joined the proceeding to challenge our rate request. We commenced billing for the requested rates and implemented the deferral plan in August 2004, in accordance with authorization from the TCEQ in July 2004. The additional revenue billed and collected prior to the final ruling is subject to refund based on the outcome of the ruling. The revenue recognized and the expenses deferred by us reflect an estimate of the final outcome of the ruling. In the event our request is denied completely or in part, we could be required to refund some or all of the revenue billed to date, and write-off some or all of the regulatory asset for the expense deferral. In December 2006, the TCEQ held hearings and issued a rate schedule that provided further clarification and an indication of the expected outcome of the rate proceeding. Based on our review of the present circumstances and as a result of the December 2006 hearings, we have revised our estimate of the final outcome of the TCEQ proceeding. During the fourth quarter of 2006, the revenue reserve was adjusted and additional revenues were recognized of $1,487 and the regulatory asset was increased resulting in lower expenses recognized of $1,199. As of December 31, 2006, we have deferred $12,382 of operating costs and $2,804 of rate case expenses; and recognized $14,859 of revenue that is subject to refund depending on the outcome of the final commission order.

Our operating subsidiaries located in other states received rate increases representing estimated annualized revenues of $7,366 in 2006 resulting from 32 rate decisions, $5,142 in 2005 resulting from 23 decisions, and $6,673 in 2004 resulting from 14 rate decisions. Revenues from these increases realized in the year of grant were approximately $3,580 in 2006, $3,144 in 2005 and $3,995 in 2004. These operating subsidiaries currently have filed 96 rate requests which are being reviewed by the state regulatory commissions, proposing an aggregate increase of $9,831 in annual revenues. During 2007, we intend to file 27 additional rate requests proposing an aggregate of approximately $26,300 of increased annual revenues; however we can provide no assurance that the full amount of the requested rate increases will be granted.

Currently, Pennsylvania, Illinois, Ohio, New York, Indiana and Missouri allow for the use of infrastructure rehabilitation surcharges. In Pennsylvania, this mechanism is referred to as a DSIC. These surcharge 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 at 5% to 9% 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 $7,873 in 2006, $10,186 in 2005 and $7,817 in 2004.

Our Regulated segment also includes certain non-regulated operating revenues of $13,525 in 2006, $13,161 in 2005 and $11,556 in 2004. These operating revenues are associated with contract operations that are integral to the utility business and operations. These amounts vary over time according to the level of activity associated with the utility contract operations.

In addition to the Regulated segment operating revenues, we had other non-regulated revenues that were primarily associated with non-regulated wastewater, septage, operating and maintenance contracts, and data processing service fees of $7,198 in 2006, $3,323 in 2005 and $2,067 in 2004. The increase in 2006 over 2005 was primarily due to the acquisition of several septage businesses during 2006. The increase in 2005 over 2004 resulted primarily from the additional revenues associated with the acquisition of an on-site septic tank pumping business, and increased revenues resulting from new and expanded contract operations. Acquisitions outside our Regulated segment have provided additional operating revenues of approximately $3,935 in 2006, $1,082 in 2005, and no additional operating revenues in 2004.

Operations and Maintenance Expenses—Operations and maintenance expenses totaled $219,560 in 2006, $203,088 in 2005 and $178,345 in 2004. Most elements of operating costs are subject to the effects of inflation, and changes in the number of customers served. Several elements are subject to the effects of changes in water consumption, weather 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 2006 as compared to 2005 by $16,472 or 8.1% primarily due to the additional operating costs associated with acquisitions of $6,316, increased water production expenses of $3,576, increased insurance expense, driven by higher claims of $1,945, stock-based compensation expense of $2,894, a reduction in the deferral of expenses related to the Texas rate case filing of $1,989, and normal increases in other operating costs, offset partially by receipt of $1,500 relating to a waiver of certain contractual rights reported outside of the Regulated segment. The additional operating costs associated with acquisitions noted above includes $3,760 associated with the businesses that provide on-site septic tank pumping, sludge hauling services and other non-regulated water and wastewater services which are not a component of the Regulated segment.

Operations and maintenance expenses increased in 2005 as compared to 2004 by $24,743 or 13.9% primarily due to the additional operating costs associated with acquisitions of $9,574, additional water production expenses of $3,856, increased postretirement benefit costs of $2,430, higher insurance costs due to the absence in 2005 of the favorable claim settlements that had occurred in 2004 of $2,142, and the effect of the $2,342 gain on the sale of the Geneva water system which was recorded as a component of operations and maintenance expense in 2004. In the consolidated statement of income for 2004, the gain on the sale of the Geneva water system is reported as a component of the line titled operations and maintenance expense.

Depreciation and Amortization Expenses—Depreciation expense was $70,895 in 2006, $60,747 in 2005 and $54,564 in 2004, and has increased principally as a result of the significant capital expenditures made to expand and improve our utility facilities, and as a result of acquisitions of water and wastewater systems.

Amortization expense was $4,146 in 2006, $4,741 in 2005 and $4,300 in 2004. The decrease in 2006 and the increase in 2005 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 $1,647 or 5.2% in 2006 as compared to 2005 and $4,100 or 14.9% in 2005 as compared to 2004. The increase in 2006 is due to additional state and local taxes, primarily property taxes. The increase in 2005 is due to additional taxes associated with acquisitions and increases in state and local taxes. The other taxes associated with acquisitions resulted from the effect of the mid-year 2004 acquisitions of Heater Utilities and the systems of Florida Water.

Interest Expense, net—Net interest expense was $58,432 in 2006, $52,062 in 2005 and $48,679 in 2004. Interest income of $3,241 in 2006, $3,040 in 2005 and $1,762 in 2004 was netted against interest expense. Interest expense increased in 2006 primarily due to additional borrowings to finance capital projects and acquisitions, and increased interest rates on short-term borrowings. Interest expense increased in 2005 primarily as a result of higher levels of borrowings, offset partially by the effects of decreased interest rates on borrowings. The higher level of average borrowings in 2005 was used to finance the Heater and Florida Water acquisitions in mid-year 2004, and capital expenditures. Interest income decreased in 2006 due to a reduction in investment income earned in 2006 as compared to 2005. Interest income increased in 2005 due to additional investment income earned in 2005 on the proceeds from the issuance of tax-exempt bonds while being held by trustees pending completion of projects financed with the issues. Such interest income is capitalized through our allowance for funds used during construction, a reduction to net interest expense. Interest expense on long-term debt during 2006 and 2005 was favorably impacted by a reduction in the weighted cost of long-term debt from 6.00% at December 31, 2004, to 5.74% at December 31, 2005, and to 5.72% at December 31, 2006.

Allowance for Funds Used During Construction—The allowance for funds used during construction (AFUDC) was $3,941 in 2006, $2,447 in 2005 and $2,304 in 2004 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 2006 is due to an increase in the average balance of CWIP to which AFUDC is applied and an increase in the AFUDC rate which is based on short-term interest rates. The increase in 2005 is due to an increase in the average balance of CWIP to which AFUDC is applied, and additional AFUDC recorded as an adjustment in 2005 of $719 resulting from the identification of a previously issued rate order which allowed the continuation of AFUDC on certain capital projects subsequent to being placed into utility service. This post-in-service AFUDC was not recognized in prior periods. These variances were partially offset by investment income earned during 2005, which reduced AFUDC.

(In thousands of dollars, except per share amounts)

Gain on Sale of Other Assets—Gain on sale of other assets totaled $1,194 in 2006, $1,177 in 2005 and $1,272 in 2004 and consisted of gains on land and marketable securities sales. Gain on sale of land totaled $1,194 in 2006, $1,177 in 2005 and $869 in 2004. Gain on sale of marketable securities totaled $403 in 2004.

Income Taxes—Our effective income tax rate was 39.6% in 2006, 38.4% in 2005 and 39.4% in 2004. The change in the effective tax rate in 2006 was due to an increase in our expenses that are not tax-deductible, including a portion of the stock-based compensation expense. The change in the effective tax rates in 2005 is due to differences between tax deductible expenses and book expenses and the recognition of the American Jobs Creation Act tax deduction for qualified domestic production activities that reduced our tax provision by approximately $740.

Summary—Operating income was $205,547 in 2006, $196,507 in 2005 and $177,234 in 2004 and net income was $92,004 in 2006, $91,156 in 2005 and $80,007 in 2004. Diluted income per share was $0.70 in 2006, $0.71 in 2005 and $0.64 in 2004. The changes in the per share income in 2006 and 2005 over the previous years were due to the aforementioned changes in income and impacted by a 2.0% increase in the average number of common shares outstanding during 2006 and a 2.8% increase in the average number of common shares outstanding during 2005, respectively. The increase in the number of shares outstanding in 2006 is primarily a result of the additional shares issued in common share offerings and additional shares issued through our dividend reinvestment plan. The increase in the number of shares outstanding in 2005 is primarily a result of the additional shares issued through our dividend reinvestment plan, employee stock purchase plan and equity compensation plan.

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—The following table provides our fourth quarter results:

	Three Months Ended December 31, 2006	Three Months Ended December 31, 2005
Operating revenues	$ 136,843	$ 122,908
Operations and maintenance	53,684	52,222
Depreciation and amortization	19,494	16,971
Taxes other than income taxes	8,352	7,663
	81,530	76,856
Operating income	55,313	46,052
Interest expense, net	14,764	13,447
Allowance for funds used during construction	(1,040)	(950)
Gain on sale of other assets	(360)	(595)
Income before income taxes	41,949	34,150
Provision for income taxes	16,226	12,000
Net income	$ 25,723	$ 22,150

The increase in operating revenues was a result of additional revenues of $13,800 resulting from an increase in water and wastewater rates implemented in various operating subsidiaries, including operating revenues of $1,487 recognized during the fourth quarter of 2006 from our revised estimate of the final outcome of the Texas rate proceeding as described in the section named "Operating Revenues." In addition, operating revenues increased due to additional revenues associated with acquisitions of $3,529, offset partially by lower infrastructure rehabilitation surcharge revenue of $2,170. The higher operations and maintenance expense is due primarily to $3,067 of additional operating costs associated with acquisitions, and higher water production costs of $449, offset partially by $1,199 of additional expenses deferred during the fourth quarter of 2006 resulting from an increase in the regulatory asset associated with the Texas rate case proceeding, and lower insurance expense of $781 due to a reduction in claims. The increased depreciation expense reflects the utility plant placed in service since the fourth quarter of 2005. Other taxes increased due to higher property taxes and additional local taxes incurred in the fourth quarter of 2006. The increased interest expense is due to additional borrowings to finance capital projects and increased interest rates on short-term borrowings.

(In thousands of dollars, except per share amounts)

FINANCIAL CONDITION

Consolidated 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, 2006 were as follows:

	Net Operating Cash Flow	Common Dividends	Capital Expenditures	Acquisitions
2002	$ 121,560	$ 36,789	$ 136,164	$ 8,914
2003	143,373	39,917	163,320	192,331
2004	173,603	45,807	195,736	54,300
2005	199,674	51,139	237,462	11,633
2006	170,726	58,023	271,706	11,848
	$ 808,936	$ 231,675	$ 1,004,388	$ 279,026

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, water meters and an office building expansion. During this five-year period, we received $59,475 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 repaid debt in the amount of $251,639, retired $1,116 of preferred stock, and have refunded $24,217 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 number of shares outstanding during the period.

Our planned 2007 capital program, exclusive of the costs of new mains financed by advances and contributions in aid of construction, is estimated to be $235,800 of which $80,308 is for infrastructure rehabilitation surcharge-qualified projects. Our planned capital program includes 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 of our capital program. Our 2007 capital program, along with $31,155 of sinking fund obligations and debt maturities, $28,866 for the acquisition of New York Water Service Corporation and $103,482 of other contractual cash obligations, as reported in the section captioned "Contractual Obligations", has been or is expected to be financed through internally-generated funds, our revolving credit facilities, the issuance of equity through public offerings or through settlement in common shares of the forward equity sale agreement, and the issuance of long-term debt. The New York Water Service Corporation, which was acquired in January 2007, was financed through the issuance of unsecured long-term notes that were issued in December 2006.

Future utility construction in the period 2008 through 2011, 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 $1,000,000. We anticipate that approximately one-half of these expenditures will require external financing of debt and the additional issuance of common stock through our dividend reinvestment and stock purchase plans and the issuance of equity through public offerings or through settlement in common shares of the forward equity sale agreement. We expect to refinance $112,155 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.

Our primary source of liquidity is cash flows from operations, borrowings under various short-term lines of credit and other credit facilities, and customer 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 and cash flow to enable them to secure the capital they will need to operate and to maintain satisfactory debt coverage ratios.

Acquisitions

During the past five years, we have expended cash of $279,026 and issued 263,169 shares of common stock, valued at $3,420 at the time of the acquisition, related to the acquisition of utility systems, both water and wastewater utilities, and non-regulated businesses that provide wastewater and septage hauling services. We included the operating results of these acquisitions in our consolidated financial statements beginning on the respective acquisition date.

On January 1, 2007 we completed the acquisition of the capital stock of New York Water Service Corporation for $28,866 in cash, as adjusted pursuant to the purchase agreement primarily based on working capital at closing, and the assumption of $23,460 of long-term debt. The operating results of New York Water Service Corporation will be included in our consolidated financial statements beginning January 1, 2007. The acquired operation provides water service to 44,792 customers in several water systems located in Nassau County, Long Island, New York. For the fiscal year ended December 31, 2005, New York Water Service had operating revenues of $21,773. The acquisition will be accounted for as a purchase and will be recorded in the first quarter of 2007. The acquisition was funded through the issuance of long-term debt that was issued in 2006.

In addition during 2006, we completed 27 acquisitions for $11,848 in cash. The acquisitions completed in 2006 included both water and wastewater systems in seven of the states in which we operate, and the acquisition of several non-regulated companies that provide on-site septic tank pumping, sludge hauling services and other wastewater services to customers in eastern Pennsylvania, New Jersey, Delaware, New York and Maryland.

During 2005, we completed 30 acquisitions for $11,633 in cash and the issuance of 24,684 shares of common stock. The acquisitions completed in 2005 included both water and wastewater systems in seven of the states in which we operate. On June 1, 2004, we acquired the capital stock of Heater Utilities, Inc. for $48,000 in cash and the assumption of long-term debt of $19,219 and short-term debt of $8,500. At the date of the acquisition, Heater provided water and wastewater service to over 50,000 water and wastewater customers primarily in the areas of suburban Raleigh, Charlotte, Gastonia and Fayetteville, North Carolina. The acquisition was accounted for as a purchase and accordingly, we recorded goodwill of $18,842. As part of the North Carolina Utilities Commission approval process for this acquisition, the Commission approved a mechanism through which we could recover up to two-thirds of the goodwill through customer rates in the future upon achieving certain objectives. We are pursuing these objectives to facilitate recognition of this premium in customer rates. However, there can be no assurance that we will be able to achieve these objectives and recover such amount of goodwill.

On June 30, 2004, we acquired certain utility assets of Florida Water Services Corporation, comprised of 63 water and wastewater systems located in central Florida for $13,090 in cash, the final purchase price as adjusted pursuant to the purchase agreement. In accordance with Florida Public Service Commission procedures, the acquisition was approved by the Commission and rate base was determined on December 20, 2005. Under the terms of the purchase agreement, the Commission's rate base determination resulted in the final purchase price which did not result in the recognition of goodwill.

The acquisitions of Heater and the Florida Water Systems were initially funded by a portion of the proceeds from the issuance by Aqua America of an unsecured short-term note which was subsequently repaid by Aqua America with the proceeds from the February 2005 issuance of $30,000 of unsecured notes and the issuance of 2,606,667 shares of common stock in a secondary equity offering for proceeds of $42,600, net of expenses. In February 2005, Aqua America issued $18,000 of notes due in 2015 with an interest rate of 5.01% and $12,000 of notes due in 2020 with an interest rate of 5.20%.

In 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 based on working capital at closing. In 2004, we were awarded and received $12,289 plus interest in an arbitration related to the calculation of the final purchase price under the terms of the purchase agreement, which resulted in a final purchase price of $178,428. In the consolidated statement of cash flow for 2004, the $12,289 award has been reported as proceeds on the line titled acquisitions of utility systems and other, net. The acquisition was funded by a portion of the proceeds from the 2003 issuance of $135,000 of unsecured notes due in 2023, with an interest rate of 4.87%, and the issuance of 6,666,667 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 and Kentucky operations which were subsequently sold to other parties). Please refer to the section captioned "Dispositions" for a discussion of the disposition of the AquaSource operations located in Connecticut and Kentucky. The acquisition provides an expanded platform from which to extend our growth-through-acquisition strategy of acquiring water and wastewater 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.

We continue to hold acquisition discussions with several water and wastewater systems. Generally 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 2004, as a result of the settlement of a condemnation action, our Ohio operating subsidiary sold its water utility assets within the municipal boundaries of the City of Geneva in Ashtabula County, Ohio for net proceeds of approximately $4,716, 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 2004 of a gain on the sale of these assets, net of expenses, of $2,342. The gain is reported in the 2004 consolidated statement of income as a reduction to operations and maintenance expense. We continue to operate this water system for the City of Geneva under a multi-year operating contract that expires in December 2008. These water utility assets represented less than 1% of Aqua America's total assets, and the total number of customers included in the water system sold represented less than 1% of our total utility customer base.

We reviewed and evaluated areas of our business and operating divisions that were acquired in 2003 with the AquaSource operations and have completed the following sale transactions of operating divisions acquired as part of the AquaSource transaction:

- In 2004, we sold our only operation in Kentucky. The sale price approximated our investment in this operation. The operation represented approximately 0.2% of the operations acquired from AquaSource, Inc.
- In 2003, we completed the sale of our only operation in Connecticut. The sale price of $4,000 approximated our investment in this operation. The operation represented approximately 2% of the operations acquired from AquaSource, Inc.

In 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 2002 of a gain on the sale of these assets, net of expenses, of $5,676. We continue to operate this water system for Ashtabula County under a multi-year operating contract that expires in December 2008. 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.

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. We have challenged whether the City is following the correct legal procedures in connection with the City's attempted condemnation and we have challenged the City's valuation of this portion of our system. The portion of the system under consideration represents approximately 1% of our total utility customer base. While we continue to discuss this matter with officials from the City of Fort Wayne, we continue to protect our legal interests in this proceeding. A sanitary district in Illinois and a city in Texas have also indicated interest in acquisition, by eminent domain or otherwise, of all or a portion of the utility assets of two of our operations. The systems represent approximately 3,000 customers or less than 0.5% of our total utility customer base. We believe that we will be entitled to fair market value for our assets if they are condemned, and that the fair market value will be in excess of the book value for such assets.

Despite these transactions, our strategy continues to be to acquire additional water and wastewater systems, to maintain our existing systems where there is a business or a strategic benefit, and to actively oppose unilateral efforts by municipal governments to acquire any of our operations.

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 $697,379 of long-term debt and obtained other short-term borrowings during the past five years. During the past five years, the Trustees released an aggregate $8,277 of the proceeds from certain long-term debt issuances in accordance with when the projects financed with the issues were completed. At December 31, 2006, we had short-term lines of credit and other credit facilities of $238,000, of which $118,850 was available. Our short-term lines of credit and other credit facilities are either payable on demand or have a 364-day term.

In December 2005, we filed a universal shelf registration with the SEC to allow for the potential future sale by us, from time to time, in one or more public offerings, of an indeterminant amount of our common stock, preferred stock, debt securities and other securities specified therein at indeterminant prices.

In August 2006, we entered into a forward equity sale agreement for 3,525,000 shares of common stock with a third party ("forward purchaser"). In connection with the forward equity sale agreement, the forward purchaser borrowed an equal number of shares of our common stock from stock lenders and sold the borrowed shares to the public. We will not receive any proceeds from the sale of our common stock by the forward purchaser until settlement of all or a portion of the forward equity sale agreement. The actual proceeds to be received by us will vary depending upon the settlement date, the number of shares designated for settlement on that settlement date and the method of settlement. We intend to use any proceeds received by us upon settlement of the forward equity sale agreement to fund our future capital expenditure program and acquisitions, and for working capital and other general corporate purposes. During the last three years, we completed the following offerings of equity:

- In June 2006, we sold 1,750,000 shares of common stock in a public offering for proceeds of $37,400, net of expenses. In August 2006, we sold 500,000 shares of common stock in a public offering for proceeds of $10,700, net of expenses. The net proceeds from these offerings were used to fund our capital expenditure program and acquisitions, and for working capital and other general corporate purposes.

- In November 2004, we sold 2,606,667 shares of common stock in a public offering for proceeds of $42,600, net of expenses. The net proceeds were used to repay a portion of our short-term debt. The short-term debt was incurred by Aqua America in connection with the Heater and Florida Water acquisitions.

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 in connection with acquisitions. During 2006, 2004 and 2003, we did not issue any shares under the acquisition shelf registration. During 2005, we issued 24,684 shares of common stock totaling $675 to acquire a water system. During 2002, we issued 238,219 shares of common stock totaling $2,745 to acquire water and wastewater systems. The balance remaining available for use under the acquisition shelf registration as of December 31, 2006 is 2,194,262 shares. We will determine the form and terms of any securities issued under these shelf registrations at the time of issuance.

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. The dividend reinvestment portion of the Plan offers a 5% discount on the purchase of shares of common stock with reinvested dividends. As of the December 2006 dividend payment, holders of 16.1% of the common shares outstanding participated in the dividend reinvestment portion of the Plan. The shares issued under the Plan are either original issue shares or shares purchased by the Company's transfer agent in the open-market. During the past five years, we have sold 2,382,804 original issue shares of common stock for net proceeds of $39,072 through the dividend reinvestment portion of the Plan and we used the proceeds to invest in our operating subsidiaries, to repay short-term debt, and for general corporate purposes.

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, 2006, 548,278 shares remain available for repurchase. Funding for future stock purchases, if any, is not expected to have a material impact on our financial position.

(In thousands of dollars, except per share amounts)

Off-Balance Sheet Financing Arrangements

We do not engage in any off-balance sheet financing arrangements. We do not have any interest in entities referred to as variable interest entities, which includes special purpose entities and other structured finance entities.

Contractual Obligations

The following table summarizes our contractual cash obligations as of December 31, 2006:

	Payments Due By Period						
	2007	2008	2009	2010	2011	Thereafter	Total
Long-term debt (a)	$ 31,155	$23,961	$ 7,004	$ 54,192	$26,998	$ 839,505	$ 982,815
Interest on fixed-rate, long-term debt (b)	56,066	53,369	52,690	50,037	46,880	588,756	847,798
Operating leases (c)	4,007	3,659	2,148	1,092	694	17,136	28,736
Unconditional purchase obligations (d)	10,764	10,333	10,008	9,582	9,774	59,091	109,552
Other purchase obligations (e)	20,614	—	—	—	—	—	20,614
Postretirement benefit plans' obligations (f)	10,260	—	—	—	—	—	10,260
Other obligations (g)	1,771	200	190	—	—	3,000	5,161
Total	$134,637	$91,522	$72,040	$114,903	$84,346	$1,507,488	$2,004,936

(a) Represents sinking fund obligations and debt maturities.

(b) Represents interest payable on fixed-rate, long-term debt. Amounts reported may differ from actual due to future refinancing of debt.

(c) Represents operating leases that are noncancelable, before expiration, for the lease of motor vehicles, buildings, land and other equipment.

(d) 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. Our actual purchases may exceed the minimum required levels.

(e) Represents an approximation of the open purchase orders as of the period end for goods and services purchased in the ordinary course of business.

(f) Represents contributions expected to be made to postretirement benefit plans. The amount of required contributions in 2008 and thereafter is not determinable.

(g) Represents capital expenditures estimated to be required under legal and binding contractual obligations.

In addition to these obligations, we pay 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 paid, 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 are dependent upon several variables, including new customer connections, customer consumption levels and future rate increases, which cannot be accurately estimated. Portions of these refund amounts are payable annually through 2021 and amounts not paid by the contract expiration dates become non-refundable.

We will fund these contractual obligations with cash flows from operations and liquidity sources held by or available to us. On January 1, 2007, we completed the acquisition of New York Water Service Corporation for $28,866 in cash and the assumption of $23,460 of long-term debt. The acquisition was funded through the issuance of long-term debt that was issued in 2006 and included in the table above.

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, 2006, the debt maturities by period and the weighted average interest rate for fixed-rate, long-term debt are as follows:

(In thousands of dollars, except per share amounts)

	2007	2008	2009	2010	2011	Thereafter	Total	Fair Value
Long-term debt (fixed rate)	$31,155	$23,961	$ 7,004	$54,192	$26,998	$ 839,505	$982,815	$986,487
Weighted average interest rate	5.10%	6.63%	4.81%	6.43%	6.42%	5.65%	5.72%	

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, 2006, our carrying value of certain investments was $499, which reflects the market value of such investments and is in excess of our original cost. As of December 31, 2005, we owned no marketable equity securities.

Capitalization

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

December 31,	2006	2005	2004	2003	2002
Long-term debt*	51.6%	52.7%	52.8%	52.8%	55.6%
Common stockholders' equity	48.4%	47.3%	47.2%	47.2%	44.4%
	100.0%	100.0%	100.0%	100.0%	100.0%

*Includes current portion.

Over the past five years, the changes in the capitalization ratios primarily resulted from the issuance of common stock, the issuance of debt to finance our acquisitions and capital program, and the 2002 repurchase of common stock from a large shareholder that was subsequently reissued in 2003. It is our goal to maintain an equity ratio adequate to support the 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 62 years. Effective September 1, 2006, our Board of Directors authorized an increase of 7.6% 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 September 2006, the annual dividend rate increased to $0.46 per share from $0.4276 per share. This is the 16th dividend increase in the past 15 years and the eighth consecutive year that we have increased our dividend in excess of five percent. 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, restrictions set forth in our debt instruments, 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 57.8% of net income.

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 judgments of matters of uncertainty. Changes in the estimates or other judgments 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 valuation of our long-lived assets which consist primarily of Utility Plant in Service, regulatory assets and goodwill, our accounting for postretirement benefits and our accounting for income taxes. We have discussed the selection and development of our critical accounting policies and estimates with the Audit Committee of the Board of Directors.

Revenue Recognition—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 judgment 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.

In some operating divisions, we commence the billing of our utility customers, under new rates, upon authorization from the respective regulatory commission and before the final commission rate order is issued. The revenue recognized reflects an estimate based on our judgment of the final outcome of the ruling. We monitor the facts and circumstances regularly, and revise the estimate as required. The revenue billed and collected prior to the final ruling is subject to refund based on the final ruling. Please refer to the section named "Operating Revenues" for a discussion of revenue currently being recognized under rate filings that are not final.

Regulatory Assets and Liabilities—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.

Valuation of Long-Lived Assets, Goodwill and Intangible Assets—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.

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," we test the goodwill attributable to each of our reporting units for impairment at least annually on July 31, or more often, if certain circumstances indicate a possible impairment may exist. We evaluate goodwill for impairment using the discounted cash flow methodologies, transaction values for other comparable companies, and other valuation techniques for all of our reporting units with goodwill balances. The evaluation requires significant management judgment and estimates that are based on budgets, general strategic business plans, historical trends and other data and relevant factors. If changes in circumstances or events occur, or estimates and assumptions which were used in our impairment test change, we may be required to record an impairment charge for goodwill. Based on our comparison of the estimated fair value of each reporting unit to their respective carrying amounts, the impairment test performed in 2006 concluded that none of our goodwill was impaired.

Accounting for Postretirement Benefits—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 assumption was determined using a yield curve that was produced from a universe containing over 500 U.S.-issued Aa-graded corporate bonds, all of which were noncallable (or callable with make-whole provisions), and excluding the 10% of the bonds with the highest yields and the 10% with the lowest yields. The discount rate was then developed as the single rate that would produce the same present value as if we used spot rates, for various time periods, to discount the projected pension benefit payments. 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 2006 pension expense by $660 and the pension liabilities by $6,500. The present values of Aqua America's future pension and other postretirement obligations were determined using discount rates of 5.90% at December 31, 2006 and 5.65% at December 31, 2005. Our expense under these plans is determined using the discount rate as of the beginning of the year, which was 5.65% for 2006, and will be 5.90% for 2007.

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 2006 pension expense by $300. For 2006, we used an 8.0% expected return on assets assumption which will remain unchanged for 2007. The expected return on assets is based on a targeted allocation of 50% to 75% equities and 25% to 50% 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 within various asset categories.

We adopted SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106 and 132(R)" on December 31, 2006. As a result of adopting SFAS No. 158 on December 31, 2006, we recorded the underfunded status of our pension and other postretirement benefit plans on the balance sheet and recorded a regulatory asset for these costs that would otherwise be charged to common stockholders' equity, as we anticipate recoverability of the costs through customer rates. See the section titled "Impact of Recent Accounting Pronouncements" for additional information. As a result of adopting SFAS No. 158, the additional minimum liability associated with our defined benefit pension plan was eliminated as it is no longer required to be recorded under SFAS No. 158. Prior to the adoption of SFAS No. 158 on December 31, 2006, our additional minimum liability was $3,498. The additional minimum liability was a result of the accumulated benefit obligation exceeding the fair value of plan assets. The decrease in the additional minimum liability from December 31, 2005 of $10,909 to December 31, 2006 of $3,498, prior to adoption of SFAS No. 158, resulted from the effect of an increased discount rate and an increase in pension plan assets during 2006 due to positive equity market performance and pension contributions. A portion of the December 31, 2005 and all of the December 31, 2006 additional minimum liability prior to adoption of SFAS No. 158, resulted in the establishment of a regulatory asset as we expect recovery of the future, increased pension expense through customer rates.

Funding requirements for qualified defined benefit pension plans are determined by government regulations and not by accounting pronouncements. In accordance with our funding policy, during 2007 our required pension contribution is expected to be approximately $7,300. The Pension Protection Act of 2006 was signed into law in August 2006. We are currently evaluating this legislation and the effect it will have on our future pension contributions and do not expect our estimate for the 2007 funding amount to change. However, future contributions may be impacted by the effect of the Pension Protection Act of 2006, though we expect future changes in the amount of contributions and expense recognized to be generally included in customer rates.

Accounting for Income taxes—We estimate the amount of income tax payable or refundable for the current year and the deferred income tax liabilities and assets that results from estimating temporary differences resulting from the treatment of certain items, such as depreciation, for tax and financial statement reporting. These differences result in the recognition of a deferred tax asset or liability on our consolidated balance sheet and require us to make judgments regarding the probability of the ultimate tax impact of the various transactions we enter into. Based on these judgments we may record tax reserves or adjustments to valuation allowances on deferred tax assets to reflect the expected realization of future tax benefits. Actual income taxes could vary from these estimates and changes in these estimates can increase income tax expense in the period that these changes in estimates occur. On January 1, 2007, we adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-An Interpretation of FASB Statement No. 109," which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. See the section titled "Impact of Recent Accounting Pronouncements" for additional information.

IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106 and 132(R)." This statement requires the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS No. 158, actuarial gains and losses, prior service costs or credits, and any remaining transition assets or obligations that have not been recognized under previous accounting standards that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects. We adopted SFAS No. 158 on December 31, 2006 as required. Because we are subject to regulation in the states in which we operate, we maintain our accounts in accordance with the regulatory authority's rules and guidelines, which may differ from other authoritative accounting pronouncements. In those instances, we follow the guidance of SFAS No. 71. Based on prior regulatory experience, and in accordance with SFAS No. 71, we recorded a regulatory asset for the pension and other postretirement benefit costs associated with SFAS No. 158, that would otherwise be charged to common stockholders' equity, for which we anticipate recoverability through customer rates. As a result, the impact of adopting SFAS No. 158 on our Consolidated Balance Sheet was to increase total liabilities by $30,305, and increase total assets by $30,305. The adoption of this standard had no impact on our results of operations or cash flow, and the impact on financial position is described above. See the Pension Plans and Other Postretirement Benefits footnote to the consolidated financial statements for further information and the required disclosures under SFAS No. 158.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The statement applies when other statements require or permit the fair value measurement of assets and liabilities. This statement does not expand the use of fair value measurement. SFAS No. 157 is effective for our fiscal year beginning January 1, 2008. We are currently evaluating the provisions of this statement and have not yet determined the effect of adoption on our results of operations or financial position.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides guidance on how prior year misstatements should be considered when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. We adopted SAB 108 as required for the fiscal year ended December 31, 2006 and it did not have a material impact on our results of operations or financial position.

In June 2006, the FASB issued FASB Interpretation No. ("FIN") 48, "Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109," which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We adopted FIN 48 as required on January 1, 2007 and it did not have a material effect on our results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment." SFAS No. 123R generally requires that we measure the cost of employee services received in exchange for stock-based awards on the grant-date fair value and this cost will be recognized over the period during which an employee provides service in exchange for the award. Prior to the adoption of SFAS No. 123R on January 1, 2006, we provided pro forma disclosure of our compensation costs associated with the fair value of stock options that had been granted, and accordingly, no compensation costs were recognized in our consolidated financial statements. We adopted this standard using the modified prospective method, and accordingly, the consolidated financial statement amounts for the prior periods presented in this report have not been restated to reflect the fair value method of expensing share-based compensation. During 2006, the adoption of SFAS No. 123R increased operations and maintenance expense by $2,894, lowered net income by $2,568, and lowered diluted net income per share by $0.019. The adoption of this standard had no material impact on our overall financial position, no impact on cash flow, and results in the reclassification on the consolidated cash flow statements of related tax benefits from cash flows from operating activities to cash flows from financing activities to the extent these tax benefits exceed the associated compensation cost recognized in the income statement. As of the date of adoption, we calculated our pool of windfall tax benefits in accordance with the method outlined in SFAS No. 123R. See the Employee Stock and Incentive Plan footnote to the consolidated financial statements for further information and the required disclosures under SFAS No 123R.

AQUA AMERICA, INC. AND SUBSIDIARIES

Management's Report On Internal Control Over Financial Reporting

Management of Aqua America, Inc. (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In assessing the effectiveness of internal control over financial reporting, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. As a result of management's assessment and based on the criteria in the framework, management has concluded that, as of December 31, 2006, the Company's internal control over financial reporting was effective.

The Company's independent registered public accounting firm, PricewaterhouseCoopers LLP, has audited management's assessment of the effectiveness of the Company's internal control over financial reporting, as stated in their report which appears herein.

/s/ Nicholas DeBenedictis

Nicholas DeBenedictis
Chairman, President and Chief Executive Officer

/s/ David P. Smeltzer

David P. Smeltzer
Senior Vice President Finance and Chief Financial Officer

February 27, 2007

Report of Independent Registered Public Accounting Firm

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

We have completed integrated audits of Aqua America, Inc.'s consolidated financial statements and of its internal control over financial reporting as of December 31, 2006 in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated Financial Statements
In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and comprehensive income, of capitalization, of common stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Aqua America, Inc. and its subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements 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.

As discussed under Summary of Significant Accounting Policies—Recent Accounting Pronouncements in the notes to the consolidated financial statements, the Company changed the manner in which it accounts for share-based compensation in 2006 and the manner in which it accounts for its defined benefit pension and other postretirement plans effective December 31, 2006.

Internal Control Over Financial Reporting
Also, in our opinion, management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that the Company maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control — Integrated Framework issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Philadelphia, Pennsylvania
February 27, 2007

AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(In thousands, except per share amounts)
Years ended December 31, 2006, 2005 and 2004

	2006	2005	2004
Operating revenues	$ 533,491	$ 496,779	$ 442,039
Costs and expenses:			
Operations and maintenance	219,560	203,088	178,345
Depreciation	70,895	60,747	54,564
Amortization	4,146	4,741	4,300
Taxes other than income taxes	33,343	31,696	27,596
	327,944	300,272	264,805
Operating income	205,547	196,507	177,234
Other expense (income):			
Interest expense, net	58,432	52,062	48,679
Allowance for funds used during construction	(3,941)	(2,447)	(2,304)
Gain on sale of other assets	(1,194)	(1,177)	(1,272)
Income before income taxes	152,250	148,069	132,131
Provision for income taxes	60,246	56,913	52,124
Net income	$ 92,004	$ 91,156	$ 80,007
Net income	$ 92,004	$ 91,156	$ 80,007
Other comprehensive income (loss), net of tax:			
Minimum pension liability adjustment	3,082	(1,340)	(1,742)
Unrealized holding gains on investments	194	—	59
Reclassification adjustment for gains reported in net income	—	—	(230)
	3,276	(1,340)	(1,913)
Comprehensive income	$ 95,280	$ 89,816	$ 78,094
Net income per common share:			
Basic	$ 0.70	$ 0.72	$ 0.64
Diluted	$ 0.70	$ 0.71	$ 0.64
Average common shares outstanding during the period:			
Basic	130,725	127,364	124,329
Diluted	131,774	129,206	125,710

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, 2006 and 2005

	2006	2005
Assets		
Property, plant and equipment, at cost	$ 3,185,111	$ 2,900,585
Less: accumulated depreciation	679,116	620,635
Net property, plant and equipment	2,505,995	2,279,950
Current assets:		
Cash and cash equivalents	44,039	11,872
Accounts receivable and unbilled revenues, net	72,149	62,690
Income tax receivable	—	8,321
Inventory, materials and supplies	8,359	7,798
Prepayments and other current assets	10,153	7,596
Total current assets	134,700	98,277
Regulatory assets	165,063	130,953
Deferred charges and other assets, net	38,075	37,061
Funds restricted for construction activity	11,490	68,625
Goodwill	22,580	20,180
	$ 2,877,903	$ 2,635,046
Liabilities and Stockholders' Equity		
Common stockholders' equity:		
Common stock at $.50 par value, authorized 300,000,000 shares, issued 133,017,325 and 129,658,806 in 2006 and 2005	$ 66,509	$ 64,829
Capital in excess of par value	548,806	478,508
Retained earnings	319,113	285,132
Treasury stock, at cost, 691,746 and 688,625 shares in 2006 and 2005	(12,992)	(12,914)
Accumulated other comprehensive income	194	(3,082)
Unearned compensation	—	(550)
Total common stockholders' equity	921,630	811,923
Minority interest	1,814	1,551
Long-term debt, excluding current portion	951,660	878,438
Commitments and contingencies	—	—
Current liabilities:		
Current portion of long-term debt	31,155	24,645
Loans payable	119,150	138,505
Accounts payable	49,406	55,455
Accrued interest	14,050	13,052
Accrued taxes	19,350	9,432
Other accrued liabilities	22,500	30,571
Total current liabilities	255,611	271,660
Deferred credits and other liabilities:		
Deferred income taxes and investment tax credits	273,199	250,346
Customers' advances for construction	76,820	74,828
Regulatory liabilities	11,592	11,751
Other	64,879	31,969
Total deferred credits and other liabilities	426,490	368,894
Contributions in aid of construction	320,698	302,580
	$ 2,877,903	$ 2,635,046

See accompanying notes to consolidated financial statements.

AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CAPITALIZATION
(In thousands of dollars, except per share amounts)
December 31, 2006 and 2005

	2006	2005
Common stockholders' equity:		
Common stock, $.50 par value	$ 66,509	$ 64,829
Capital in excess of par value	548,806	478,508
Retained earnings	319,113	285,132
Treasury stock, at cost	(12,992)	(12,914)
Accumulated other comprehensive income	194	(3,082)
Unearned compensation	—	(550)
Total common stockholders' equity	921,630	811,923
Long-term debt:		
Long-term debt of subsidiaries (substantially secured by utility plant):		
Interest Rate Range		
0.00% to 2.49%	25,740	21,574
2.50% to 2.99%	25,272	28,684
3.00% to 3.49%	17,220	17,380
3.50% to 3.99%	6,073	6,748
4.00% to 4.99%	30,645	30,695
5.00% to 5.49%	262,496	262,588
5.50% to 5.99%	79,000	79,000
6.00% to 6.49%	94,360	88,504
6.50% to 6.99%	22,000	32,000
7.00% to 7.49%	13,288	15,878
7.50% to 7.99%	24,778	25,012
8.00% to 8.49%	26,288	26,507
8.50% to 8.99%	9,000	9,000
9.00% to 9.49%	46,101	46,764
9.50% to 9.99%	38,738	40,933
10.00% to 10.50%	6,000	6,000
	726,999	737,267
Unsecured notes payable, 4.87%, maturing in various installments 2010 through 2023	135,000	135,000
Unsecured notes payable, 5.95%, due in 2023 through 2034	40,000	—
Unsecured notes payable, 5.64%, due in 2014 through 2021	20,000	—
Unsecured notes payable, 5.54%, due in 2013 through 2018	30,000	—
Unsecured notes payable, 5.01%, due 2015	18,000	18,000
Unsecured notes payable, 5.20%, due 2020	12,000	12,000
Notes payable, 6.05%, maturing in 2007 and 2008	816	816
	982,815	903,083
Current portion of long-term debt	31,155	24,645
Long-term debt, excluding current portion	951,660	878,438
Total capitalization	$ 1,873,290	$ 1,690,361

See accompanying notes to consolidated financial statements.

AQUA AMERICA, INC. AND SUBSIDIArIES
CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDERS' EQUITY
(In thousands of dollars, except per share amounts)

	Common stock	Capital in excess of par value	Retained earnings	Treasury stock	Accumulated Other Comprehensive Income	Unearned Compensation on Restricted Stock	Total
Balance at December 31, 2003	$ 46,635	$ 413,008	$ 210,915	$ (12,611)	$ 171	$ —	$ 658,118
Net income	—	—	80,007	—	—	—	80,007
Other comprehensive income (loss):							
Minimum pension liability adjustment, net of income tax of $938	—	—	—	—	(1,742)	—	(1,742)
Unrealized gain on securities, net of income tax of $32	—	—	—	—	59	—	59
Less: reclassification adjustment for gains reported in net income, net of income tax of $173	—	—	—	—	(230)	—	(230)
Dividends	—	—	(45,807)	—	—	—	(45,807)
Sale of stock (3,181,203 shares)	1,170	48,971	—	991	—	—	51,132
Repurchase of stock (51,808 shares)	—	—	—	(1,082)	—	—	(1,082)
Equity Compensation Plan (45,535 shares)	17	692	—	—	—	—	709
Exercise of stock options (570,064 shares)	214	4,847	—	—	—	—	5,061
Employee stock plan tax benefits	—	1,006	—	—	—	—	1,006
Balance at December 31, 2004	48,036	468,524	245,115	(12,702)	(1,742)	—	747,231
Net income	—	—	91,156	—	—	—	91,156
Other comprehensive loss: minimum pension liability adjustment, net of income tax of $722	—	—	—	—	(1,340)	—	(1,340)
Dividends	—	—	(51,139)	—	—	—	(51,139)
Stock issued for acquisitions (24,684 shares)	12	663	—	—	—	—	675
Stock split	16,095	(16,095)	—	—	—	—	—
Sale of stock (471,682 shares)	161	7,943	—	1,537	—	—	9,641
Repurchase of stock (56,930 shares)	—	—	—	(1,749)	—	—	(1,749)
Equity Compensation Plan (37,751 shares)	14	708	—	—	—	(722)	—
Exercise of stock options (1,327,717 shares)	511	11,264	—	—	—	—	11,775
Employee stock plan tax benefits	—	5,501	—	—	—	—	5,501
Amortization of unearned compensation	—	—	—	—	—	172	172
Balance at December 31, 2005	64,829	478,508	285,132	(12,914)	(3,082)	(550)	811,923
Net income	—	—	92,004	—	—	—	92,004
Other comprehensive income:							
Unrealized holding gain on investments, net of income tax of $105	—	—	—	—	194	—	194
Minimum pension liability adjustment, net of income tax of $1,660	—	—	—	—	3,082	—	3,082
Dividends	—	—	(58,023)	—	—	—	(58,023)
Sale of stock (2,688,332 shares)	1,328	55,866	—	894	—	—	58,088
Repurchase of stock (36,346 shares)	—	—	—	(972)	—	—	(972)
Equity Compensation Plan (37,200 shares)	19	(19)	—	—	—	—	—
Reclassification of unearned compensation	—	(550)	—	—	—	550	—
Exercise of stock options (666,212 shares)	333	7,629	—	—	—	—	7,962
Stock-based compensation	—	4,235	—	—	—	—	4,235
Employee stock plan tax benefits	—	3,137	—	—	—	—	3,137
Balance at December 31, 2006	$ 66,509	$ 548,806	$ 319,113	$ (12,992)	$ 194	$ —	$ 921,630

See accompanying notes to consolidated financial statements.

AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands of dollars)
Years ended December 31, 2006, 2005 and 2004

	2006	2005	2004
Cash flows from operating activities:			
Net income	$ 92,004	$ 91,156	$ 80,007
Adjustments to reconcile net income to net cash flows from operating activities:			
Depreciation and amortization	75,041	65,488	58,864
Deferred income taxes	10,794	26,027	40,577
Stock-based compensation	3,604	—	—
Gain on sale of water system	—	—	(2,342)
Gain on sale of other assets	(1,194)	(1,177)	(1,272)
Net decrease (increase) in receivables, inventory and prepayments	(8,769)	7,572	(2,766)
Net increase (decrease) in payables, accrued interest, accrued taxes and other accrued liabilities	(5,609)	12,933	863
Other	4,855	(2,325)	(328)
Net cash flows from operating activities	170,726	199,674	173,603
Cash flows from investing activities:			
Property, plant and equipment additions, including allowance for funds used during construction of $3,941, $2,447 and $2,304	(271,706)	(237,462)	(195,736)
Acquisitions of utility systems and other, net	(11,848)	(11,633)	(54,300)
Release of funds previously restricted for construction activity	59,467	56,137	14,015
Additions to funds restricted for construction activity	(2,332)	(107,566)	(2,772)
Net proceeds from the sale of water systems	—	—	4,716
Net proceeds from the sale of other assets	1,283	1,300	2,098
Other	(213)	102	(517)
Net cash flows used in investing activities	(225,349)	(299,122)	(232,496)
Cash flows from financing activities:			
Customers' advances and contributions in aid of construction	12,031	14,728	14,269
Repayments of customers' advances	(5,168)	(4,792)	(4,930)
Net proceeds (repayments) of short-term debt	(19,355)	63,695	(30,150)
Proceeds from long-term debt	103,360	147,012	130,258
Repayments of long-term debt	(24,606)	(83,235)	(55,928)
Change in cash overdraft position	11,166	(8,808)	(2,190)
Proceeds from issuing common stock	58,088	9,641	51,132
Proceeds from exercised stock options	7,962	11,775	5,061
Stock-based compensation windfall tax benefits	2,307	—	—
Repurchase of common stock	(972)	(1,749)	(1,082)
Dividends paid on common stock	(58,023)	(51,139)	(45,807)
Other	—	—	179
Net cash flows from financing activities	86,790	97,128	60,812
Net increase (decrease) in cash and cash equivalents	32,167	(2,320)	1,919
Cash and cash equivalents at beginning of year	11,872	14,192	12,273
Cash and cash equivalents at end of year	$ 44,039	$ 11,872	$ 14,192
Cash paid during the year for:			
Interest, net of amounts capitalized	$ 53,222	$ 48,278	$ 45,261
Income taxes	$ 28,700	$ 30,734	$ 22,322

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.

Summary of Significant Accounting Policies

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, North Carolina, Illinois, Texas, New Jersey, New York, Florida, Indiana, Virginia, Maine, Missouri and South Carolina. Our largest operating subsidiary, Aqua Pennsylvania, Inc., accounted for approximately 55% of our operating revenues for 2006 and provided water or wastewater services to customers in the suburban areas north and west of the City of Philadelphia and in 23 other counties in Pennsylvania. The Company's other subsidiaries provide similar services in 12 other states. In addition, the Company provides water and wastewater service through operating and maintenance contracts with municipal authorities and other parties, and septage hauling services, close to our utility companies' service territories.

The company has identified fourteen operating segments and has one reportable segment named the Regulated segment. The reportable segment is comprised of thirteen operating segments for our water and wastewater regulated utility companies which are organized by the states where we provide these services. These operating segments are aggregated into one reportable segment since each of the Company's operating segments has the following similarities: economic characteristics, nature of services, production processes, customers, water distribution or wastewater collection methods, and the nature of the regulatory environment. In addition, one segment is not quantitatively significant to be reportable and is comprised of the businesses that provide on-site septic tank pumping, sludge hauling services and certain other non-regulated water and wastewater services. This segment is included as a component of "other," in addition to corporate costs that have not been allocated to the Regulated segment and intersegment eliminations.

Regulation—Most of the operating companies that are regulated public utilities are subject to regulation by the 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.

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. Non-regulated revenues are recognized when services are performed and are primarily associated with septage hauling services, operating and maintenance contracts and data processing service fees. The Company's Regulated segment includes non-regulated revenues that totaled $13,525 in 2006, $13,161 in 2005 and $11,556 in 2004. In addition to the Regulated segment operating revenues, the Company has other non-regulated revenues of $7,198 in 2006, $3,323 in 2005 and $2,067 in 2004.

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, 2006, utility plant includes a net credit acquisition adjustment of $51,434, which is generally being amortized from 0 to 20 years. Amortization of the acquisition adjustments totaled $4,239 in 2006, $3,674 in 2005 and $3,961 in 2004.

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. Utility expenditures for water main cleaning and relining of pipes are deferred and recorded in net property, plant and equipment in accordance with SFAS No. 71. As of December 31, 2006, $5,192 of costs has been incurred since the last rate proceeding and the Company expects to recover these costs in future rates.

The cost of software upgrades and enhancements are capitalized if they result in added functionality which enable the software to perform tasks it was previously incapable of performing. Certain information technology costs associated with major system installations, conversions and improvements, such as software training, data conversion and business process reengineering costs, are deferred as a regulatory asset if the Company expects to recover these costs in future rates. If these costs are not deferred in accordance with SFAS No. 71, then these costs are charged to operating expenses when incurred. As of December 31, 2006, $5,597 of costs have been deferred, since the last rate proceeding, as a regulatory asset, and the deferral is reported as a component of net property, plant and equipment.

When units of utility property are replaced, retired or abandoned, the recorded value thereof is credited to the asset account and such value, together with the net cost of removal, is charged to accumulated depreciation. To the extent the Company 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.

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.

In accordance with the requirements of 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 2006 was $6 and in 2005 was $1. There was no AFUDC related to equity funds in 2004. No interest was capitalized by our non-regulated businesses.

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

The Company had a book overdraft for certain of its disbursement cash accounts of $13,739 and $2,573 at December 31, 2006 and 2005, respectively. A book overdraft represents transactions that have not cleared the bank accounts at the end of the period. The Company transfers cash on an as-needed basis to fund these items as they clear the bank in subsequent periods. The balance of the book overdraft is reported as accounts payable and the change in the book overdraft balance is reported as cash flows from financing activities.

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

Regulatory Assets, Deferred Charges and Other Assets—Deferred charges and other assets consist of financing expenses, other costs and marketable securities. Deferred bond issuance expenses are amortized 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 as a regulatory asset 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.

(In thousands of dollars, except per share amounts)

Goodwill—Goodwill represents the excess cost over the fair value of net tangible and identifiable intangible assets acquired through acquisitions. Goodwill is not amortized but is tested for impairment annually, or more often, if circumstances indicate a possible impairment may exist. In accordance with the requirements of SFAS No. 142, "Goodwill and Other Intangible Assets," the Company tested the goodwill attributable to each of our reporting units for impairment as of July 31, 2006, in conjunction with the timing of our annual strategic business plan. Based on the Company's comparison of the estimated fair value of each reporting unit to their respective carrying amounts, the impairment test concluded that none of its goodwill was impaired. The following table summarizes the changes in the Company's goodwill:

	Regulated Segment	Other	Consolidated
Balance at December 31, 2004	$ 20,122	$ —	$ 20,122
Goodwill acquired during year	—	102	102
Reclassifications to utility plant acquisition adjustment	(44)	—	(44)
Balance at December 31, 2005	20,078	102	20,180
Goodwill acquired during year	226	3,941	4,167
Reclassifications to utility plant acquisition adjustment	(1,767)	—	(1,767)
Balance at December 31, 2006	$ 18,537	$ 4,043	$ 22,580

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 and Contributions in Aid of 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. Non-cash property, in the form of water mains, has been received, generally from developers, as advances or contributions of $16,852, $15,729 and $9,273 in 2006, 2005 and 2004, respectively. 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. Contributions in aid of construction include direct non-refundable contributions and the portion of customers' advances for construction that become non-refundable. Contributed property is generally not depreciated. Certain of the subsidiaries do depreciate contributed property and amortize contributions in aid of construction at the composite rate of the related property.

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

Stock-Based Compensation—Effective January 1, 2006, the Company accounts for stock-based compensation using the fair value recognition provisions of SFAS No. 123R, "Share-Based Payment". Prior to January 1, 2006, the Company accounted for stock-based compensation using the intrinsic value method in accordance with APB Opinion No. 25. Accordingly, no compensation expense related to granting of stock options had been recognized in the financial statements prior to adoption of SFAS No. 123R for stock options that were granted. Please refer to the Recent Accounting Pronouncements section of this footnote for information concerning the Company's accounting for stock-based compensation. The following table provides the pro forma net income and earnings per share prior to January 1, 2006 as if compensation cost for stock-based employee compensation was determined as of the grant date under the fair value method of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148 "Accounting for Stock-Based Compensation — Transition and Disclosure."

(In thousands of dollars, except per share amounts)

	Years Ended December 31, 2005	Years Ended December 31, 2004
Net income, as reported	$ 91,156	$ 80,007
Add: stock-based employee compensation expense included in reported net income, net of tax	290	266
Less: pro forma expense related to stock options granted, net of tax effects	(2,054)	(1,990)
Pro forma	$ 89,392	$ 78,283
Basic net income per share:		
As reported	$ 0.72	$ 0.64
Pro forma	0.70	0.63
Diluted net income per share:		
As reported	$ 0.71	$ 0.64
Pro forma	0.69	0.62

For the purposes of this pro forma disclosure, the fair value of the options at the date of the grant was estimated using the Black-Scholes option-pricing model.

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 changed to conform with current year's presentation.

Recent Accounting Pronouncements—In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106 and 132(R)." This statement requires the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS No. 158, actuarial gains and losses, prior service costs or credits, and any remaining transition assets or obligations that have not been recognized under previous accounting standards that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects. The Company adopted SFAS No. 158 on December 31, 2006 as required. Because the Company is subject to regulation in the states in which it operates, the Company maintains its accounts in accordance with the regulatory authority's rules and guidelines, which may differ from other authoritative accounting pronouncements. In those instances, the Company follows the guidance of SFAS No. 71. Based on prior regulatory experience, and in accordance with SFAS No. 71, the Company has recorded a regulatory asset for the pension and other postretirement benefit costs associated with SFAS No. 158 that would otherwise be charged to common stockholders' equity, for which the Company anticipates recoverability through customer rates. As a result, the impact of adopting SFAS No. 158 on the Company's Consolidated Balance Sheet was to increase total liabilities by $30,305, and increase total assets by $30,305. The adoption of this standard had no impact on the Company's results of operations or cash flow, and the impact on financial position is described above. See the Pension Plans and Other Postretirement Benefits footnote to the consolidated financial statements for further information and the required disclosures under SFAS No. 158.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The statement applies when other statements require or permit the fair value measurement of assets and liabilities. This statement does not expand the use of fair value measurement. SFAS No. 157 is effective for the Company's fiscal year beginning January 1, 2008. The Company is currently evaluating the provisions of this statement and has not yet determined the effect of adoption on its results of operations or financial position.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides guidance on how prior year misstatements should be considered when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. The Company adopted SAB 108 as required for the fiscal year ended December 31, 2006 and it did not have a material impact on its results of operations or financial position.

In June 2006, the FASB issued FASB Interpretation No. ("FIN") 48, "Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109," which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company adopted FIN 48 as required on January 1, 2007 and it did not have a material effect on its results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment." SFAS No. 123R generally requires that we measure the cost of employee services received in exchange for stock-based awards on the grant-date fair value and this cost will be recognized over the period during which an employee provides service in exchange for the award. Prior to the adoption of SFAS No. 123R on January 1, 2006, the Company provided pro forma disclosure of its compensation costs associated with the fair value of stock options that had been granted, and accordingly, no compensation costs were recognized in its consolidated financial statements. The Company adopted this standard using the modified prospective method, and accordingly, the consolidated financial statement amounts for the prior periods presented in this report have not been restated to reflect the fair value method of expensing share-based compensation. During 2006, the adoption of SFAS No. 123R increased operations and maintenance expense by $2,894, lowered net income by $2,568, and lowered diluted net income per share by $0.019. The adoption of this standard had no material impact on the Company's overall financial position, no impact on cash flow, and results in the reclassification on the consolidated cash flow statements of related tax benefits from cash flows from operating activities to cash flows from financing activities to the extent these tax benefits exceed the associated compensation cost recognized in the income statement. See the Employee Stock and Incentive Plan footnote to the consolidated financial statements for further information and the required disclosures under SFAS No. 123R.

Acquisitions

New York Water Service Corporation—Pursuant to our strategy to grow through acquisitions, on January 1, 2007 the Company completed the acquisition of the capital stock of New York Water Service Corporation ("New York Water") for $28,866 in cash, as adjusted pursuant to the purchase agreement primarily based on working capital at closing, and the assumption of $23,460 of long-term debt. The operating results of New York Water will be included in our consolidated financial statements beginning January 1, 2007. The acquired operation provides water service to 44,792 customers in several water systems located in Nassau County, Long Island, New York. For the fiscal year ended December 31, 2005, New York Water had operating revenues of $21,773 (unaudited). The acquisition will be accounted for as a purchase and will be recorded in the first quarter of 2007.

Heater—Pursuant to our strategy to grow through acquisitions, on June 1, 2004 the Company acquired the capital stock of Heater Utilities, Inc. for $48,000 in cash and the assumption of long-term debt of $19,219 and short-term debt of $8,500. At the date of acquisition, Heater provided water and wastewater service to over 50,000 water and wastewater customers primarily in the areas of suburban Raleigh, Charlotte, Gastonia and Fayetteville, North Carolina. The acquisition was accounted for as a purchase and accordingly the Company recorded goodwill of $18,842.

As part of the North Carolina Utilities Commission approval process for this acquisition, the Commission approved a mechanism through which the Company could recover up to two-thirds of the goodwill through customer rates in the future upon achieving certain objectives. The Company is pursuing these objectives to facilitate recognition of this premium in customer rates. However, there can be no assurance that the Company will be able to achieve these objectives and recover such amount of goodwill.

Florida Water—On June 30, 2004, the Company acquired certain utility assets of Florida Water Services Corporation, comprised of 63 water and wastewater systems located in central Florida for $13,090 in cash, the final purchase price as adjusted pursuant to the purchase agreement. In accordance with Florida Public Service Commission procedures, the acquisition was approved by the Commission and rate base was determined on December 20, 2005. Under the terms of the purchase agreement, the Commission's rate base determination resulted in a reduction of the final purchase price which did not result in the recognition of goodwill.

AquaSource—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 based on working capital at closing. In August 2004, we were awarded and received $12,289 plus interest in an arbitration related to the calculation of the final purchase price under the terms of the purchase agreement, which resulted in a final purchase price of $178,428. In the consolidated statement of cash flow for 2004, the $12,289 award has been reported as proceeds on the line titled acquisitions of utility systems and other, net.

Other Acquisitions—During 2006, the Company completed 27 acquisitions or other growth ventures in various states for an aggregate purchase price of $11,848 in cash. The operating revenues included in the consolidated financial statements of the Company during the period owned by the Company were $4,511.

During 2005, the Company completed 30 acquisitions or other growth ventures in various states. The total purchase price of $12,308 for the systems acquired in 2005 consisted of $11,633 in cash and the issuance of 24,684 shares of the Company's common stock. The operating revenues included in the consolidated financial statements of the Company during the period owned by the Company were $6,203 in 2006 and $2,145 in 2005.

During 2004, in addition to the Heater and Florida Water acquisitions, the Company completed 27 acquisitions or other growth ventures in the various states in which the Company operates for an aggregate purchase price of $3,842 in cash. The operating revenues included in the consolidated financial statements of the Company during the period owned by the Company were $2,309 in 2006, $1,580 in 2005 and $617 in 2004.

Dispositions

In 2004, as a result of the settlement of a condemnation action, the Company's Ohio operating subsidiary sold its water utility assets within the municipal boundaries of the City of Geneva in Ashtabula County, Ohio for net proceeds of approximately $4,716, 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 2004 of a gain on the sale of these assets, net of expenses, of $2,342. The gain is reported in the 2004 consolidated statement of income as a reduction to operations and maintenance expense. We continue to operate this water system for the City of Geneva under a multi-year operating contract that expires in December 2008. These water utility assets represented less than 1% of Aqua America's total assets, and the total number of customers included in the water system sold represented less than 1% of our total utility customer base.

In 2004, the Company sold its only operations in Kentucky. The sale price approximates our investment in this operation. The operation represented approximately 0.2% of the operations acquired from AquaSource, Inc.

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 the Company acquired in connection with the AquaSource acquisition in 2003. The Company has challenged whether the City is following the correct legal procedures in connection with the City's attempted condemnation and the Company has challenged the City's valuation of this portion of its system. The portion of the system under consideration represents approximately 1% of the Company's total utility customer base. While the Company continues to discuss this matter with officials from the City of Fort Wayne, the Company continues to protect its legal interests in this proceeding. A sanitary district in Illinois and a city in Texas have also indicated interest in acquisition, by eminent domain or otherwise, of all or a portion of the utility assets of two of the Company's operations. The systems represent approximately 3,000 customers or less than 0.5% of our total utility customer base. The Company believes that it will be entitled to fair market value for its assets if they are condemned, and it is believed that the fair market value will be in excess of the book value for such assets.

(In thousands of dollars, except per share amounts)

Property, Plant and Equipment

	December 31, 2006	December 31, 2005	Approximate range of remaining lives
Utility plant and equipment:			
Mains and accessories	$ 1,287,142	$ 1,187,597	15 to 82 years
Services, hydrants, treatment plants and reservoirs	801,755	660,279	5 to 85 years
Operations structures and water tanks	172,850	222,107	15 to 77 years
Miscellaneous pumping and purification equipment	381,149	376,599	5 to 50 years
Meters, data processing, transportation and operating equipment	428,326	341,550	5 to 50 years
Land and other non-depreciable assets	80,479	73,346	—
Utility Plant and equipment	3,151,701	2,861,478	
Utility construction work in progress	76,653	98,898	—
Net utility plant acquisition adjustment	(51,434)	(64,165)	0 to 20 years
Non-utility plant and equipment	8,191	4,374	3 to 25 years
Total property, plant and equipment	$ 3,185,111	$ 2,900,585	

Accounts Receivable

	December 31, 2006	December 31, 2005
Billed utility revenue	$ 49,129	$ 42,541
Unbilled utility revenue	23,842	21,419
Other	4,147	3,136
	77,118	67,096
Less allowance for doubtful accounts	4,969	4,406
Net accounts receivable	$ 72,149	$ 62,690

The Company's utility customers are located principally in the following states: 47% in Pennsylvania, 10% in Ohio, 9% in North Carolina, 8% in Illinois, 6% in Texas, 6% in New Jersey, 5% in Indiana and 4% in Florida. No single customer accounted for more than one percent of the Company's operating revenues during the years ended December 31, 2006, 2005 or 2004. The following table summarizes the changes in the Company's allowance for doubtful accounts:

	2006	2005	2004
Balance at January 1,	$ 4,406	$ 4,849	$ 5,851
Amounts charged to expense	3,716	3,116	3,695
Accounts written off	(3,607)	(4,113)	(5,460)
Recoveries of accounts written off	454	554	701
Allowance acquired through acquisitions	—	—	62
Balance at December 31,	$ 4,969	$ 4,406	$ 4,849

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 regulatory liabilities are as follows:

(In thousands of dollars, except per share amounts)

	December 31, 2006		December 31, 2005	
	Regulatory Assets	Regulatory Liabilities	Regulatory Assets	Regulatory Liabilities
Income taxes	$ 70,146	$ 2,104	$ 69,531	$ 2,203
Utility plant retirement costs	20,060	8,960	17,421	8,368
Postretirement benefits	36,469	—	10,871	—
Texas rate filing expense deferral	12,382	—	9,486	—
Competitive Transition Charge payment	4,586	—	5,733	—
Water tank painting	4,822	32	4,292	267
Fair value of long-term debt assumed in acquisition	2,594	—	2,804	—
Merger costs	1,111	—	1,641	—
Rate case filing expenses & other	12,893	496	9,174	913
	$ 165,063	$ 11,592	$ 130,953	$ 11,751

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 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.

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. In addition, a regulatory asset has been recorded for the costs that would otherwise be charged to common stockholders' equity in accordance with SFAS No. 158, for the underfunded status of our pension and other postretirement benefit plans. See the Pension Plans and Other Postretirement Benefits footnote to the consolidated financial statements for the effect on regulatory assets of the adoption of SFAS No. 158. 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 for the Texas rate filing of 2004 results from a multi-year plan to increase annual revenues in phases, and to defer and amortize a portion of the Company's depreciation, operating and other tax expense over a similar multi-year period. These costs will be amortized over a period of time, expected to approximate four years, as determined by the final rate order.

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 an electric distribution 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.

Expenses associated with water tank painting are deferred and amortized over a period of time as approved in the regulatory process. Water tank painting costs are generally being amortized over a period ranging from 5 to 17 years.

(In thousands of dollars, except per share amounts)

As a requirement of purchase accounting, the Company recorded a fair value adjustment for fixed-rate, long-term debt assumed in acquisitions. The regulatory asset results from the rate setting process continuing to recognize the historical interest cost of the assumed debt.

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 ten-year recovery period.

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 five years. Other represents costs incurred by the Company for which it has received or expects to receive rate recovery.

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

Income Taxes

The provision for income taxes consists of:

	Years Ended December 31,		
	2006	2005	2004
Current:			
Federal	$ 39,956	$ 24,417	$ 2,042
State	9,502	6,586	7,553
	49,458	31,003	9,595
Deferred:			
Federal	9,531	22,294	41,414
State	1,257	3,616	1,115
	10,788	25,910	42,529
Total tax expense	$ 60,246	$ 56,913	$ 52,124

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 5.00% to 9.99% for all years presented. The Company's Federal income tax returns for all years through 2002 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,		
	2006	2005	2004
Computed Federal tax expense at statutory rate	$ 53,287	$ 51,824	$ 46,245
Increase in tax expense for depreciation expense to be recovered in future rates	716	806	1,376
Domestic Production Credit	(602)	(656)	—
Stock-based compensation	715	—	—
Deduction for Aqua America common dividends paid under employee benefit plan	(307)	(321)	(245)
Amortization of deferred investment tax credits	(274)	(359)	(285)
Prior year rate reductions	(154)	(437)	(538)
State income taxes, net of federal tax benefit	6,999	6,631	5,634
Other, net	(134)	(575)	(63)
Actual income tax expense	$ 60,246	$ 56,913	$ 52,124

(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, 2006	December 31, 2005
Deferred tax assets:		
Customers' advances for construction	$ 17,786	$ 17,549
Costs expensed for book not deducted for tax, principally accrued expenses	2,787	1,803
Utility plant acquisition adjustment basis differences	18,673	29,429
Postretirement benefits	12,530	1,660
Other	295	—
Total gross deferred tax assets	52,071	50,441
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	278,917	267,835
Deferred taxes associated with the gross-up of revenues necessary to recover, in rates, the effect of temporary differences	26,276	25,796
Tax effect of regulatory asset for postretirement benefits	12,530	—
Deferred investment tax credit	5,801	6,066
Other	1,746	1,090
Total gross deferred tax liabilities	325,270	300,787
Net deferred tax liability	$ 273,199	$ 250,346

In June 2006, the FASB issued FASB Interpretation No. ("FIN") 48, "Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109," which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We adopted FIN 48 as required on January 1, 2007 and it did not have a material effect on our results of operations or financial position.

(In thousands of dollars, except per share amounts)

Taxes Other than Income Taxes

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

	Years Ended December 31,		
	2006	2005	2004
Property	$ 14,953	$ 13,247	$ 10,919
Capital Stock	3,675	3,706	3,402
Gross receipts, excise and franchise	6,750	6,483	5,778
Payroll	5,701	5,648	5,134
Other	2,264	2,612	2,363
Total taxes other than income	$ 33,343	$ 31,696	$ 27,596

Commitments and Contingencies

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 through 2011 are expected to approximate $10,092 and $59,091 thereafter. The Company purchased approximately $10,497, $10,603 and $8,724 of water under these agreements during the years ended December 31, 2006, 2005 and 2004, respectively.

The Company leases motor vehicles, buildings and other equipment under operating leases that are noncancelable. The future annual minimum lease payments due are: $3,450 in 2007, $3,100 in 2008, $1,587 in 2009, $547 in 2010, $147 in 2011 and $132 thereafter. 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 2010 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. Subject to the aforesaid adjustment, during each of the next five years, approximately $554 of annual lease payments for land are due, and $17,004 thereafter. The Company leases treatment plants to other parties under lease agreements that require payments to the Company of $366 in 2007, $366 in 2008, $366 in 2009, $366 in 2010, $366 in 2011 and $5,553 thereafter.

Rent expense was $4,478, $3,390 and $3,267 for the years ended December 31, 2006, 2005 and 2004, respectively.

Contingencies—The Company is routinely involved in condemnation proceedings and legal matters during the ordinary course of business. See Water and Wastewater Rates footnote for a discussion of the rate proceeding process involving our subsidiaries in Texas. Although the results of legal proceedings cannot be predicted with certainty, there are no other pending legal proceedings to which the Company or any of its subsidiaries is a party or to which any of its properties is the subject that are material or are expected to have a material effect on the Company's financial position, results of operations or cash flows.

Long-term Debt and Loans Payable

The Consolidated Statements of Capitalization provide a summary of long-term debt as of December 31, 2006 and 2005. 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, 2006, approximately $326,000 of Aqua Pennsylvania's retained earnings of approximately $346,000 and $76,000 of the retained earnings of $85,000 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.

(In thousands of dollars, except per share amounts)

Sinking fund payments are required by the terms of certain issues of long-term debt. The future sinking fund payments and debt maturities of the Company's long-term debt are as follows:

Interest Rate Range	2007	2008	2009	2010	2011	Thereafter
0.00% to 2.49%	$ 1,514	$ 1,614	$ 1,657	$ 1,689	$ 1,714	$ 17,552
2.50% to 2.99%	1,533	1,604	1,649	1,682	1,729	17,075
3.00% to 3.49%	12,248	258	276	287	299	3,852
3.50% to 3.99%	685	695	706	717	328	2,942
4.00% to 4.99%	50	50	55	27,055	55	138,380
5.00% to 5.49%	—	—	—	—	—	292,496
5.50% to 5.99%	—	—	—	—	—	169,000
6.00% to 6.49%	644	10,172	—	—	15,000	69,360
6.50% to 6.99%	10,000	—	—	—	—	12,000
7.00% to 7.49%	2,540	2,585	634	687	744	6,098
7.50% to 7.99%	210	227	245	264	286	23,546
8.00% to 8.49%	152	167	184	202	222	25,361
8.50% to 8.99%	—	—	—	—	—	9,000
9.00% to 9.49%	584	594	604	20,615	5,627	18,077
9.50% to 9.99%	995	5,995	994	994	994	28,766
10.00% to 10.50%	—	—	—	—	—	6,000
Total	$ 31,155	$ 23,961	$ 7,004	$ 54,192	$ 26,998	$ 839,505

In March 2006, Aqua Pennsylvania issued $40,000 of unsecured notes at 5.95% of which $10,000 are due in 2023, 2024, 2033 and 2034. In September 2006, Aqua Pennsylvania issued $20,000 of unsecured notes at 5.64% with amounts due in 2014, 2016, 2020 and 2021. Proceeds from the sales of these notes were used to repay short-term borrowings. In December 2006, the Company issued $30,000 of unsecured notes with an interest rate of 5.54% of which $10,000 are due in 2013, 2017 and 2018. The proceeds of this financing were used to fund acquisitions. At various times during 2006, Aqua Pennsylvania and other operating subsidiaries issued other notes payable and first mortgage bonds in aggregate of $14,728 at a weighted average interest rate of 3.64% due at various times ranging from 2016 to 2036. 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.

In February 2005, the Company issued $30,000 of unsecured notes of which $18,000 are due in 2015 with an interest rate of 5.01% and $12,000 are due in 2020 with an interest rate of 5.20%. The proceeds of this financing were used to refinance existing short-term debt. In May 2005, Aqua Pennsylvania issued $72,000 of tax-exempt bonds secured by a supplement to its first mortgage indenture at the following terms: $22,000 at 4.87% due 2036, $25,000 at 4.88% due 2037 and $25,000 at 4.89% due 2038. Of the $72,000 in proceeds, $22,000 was used to retire previously issued tax-exempt bonds in August 2005 and the balance of proceeds are restricted to funding the costs of certain capital projects during the period 2005 through 2007. In December 2005, Aqua Pennsylvania issued $25,000 of tax-exempt bonds at 4.82% due 2035, which were secured by a supplement to its first mortgage indenture. The proceeds are restricted to funding certain capital projects during the period 2006 through 2008. At various times during 2005, Aqua Pennsylvania and other operating subsidiaries issued other notes payable, first mortgage bonds and tax-exempt bonds aggregating $24,677 at a weighted-average interest rate of 4.10% due at various times ranging from 2019 to 2035. The proceeds from these issuances were used to reduce a portion of the balance of short-term debt at each of the respective operating subsidiaries and to redeem $10,260 of first mortgage bonds of an operating subsidiary with an interest rate of 5.60%. As of December 31, 2006, the Trustees for ten issues held $11,490 pending construction of the projects to be financed with the issues and are reported in the consolidated balance sheet as funds restricted for construction activity. The weighted average cost of long-term debt at December 31, 2006 and 2005 was 5.72% and 5.74%, respectively.

(In thousands of dollars, except per share amounts)

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, 2006 and 2005, funds borrowed under the Aqua Pennsylvania revolving credit agreements were $3,000 and $65,000, respectively, and $20,000 and $17,000 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 short-term borrowings of Aqua Pennsylvania and the Company. A commitment fee of 1/10 of 1% is charged on the total commitment amount of Aqua Pennsylvania's revolving credit agreement. The average cost of borrowing under these facilities was 5.4% and 3.8%, and the average borrowing was $66,283 and $63,355, during 2006 and 2005, respectively. The maximum amount outstanding at the end of any one month was $85,000 in both 2006 and 2005.

At December 31, 2006 and 2005, the Company had combined short-term lines of credit of $148,000 and $127,000, respectively. Funds borrowed under these lines are classified as loans payable and are used to provide working capital. As of December 31, 2006 and 2005, funds borrowed under the short-term lines of credit were $96,150 and $56,505, respectively. The average borrowing under the lines was $77,528 and $35,610 during 2006 and 2005, respectively. The maximum amount outstanding at the end of any one month was $96,150 in 2006 and $56,505 in 2005. 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 2006 and 2005 was 5.5% and 3.9%, respectively.

Interest income of $3,241, $3,040 and $1,762 was netted against interest expense on the consolidated statements of income for the years ended December 31, 2006, 2005 and 2004, respectively. The total interest cost was $61,673, $55,102 and $50,441 in 2006, 2005 and 2004, including amounts capitalized of $3,941, $2,447 and $2,304, respectively.

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,	
	2006	2005
Carrying amount	$ 982,815	$ 903,083
Estimated fair value	986,487	950,479

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 $76,820 and $74,828 at December 31, 2006 and 2005, 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 2021 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.

Stockholders' Equity

At December 31, 2006, the Company had 300,000,000 shares of common stock authorized; par value $0.50. Shares outstanding at December 31, 2006, 2005 and 2004 were 132,325,579, 128,970,181 and 127,179,777, respectively. Treasury shares held at December 31, 2006, 2005 and 2004 were 691,746, 688,625 and 686,747, respectively. At December 31, 2006, the Company had 1,738,619 shares of authorized but unissued Series Preferred Stock, $1.00 par value.

In December 2005, the Company filed a universal shelf registration with the Securities and Exchange Commission to allow for the potential future sale by us, from time to time, in one or more public offerings, of an indeterminant amount of our common stock, preferred stock, debt securities and other securities specified therein at indeterminant prices.

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

The Company may elect to settle the forward equity sale agreement by means of a physical share settlement, net cash settlement, or net share settlement, on a settlement date or dates, no later than August 1, 2008. The forward equity sale agreement provides that the forward sale price will be computed based upon the initial forward sale price of $21.857 per share. Under limited circumstances or certain unanticipated events, the forward purchaser also has the ability to require the Company to physically settle the forward equity sale agreement in shares prior to the maturity date. The maximum number of shares that could be required to be issued by the Company to settle the forward equity sale agreement is 3,525,000 shares. As of December 31, 2006, a net cash settlement under the forward equity sale agreement would have resulted in a payment by the Company to the forward purchaser of $2,845 or a net share settlement would have resulted in the issuance of 124,876 shares by the Company to the forward purchaser. For each increase or decrease of one dollar in the average market price of Aqua America common stock above or below the forward sale price on December 31, 2006, the cash settlement option from the Company’s perspective would decrease or increase by $3,525 and the net share settlement option would decrease by 161,846 shares or increase by 148,234 shares, respectively.

During the last three years, the Company completed the following offerings of equity:

- In June 2006, the Company sold 1,750,000 shares of common stock in a public offering for proceeds of $37,400, net of expenses. In August 2006, the Company sold 500,000 shares of common stock in a public offering for proceeds of $10,700, net of expenses. The net proceeds from these offerings were used to fund the Company’s capital expenditure program and acquisitions, and for working capital and other general corporate purposes.

- In November 2004, the Company issued 2,606,667 shares of common stock in a public offering for proceeds of $42,600, net of expenses. The net proceeds were used to repay a portion of the Company’s short-term debt. The indebtedness was incurred by Aqua America in connection with acquisitions.

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 in connection with acquisitions. During 2005, 24,684 shares of common stock totaling $675 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, 2006 is 2,194,262 shares. The form and terms of any securities issued under these shelf registrations will be determined at the time of issuance.

The Company has a Dividend Reinvestment and Direct Stock Purchase Plan (“Plan”) that allows reinvested dividends to be used to purchase shares of common stock at a five percent discount from the current market value. Under the direct stock purchase program, shares are purchased by investors at market price. The shares issued under the Plan are either original issue shares or shares purchased by the Company’s transfer agent in the open-market. During 2006, 2005 and 2004, under the dividend reinvestment portion of the Plan, 405,107, 401,503 and 512,609 original issue shares of common stock were sold providing the Company with proceeds of $9,341, $8,516 and $7,808, respectively.

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, 2006, 548,278 shares remain available for repurchase.

The Company reports comprehensive income in accordance with SFAS No. 130, “Reporting Comprehensive Income.” Accordingly, the Company’s accumulated other comprehensive income is reported in the Common Stockholders’ Equity section of the Consolidated Balance Sheets, the Consolidated Statements of Common Stockholders’ Equity and the related other comprehensive income is reported in the Consolidated Statements of Income and Comprehensive Income. The Company reports its unrealized gains on investments as other comprehensive income and accumulated other comprehensive income. Prior to the fourth quarter of 2006, a portion of the Company’s minimum pension liability had been charged to accumulated other comprehensive income or loss. During the fourth quarter of 2006, the Company recorded a regulatory asset for its minimum pension liability as it anticipates recovery of its future pension expense through customer rates. Concurrent with this adjustment, the minimum pension liability was adjusted through other comprehensive income and removed from accumulated other 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 and shares issuable under the forward equity sale agreement (from the date the company entered into the forward equity sale agreement to the settlement date) is included in the computation of diluted net income per share. The dilutive effect of stock options and shares issuable under the forward equity sale agreement is calculated using the treasury stock method and expected proceeds upon exercise of the stock options and settlement of the forward equity sale agreement. The following table summarizes the shares, in thousands, used in computing basic and diluted net income per share:

	Years ended December 31,		
	2006	2005	2004
Average common shares outstanding during the period for basic computation	130,725	127,364	124,329
Effect of dilutive securities:			
Employee stock options	978	1,842	1,381
Forward equity shares	71	—	—
Average common shares outstanding during the period for diluted computation	131,774	129,206	125,710

For the years ended December 31, 2006 and 2004, employee stock options outstanding to purchase 581,850 and 759,867 shares of common stock, respectively, were excluded from the calculations of diluted net income per share as the options' exercise prices were greater than the average market price of the Company's common stock. For the year ended December 31, 2005, there were no outstanding employee stock options excluded from the calculation of diluted net income per share as the average market price of the Company's common stock was greater than the options' exercise price.

Equity per common share was $6.96 and $6.30 at December 31, 2006 and 2005, 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.

Employee Stock and Incentive Plan

Under the 2004 Equity Compensation Plan (the "2004 Plan"), as approved by the shareholders to replace the 1994 Equity Compensation Plan (the "1994 Plan"), qualified and non-qualified stock options may be granted to officers, key employees and consultants at prices equal to the market price of the stock on the day of the grant. Officers and key employees may also be granted dividend equivalents and restricted stock. Restricted stock may also be granted to non-employee members of the Board of Directors. The 2004 Plan authorizes 4,900,000 shares for issuance under the plan. A maximum of 50% of the shares available for issuance under the 2004 Plan may be issued as restricted stock and the maximum number of shares that may be subject to grants under the plans to any one individual in any one year is 200,000. Awards under the 2004 Plan are made by a committee of the Board of Directors. At December 31, 2006, 3,521,136 options underlying stock option and restricted stock awards were still available for grant under the 2004 Plan, although under the terms of the 2004 Plan, terminated, expired or forfeited grants under the 1994 Plan and shares withheld to satisfy tax withholding requirements under the 1994 Plan may be re-issued under the plan.

(In thousands of dollars, except per share amounts)

Stock Options—Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123R, "Share-Based Payment," which revised SFAS No. 123, "Accounting for Stock-based Compensation," and superseded APB No. 25, "Accounting for Stock Issued to Employees." Prior to January 1, 2006, the Company accounted for stock-based compensation using the intrinsic value method in accordance with APB Opinion No. 25. Accordingly, no compensation expense related to granting of stock options had been recognized in the financial statements prior to adoption of SFAS No. 123R for stock options that were granted, as the grant price equaled the market price on the date of grant.

The Company adopted this standard using the modified prospective method, and accordingly the financial statement amounts for the prior periods presented in this report have not been restated to reflect the fair value method of expensing share-based compensation. Under this transition method, compensation cost recognized in the year ended December 31, 2006 includes compensation cost for all share-based payments granted prior to, but not vested as of January 1, 2006, and share-based payments granted after January 1, 2006. For the year ended December 31, 2006, the impact of the adoption of SFAS No. 123R as compared to if the Company had continued to account for share-based compensation under APB Opinion No. 25: increased operations and maintenance expense by $2,894, increased capitalized compensation costs within property, plant and equipment by $631, lowered income tax expense by $326, lowered net income by $2,568, lowered diluted net income per share by $0.019, and lowered basic net income per share by $0.02. SFAS 123R requires the Company to estimate forfeitures in calculating the compensation expense instead of recognizing these forfeitures and the resulting reduction in compensation expense as they occur. As of January 1, 2006, the cumulative after-tax effect of this change in accounting for forfeitures, if this adjustment was recorded, would have been to reduce stock-based compensation by $12. The estimate of forfeitures will be adjusted over the vesting period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. The adoption of this standard had no impact on net cash flows and results in the reclassification on the consolidated cash flow statements of related tax benefits from cash flows from operating activities to cash flows from financing activities to the extent these tax benefits exceeded the associated compensation cost as determined under SFAS 123R. As of the date of adoption, the Company has calculated its pool of windfall tax benefits in accordance with the method outlined in SFAS 123R.

Options under the plans 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 fair value of each option is amortized into compensation expense on a straight-line basis over their respective 36 month vesting period, net of estimated forfeitures. The fair value of options was estimated at the grant date using the Black-Scholes option-pricing model. The per share weighted-average fair value at the date of grant for stock options granted during the years ended December 31, 2006, 2005 and 2004 was $7.82, $4.54 and $4.07 per option, respectively. The application of this valuation model relies on the following assumptions that are judgmental and sensitive in the determination of the compensation expense for the periods reported:

	2006	2005	2004
Expected term (years)	5.2	5.2	4.5
Risk-free interest rate	4.7%	4.0%	4.0%
Expected volatility	25.8%	27.8%	29.9%
Dividend yield	1.76%	2.40%	2.23%

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

(In thousands of dollars, except per share amounts)

The following table summarizes stock option transactions for the year ended December 31, 2006:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Life (years)	Aggregate Intrinsic Value
Options:				
Outstanding, beginning of year	3,492,363	$ 13.70		
Granted	611,950	29.46		
Forfeited	(46,684)	22.84		
Expired	(26,639)	22.04		
Exercised	(666,212)	11.95		
Outstanding, end of year	3,364,778	$ 16.72	6.6	$ 24,268
Exercisable, end of year	2,044,825	$ 12.76	5.4	$ 20,486

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

	Years ended December 31,		
	2006	2005	2004
Intrinsic value of options exercised	$ 9,779	$ 18,473	$ 4,180
Fair value of options vested	3,794	3,532	3,079

The following table summarizes information about the options outstanding and options exercisable as of December 31, 2006:

	Options Outstanding			Options Exercisable	
	Shares	Weighted Average Remaining Life (years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Range of prices:					
$5.81 - 9.99	382,949	2.3	$ 7.60	382,949	$ 7.60
$10.00 - 12.99	997,750	5.4	12.21	997,750	12.21
$13.00 - 15.99	90,779	6.4	13.76	90,779	13.76
$16.00 - 16.99	576,865	7.3	16.15	347,925	16.15
$17.00 - 18.33	734,585	8.2	18.33	225,422	18.33
$29.00 - 29.99	581,850	9.3	29.46	—	—
	3,364,778	6.6	$ 16.72	2,044,825	$ 12.76

As of December 31, 2006, there was $4,732 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the plans. The cost is expected to be recognized over a weighted-average period of 1.1 years.

(In thousands of dollars, except per share amounts)

Restricted Stock—Restricted stock awards provide the grantee with the rights of a shareholder, including the right to receive dividends and to vote such shares, but not the right to sell or otherwise transfer the shares during the restriction period. Restricted stock awards result in compensation expense which is equal to the fair market value of the stock on the date of the grant and is amortized ratably over the restriction period. The adoption of SFAS No. 123R had no impact on the Company's recognition of stock-based compensation expense associated with restricted stock awards. The Company expects forfeitures of restricted stock to be de minimus. There were no forfeitures prior to the adoption of SFAS 123R for the grants that were under restriction as of January 1, 2006. During the years ended December 31, 2006, 2005 and 2004, the company recorded stock-based compensation related to restricted stock awards as operations and maintenance expense in the amounts of $710, $495 and $439, respectively. The following table summarizes nonvested restricted stock transactions for the year ended December 31, 2006:

	Number of Shares	Weighted Average Fair Value
Nonvested shares at beginning of period	43,998	$ 17.70
Granted	42,200	28.39
Vested	(24,310)	19.11
Forfeited	(5,000)	29.46
Nonvested shares at end of period	56,888	$ 23.98

The following table summarizes the value of restricted stock awards at the date the restriction lapsed:

	Years ended December 31,		
	2006	2005	2004
Intrinsic value of restricted stock awards vested	$ 660	$ 614	$ 449
Fair value of restricted stock awards vested	465	500	360

As of December 31, 2006, $890 of unrecognized compensation costs related to restricted stock is expected to be recognized over a weighted-average period of 1.0 year. The aggregate intrinsic value of restricted stock as of December 31, 2006 was $1,296. The aggregate intrinsic value of restricted stock is based on the number of shares of restricted stock and the market value of the Company's common stock as of the period end date.

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.

(In thousands of dollars, except per share amounts)

The Company adopted SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106 and 132(R)" on December 31, 2006. As a result of adopting SFAS No. 158, the Company recorded the underfunded status of its pension and other postretirement benefit plans on the balance sheet and recorded a regulatory asset for these costs that would otherwise be charged to common stockholders' equity, as we anticipate recoverability of the costs through customer rates. As a result of adopting SFAS No. 158, the additional minimum liability associated with the Company's defined benefit pension plan was eliminated as it is no longer required to be recorded under SFAS No. 158. Prior to the adoption of SFAS No. 158 on December 31, 2006, the Company's additional minimum liability was $3,498. The additional minimum liability was a result of the accumulated benefit obligation exceeding the fair value of plan assets. The decrease in the additional minimum liability from December 31, 2005 of $10,909 to December 31, 2006 of $3,498, prior to adoption of SFAS No. 158, resulted from the effect of an increased discount rate and an increase in pension plan assets during 2006 due to positive equity market performance and pension contributions. In accordance with SFAS No. 158, the Company's 2005 accounting and related disclosures were not affected by the adoption of the new accounting standard. The adoption of this standard had no impact on the Company's results of operations or cash flow. The table below summarizes the incremental effects of SFAS No. 158 adoption on the individual line items on the Company's Consolidated Balance Sheet at December 31, 2006:

	Pre - SFAS No. 158 Adoption	SFAS No. 158 Adjustment	Post - SFAS No. 158 Adoption
Assets:			
Regulatory assets	$ 4,167	$ 32,302	$ 36,469
Deferred charges and other assets, net	1,997	(1,997)	—
	$ 6,164	$ 30,305	$ 36,469
Liabilities:			
Other accrued liabilities	$ 10,391	$ (10,260)	$ 131
Other liabilities	18,718	40,565	59,283
	$ 29,109	$ 30,305	$ 59,414

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

	Pension Benefits	Other Postretirement Benefits
Years:		
2007	$ 7,017	$ 964
2008	7,363	1,024
2009	7,794	1,105
2010	8,259	1,210
2011	8,848	1,293
2012 - 2016	56,262	8,186

(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:

	Pension Benefits		Other Postretirement Benefits	
	2006	2005	2006	2005
Change in benefit obligation:				
Benefit obligation at January 1,	$ 179,741	$ 171,076	$ 29,161	$ 32,804
Service cost	4,784	4,847	1,002	1,223
Interest cost	10,094	9,805	1,581	1,882
Plan amendments	406	—	—	(7,047)
Actuarial (gain) loss	(10,469)	420	(2,941)	1,317
Plan participants' contributions		—	249	584
Benefits paid	(6,272)	(6,407)	(842)	(1,602)
Benefit obligation at December 31,	178,284	179,741	28,210	29,161
Change in plan assets:				
Fair value of plan assets at January 1,	117,671	115,292	18,942	16,606
Actual return on plan assets	8,757	7,790	933	675
Employer contributions	6,521	996	1,367	2,678
Benefits paid	(6,483)	(6,407)	(628)	(1,017)
Fair value of plan assets at December 31,	126,466	117,671	20,614	18,942
Funded status of plan:				
Funded status at December 31,	51,818	62,070	7,596	10,219
Unrecognized actuarial loss	—	(42,092)	—	(8,537)
Unrecognized prior service cost	—	(1,687)	—	7,517
Unrecognized net transition obligation	—	809	—	(5,624)
Net amount recognized	$ 51,818	$ 19,100	$ 7,596	$ 3,575

Company's pension plans had an accumulated benefit obligation of $150,999 and $148,629 at December 31, 2006 and 2005, respectively. The following table provides the net liability recognized on the Consolidated Balance Sheets at December 31:

	Pension Benefits		Other Postretirement Benefits	
	2006	2005	2006	2005
Current liability	$ (131)	$ —	$ —	$ —
Noncurrent liability	(51,687)	—	(7,596)	—
Prepaid benefits cost	—	—	—	555
Accrued benefit cost	—	(19,100)	—	(4,130)
Additional minimum liability	—	(12,726)	—	—
Intangible assets	—	1,817	—	—
Regulatory asset	—	6,167	—	—
Accumulated other comprehensive loss	—	4,742	—	—
Net liability recognized	$ (51,818)	$ (19,100)	$ (7,596)	$ (3,575)

(In thousands of dollars, except per share amounts)

At December 31, 2006 and 2005, 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	
	2006	2005
Projected benefit obligation	$ 178,284	$ 179,741
Fair value of plan assets	126,466	117,671

	Accumulated Benefit Obligation Exceeds the Fair Value of Plan Assets	
	2006	2005
Accumulated benefit obligation	$ 150,999	$ 148,629
Fair value of plan assets	126,466	117,671

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

	Pension Benefits			Other Postretirement Benefits		
	2006	2005	2004	2006	2005	2004
Service cost	$ 4,783	$ 4,847	$ 4,312	$ 1,003	$ 1,223	$ 1,112
Interest cost	10,094	9,805	9,512	1,582	1,882	1,825
Expected return on plan assets	(9,397)	(9,536)	(9,169)	(1,299)	(1,261)	(1,086)
Amortization of transition obligation (asset)	(209)	(209)	(209)	104	803	803
Amortization of prior service cost	216	403	419	(281)	(57)	(57)
Amortization of actuarial (gain) loss	1,756	1,606	1,009	300	219	125
Amortization of regulatory asset	—	—	—	152	136	144
Capitalized costs & other	(1,826)	(1,847)	(1,021)	(757)	(739)	(629)
Net periodic benefit cost	$ 5,417	$ 5,069	$ 4,853	$ 804	$ 2,206	$ 2,237

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.

(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	
	2006	2005	2006	2005
Weighted-average Assumptions Used to Determine Benefit Obligations as of December 31,				
Discount rate	5.90%	5.65%	5.90%	5.65%
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	9%	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	2011	2011
Weighted-average Assumptions Used to Determine Net Periodic Benefit Costs for Years Ended December 31,				
Discount rate	5.65%	5.75%	5.65%	5.75%
Expected return on plan assets	8.0%	8.5%	5.33-8.0%	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%	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	2011	2010

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	$ 1,516	$ (1,483)
Effect on total service and interest cost components of net periodic postretirement health-care benefit cost	$ 150	$ (150)

(In thousands of dollars, except per share amounts)

The Company's discount rate assumption was determined using a yield curve that was produced from a universe containing over 500 U.S.-issued Aa-graded corporate bonds, all of which were noncallable (or callable with make-whole provisions), and excluding the 10% of the bonds with the highest yields and the 10% with the lowest yields. The discount rate was then developed as the single rate that would produce the same present value as if the Company used spot rates, for various time periods, to discount the projected pension benefit payments. The Company's pension expense and liability (benefit obligations) increases as the discount rate is reduced. A 25 basis-point reduction in this assumption would have increased 2006 pension expense by $660 and the pension liabilities by $6,500.

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. A 25 basis-point reduction in this assumption would have increased 2006 pension expense by $300. For 2006, the Company used an 8.0% expected return on assets assumption which will remain unchanged for 2007. 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 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:

	2007 Target Allocation	Percentage of Plan Assets at December 31, 2006	2005
Asset Category:			
Equity securities	50 to 75%	63%	60%
Debt securities	25 to 50%	28%	24%
Cash	0%	7%	16%
Other	0%	2%	0%
Total	100%	100%	100%

Equity securities include Aqua America, Inc. common stock in the amounts of $9,460 or 7.5% of total plan assets and $11,121 or 9.5% of total plan assets as of December 31, 2006 and 2005, respectively.

The asset allocation for the Company's other postretirement benefit plans and the target allocation by asset category are as follows:

	2007 Target Allocation	Percentage of Plan Assets at December 31, 2006	2005
Asset Category:			
Cash	65%	66%	67%
Equity securities	35%	34%	33%
Total	100%	100%	100%

Minimum funding requirements for qualified defined benefit pension plans are determined by government regulations and not by accounting pronouncements. In accordance with funding rules and the Company's funding policy, during 2007 our pension contribution is expected to be $7,300. The Pension Protection Act of 2006 was signed into law in August 2006. The Company is currently evaluating this legislation and the effect it will have on its future pension contributions and does not expect its estimate for the 2007 funding amount to change. The Company's funding of its PBOP cost during 2007 is expected to approximate $2,960.

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 $1,289, $1,236 and $1,160 for the years ended December 31, 2006, 2005 and 2004, respectively.

Water and Wastewater Rates

On June 22, 2006, the Pennsylvania Public Utility Commission ("PAPUC") granted the Company's operating subsidiary in Pennsylvania a $24,900 base water rate increase, on an annualized basis. The rates in effect at the time of the filing included $12,397 in Distribution System Improvement Charges ("DSIC") or 5.0% above the prior base rates. Consequently, the total base rates increased by $37,297 and the DSIC was reset to zero. On August 5, 2004, the PAPUC granted Aqua Pennsylvania, Inc. a $13,800 base rate increase. The rates in effect at the time of the filing included $11,200 in Distribution System Improvement Charges ("DSIC") or 5.0% above the prior base rates. Consequently, the total base rates increased by $25,000 and the DSIC was reset to zero.

In May 2004, the Company's operating subsidiary in Texas filed an application with the Texas Commission on Environmental Quality ("TCEQ") to increase rates, on an annualized basis, by $11,920 over a multi-year period. The application seeks to increase annual revenues in phases and is accompanied by a plan to defer and amortize a portion of the Company's depreciation, operating and other tax expense over a similar multi-year period, such that the impact on operating income approximates the requested amount during the first years that the new rates are in effect. The application is currently pending before the TCEQ and several parties have joined the proceeding to challenge the rate request. The Company commenced billing for the requested rates and implemented the deferral plan in August 2004, in accordance with authorization from the TCEQ in July 2004. The additional revenue billed and collected prior to the final ruling is subject to refund based on the outcome of the ruling. The revenue recognized and the expenses deferred by the Company reflect an estimate of the final outcome of the ruling. In the event the Company's request is denied completely or in part, the Company could be required to refund some or all of the revenues billed to date, and write-off some or all of the regulatory asset for the expense deferral. In December 2006, the TCEQ held hearings and issued a rate schedule that provided further clarification and an indication of the expected outcome of the rate proceeding. Based on the Company's review of the present circumstances and as a result of the December 2006 hearings, the Company has revised its estimates of the final outcome of the TCEQ proceeding. During the fourth quarter of 2006, the revenue reserve was adjusted and additional revenues were recognized of $1,487 and the regulatory asset was increased resulting in lower expenses recognized of $1,199. As of December 31, 2006, we have deferred $12,382 of operating costs and $2,804 of rate case expenses and recognized $14,859 of revenue that is subject to refund based on the outcome of the final commission order.

The Company's other operating subsidiaries were allowed annual rate increases of $7,366 in 2006, $5,142 in 2005 and $6,673 in 2004, represented by thirty-two, twenty-three and fourteen rate decisions, respectively. Revenues from these increases realized in the year of grant were approximately $3,580, $3,144 and $3,995 in 2006, 2005 and 2004, respectively.

Six states in which the Company operates permit water utilities, and in two 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, New York, Indiana and Missouri 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 at 5% to 9% 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 2006, 2005 and 2004 of $7,873, $10,186 and $7,817, respectively.

(In thousands of dollars, except per share amounts)

Segment Information

The Company has identified fourteen operating segments and one reportable segment. Prior to the acquisition in 2006 of companies that provide on-site septic tank pumping and sludge hauling services, the Company's non-regulated operations were limited in scope and impact on its financial results and assets, and as a result the Company previously operated them as part of its regulated operating segments. The Company made this determination based on an evaluation of its operating segments during the fourth quarter of 2006.

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

One segment is included within the other category below. This segment is not quantitatively significant and is comprised of the Company's businesses that provide on-site septic tank pumping, sludge hauling services and other water and wastewater services. In addition to this segment, other is comprised of other business activities not included in the reportable segment, including corporate costs that have not been allocated to the Regulated segment and intersegment eliminations. Corporate costs include certain general and administrative expenses, and interest expense for certain of the Company's regulated utility companies that do not have their own credit facilities.

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

	As of or For the Year Ended December 31, 2006			As of or For the Year Ended December 31, 2005		
	Regulated	Other	Consolidated	Regulated	Other	Consolidated
Operating revenues	$ 526,293	$ 7,198	$ 533,491	$ 493,456	$ 3,323	$ 496,779
Operations and maintenance expense	216,919	2,641	219,560	202,662	426	203,088
Depreciation	73,380	(2,485)	70,895	63,756	(3,009)	60,747
Operating income	199,224	6,323	205,547	191,419	5,088	196,507
Interest expense, net of AFUDC	43,348	11,143	54,491	41,857	7,758	49,615
Income tax	62,134	(1,888)	60,246	58,647	(1,734)	56,913
Net income	94,941	(2,937)	92,004	92,092	(936)	91,156
Capital expenditures	271,777	(71)	271,706	236,637	825	237,462
Total assets	2,819,385	58,518	2,877,903	2,699,941	(64,895)	2,635,046
Goodwill	18,537	4,043	22,580	20,078	102	20,180

	As of or For the Year Ended December 31, 2004		
	Regulated	Other	Consolidated
Operating revenues	$ 439,972	$ 2,067	$ 442,039
Operations and maintenance expense	179,332	(987)	178,345
Depreciation	57,840	(3,276)	54,564
Operating income	171,413	5,821	177,234
Interest expense, net of AFUDC	39,372	7,003	46,375
Income tax	52,816	(692)	52,124
Net income	80,094	(87)	80,007
Capital expenditures	195,299	437	195,736
Total assets	2,400,696	(45,322)	2,355,374
Goodwill	20,122	—	20,122

(In thousands of dollars, except per share amounts)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
2006					
Operating revenues	$ 117,949	$ 131,749	$ 146,950	$ 136,843	$ 533,491
Operations and maintenance expense	51,316	55,433	59,127	53,684	219,560
Operating income	40,622	50,089	59,523	55,313	205,547
Net income	16,564	22,386	27,331	25,723	92,004
Basic net income per common share	0.13	0.17	0.21	0.19	0.70
Diluted net income per common share	0.13	0.17	0.21	0.19	0.70
Dividend paid per common share	0.1069	0.1069	0.1150	0.1150	0.4438
Dividend declared per common share	0.1069	0.1069	0.2300	—	0.4438
Price range of common stock					
- high	29.79	27.82	23.93	24.94	29.79
- low	26.50	20.13	21.13	21.54	20.13
2005					
Operating revenues	$ 113,988	$ 123,100	$ 136,783	$ 122,908	$ 496,779
Operations and maintenance expense	47,309	50,891	52,666	52,222	203,088
Operating income	42,771	48,593	59,091	46,052	196,507
Net income	18,871	22,218	27,917	22,150	91,156
Basic net income per common share	0.15	0.17	0.22	0.17	0.72
Diluted net income per common share	0.15	0.17	0.21	0.17	0.71
Dividend paid per common share	0.0975	0.0975	0.0975	0.1069	0.3994
Dividend declared per common share	0.0975	0.0975	0.2044	—	0.3994
Price range of common stock					
- high	19.37	23.24	29.15	29.22	29.22
- low	17.49	18.03	21.61	22.88	17.49

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 2006 of $0.115 and December 2005 of $0.1069 were declared in September 2006 and August 2005, respectively.

Years ended December 31,	2006	2005	2004 (a)	2003 (b)	2002
PER COMMON SHARE:					
Net income					
Basic	$ 0.70	$ 0.72	$ 0.64	$ 0.60	$ 0.59
Diluted	0.70	0.71	0.64	0.59	0.58
Cash dividends declared and paid	0.44	0.40	0.37	0.34	0.32
Return on average stockholders' equity	10.6%	11.7%	11.4%	12.3%	13.9%
Book value at year end	$ 6.96	$ 6.30	$ 5.88	$ 5.33	$ 4.35
Market value at year end	22.78	27.30	18.44	16.58	12.36
INCOME STATEMENT HIGHLIGHTS:					
Operating revenues	$ 533,491	$ 496,779	$ 442,039	$ 367,233	$ 322,028
Depreciation and amortization	75,041	65,488	58,864	51,463	44,322
Interest expense, net (c)	54,491	49,615	46,375	42,535	39,007
Income before income taxes	152,250	148,069	132,131	116,718	109,252
Provision for income taxes	60,246	56,913	52,124	45,923	42,046
Net income available to common stock	92,004	91,156	80,007	70,785	67,154
BALANCE SHEET HIGHLIGHTS:					
Total assets	$ 2,877,903	$ 2,635,046	$ 2,355,374	$ 2,071,252	$ 1,716,030
Property, plant and equipment, net	2,505,995	2,279,950	2,069,812	1,824,291	1,486,703
Common stockholders' equity	921,630	811,923	747,231	658,118	492,594
Long-term debt, including current portion	982,815	903,083	834,656	736,052	617,175
Total debt	1,101,965	1,041,588	909,466	832,511	732,288
ADDITIONAL INFORMATION:					
Net cash flows from operating activities	$ 170,726	$ 199,674	$ 173,603	$ 143,373	$ 121,560
Capital additions	271,706	237,462	195,736	163,320	136,164
Net cash expended for acquisitions of utility systems and other	11,848	11,633	54,300	192,331	8,914
Dividends on common stock	58,023	51,139	45,807	39,917	36,789
Number of utility customers served (d)	927,235	864,894	835,512	749,491	605,474
Number of shareholders of common stock	28,348	27,054	24,082	22,726	21,389
Common shares outstanding (000)	132,326	128,970	127,180	123,452	113,194
Employees (full-time)	1,540	1,489	1,442	1,260	971

(a) 2004 includes a partial year of financial results for the mid-year acquisition of Heater Utilities, Inc. and certain utility assets of Florida Water Services Corporation.

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

(c) Net of allowance for funds used during construction and interest income.

(d) 2006 includes 44,792 customers associated with the New York Water Service Corporation. The operating results of this acquisition will be reported in our consolidated financial statements beginning January 1, 2007.

Exhibit 21.1

AQUA AMERICA, INC. AND SUBSIDIARIES

The following table lists the significant subsidiaries and other active subsidiaries of Aqua America, Inc. at December 31, 2006:

Aqua Pennsylvania, Inc. (Pennsylvania)
Aqua Resources, Inc. (Pennsylvania)
Aqua Services, Inc. (Delaware)
Aqua Ohio, Inc. (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)
Heater Utilities, Inc. (North Carolina)
Aqua New York, Inc. (New York)
Aqua Wastewater Management, Inc.

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 333-61772, 333-42275, 333-104290, 333-122900 and 333-130400), on Form S-4 (No. 333-93243), and on Form S-8 (Nos. 333-61768, 333-70859, 033-52557, 033-53689, 333-26613, 333-81085, 333-107673, 333-113502, 333-116776 and 333-126042) of Aqua America, Inc. of our report dated February 27, 2007 relating to the consolidated financial statements, management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting, which appears in the Annual Report to Shareholders, which is incorporated in this Annual Report on Form 10-K.

/S/ PRICEWATERHOUSECOOPERS LLP

PRICEWATERHOUSECOOPERS LLP
Philadelphia, Pennsylvania
February 27, 2007

Exhibit 31.1

CERTIFICATION

I, Nicholas DeBenedictis, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

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 the 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: February 27, 2007

NICHOLAS DEBENEDICTIS
Nicholas DeBenedictis
Chairman, President and Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, David P. Smeltzer, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

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 the 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: February 27, 2007

DAVID P. SMELTZER
David P. Smeltzer
Senior Vice President – Finance and Chief Financial Officer

Exhibit 32.1

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, 2006 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
February 27, 2007

Exhibit 32.2

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, 2006 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
February 27, 2007