120 years of water.
Pure and simple.
AQUA AMERICA, INC. • 2005 ANNUAL REPORT

AQUA America℠

Company Profile

Aqua America, Inc.

is the largest U.S.-based publicly-traded water utility serving more than 2.5 million residents in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, Florida, Indiana, Virginia, Maine, Missouri, New York and South Carolina.

Aqua America is listed on the New York and Philadelphia Stock Exchanges under the ticker symbol WTR.

Financial Highlights

(In thousands of dollars, except per share amounts)

	2005	2004	% Change
• Operating revenues	$ 496,779	$ 442,039	12.4
• Net income available to common stock	91,156	80,007	13.9
• Diluted net income per common share (a)	0.71	0.64	10.9
• Annual dividend rate per common share (a)	0.4276	0.3900	9.6
• Dividends paid per common share (a)	0.3994	0.3675	8.7
• Common stockholders' equity per share (a)	6.30	5.88	7.1
• Common stockholders' equity	811,923	747,231	8.7
• Total assets	2,626,725	2,355,374	11.5
• Net cash flows from operating activities	199,674	173,603	15.0
• Capital additions (b)	237,462	195,736	21.3
• Number of customers served	864,894	835,512	3.5

(a) Restated for 2005 4-for-3 stock-split

(b) Excludes net payments for acquired water and wastewater systems: $11,633 in 2005 and $54,300 in 2004.

Aqua America, Inc.

- The largest U.S.-based, publicly-traded water utility.
- Growing at twice the rate of other water utilities
- More than 100 acquisitions and growth ventures in the past five years.

Chairman's Message

March 9, 2006

The year 2006 marks the 120 year anniversary of Aqua America.

Founded in 1886 in Springfield, Pennsylvania by a group of Swarthmore College professors, the company operated exclusively for 113 of the last 120 years in Southeastern Pennsylvania. In 1999, we made the strategic decision to acquire Consumers Water Company and take our first step outside of Southeastern Pennsylvania and enter four new states—New Jersey, Illinois, Ohio and Maine. In 2003, we took another strategic step and acquired the regulated water and wastewater operations of AquaSource, Inc., extending our reach to our current total of 13 states—adding Texas, Virginia, Florida, Indiana, South Carolina, Missouri and New York (the company first acquired a number of North Carolina systems in 2001 and expanded that number with the Heater Utilities Inc. and AquaSource acquisitions).

Our geographic expansion benefited shareholders by mitigating two of our key financial risks: regulatory environment and weather. When located only in Southeastern Pennsylvania, we were 100 percent beholden to the impact of regulatory decisions and weather patterns in one state. Now these risks are spread across our 13 states. However, even with our expansion, Pennsylvania still represents half of our growing company and has been a key part of our historical, long-term success.

The year 2005 brought well above-average stock performance with shareholders benefiting from this year's total return of more than 50 percent. This is well above our five, 10 and 15 year average total returns, which are closer to 20 percent annually. The company, our stock, and our industry benefited from increased media and investor attention during the year with feature articles appearing in *Forbes, The Wall Street Journal, The New York Times,* and various television segments on Bloomberg and CNBC.

The continuation of positive financial performance—with full year 2005 results producing 12 percent revenue growth and 14 percent net income growth over last year—allowed us to offer an above-historical-average dividend increase last year. In August, the company's board of directors approved a 10 percent increase in our shareholder dividend. The board also approved a four-for-three stock split in the form of a stock distribution at the same time. The new annualized dividend rate, adjusted for the split, is $.4276 per share. Both actions were effected on December 1, 2005.

Our growth strategy was once again in full swing this year, as we completed a record 30 acquisitions of water and wastewater systems in many of our states. Unlike our growth in 2004, which was primarily from the acquisition of two larger systems—Heater in North Carolina and Florida Water Services—this year's small system acquisitions were consistent with the type we consider our "bread and butter" and the foundation of our growth-through-acquisition program. We value these small systems because they bring new revenues, provide new platforms for future capital investment and future growth, and are also easily integrated into our operations.

We spent record amounts of capital in 2005, $237.5 million, fixing and expanding our water and wastewater systems around the country. These capital investments are critical to upgrading our infrastructure and meeting the national drinking water standards and providing quality drinking water to our customers. Capital investment is also the foundation of earnings growth using the regulated model. After making these investments, we are permitted to file for rate relief with the affected jurisdiction and request a fair, regulated return on our investment. These returns come to us in the form of new revenues and help to build our future earnings. We have earned credibility with the regulatory commissions in our states by consistently delivering on our promises. This has helped us receive a warm welcome in new states and fair treatment during the rate process.

In 2005, we were pleased to add two new directors to our board: Mr. Lon Greenberg, the CEO of UGI Corporation, and Dr. Constantine Papadakis, the President of Drexel University. We welcome the addition of both esteemed executives to our board and have already benefited from their contributions. With the entrance of our two newest directors, we also say goodbye to Mr. John Menario, former Chairman of Consumers Water Company and Mr. Jack McCaughn, former president of BetzDearborn, Inc.—both of whom retired after the March 7, 2006 board of directors meeting. Their wisdom through their combined 27 years of service offered invaluable guidance to the company through some key transitional and growth periods over the last decade. We thank them for their commitment and service.

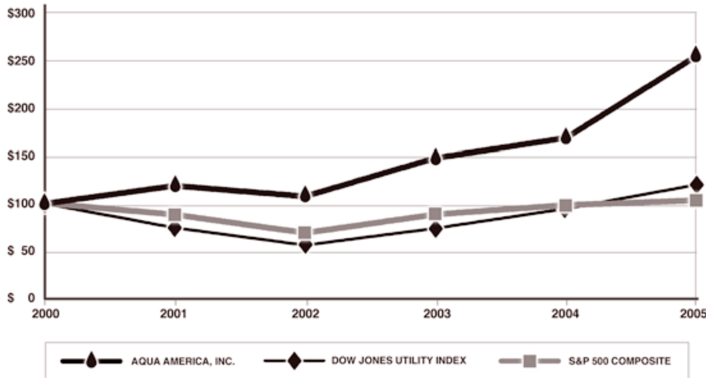
As we move forward into our 120th year, we do so with confidence in our long-term strategy and our future outlook. We believe our growth strategy has a strong foundation and, with more than 50,000 water systems and 16,000 wastewater systems in the U.S. today, plenty of future opportunity. We have completed 175 acquisitions and growth ventures over the past 10 years, giving us an expertise on which we believe we will continue to capitalize in the years to come.

Thanks to our shareholders, customers, employees and the communities we serve, we have an excellent network to support our continued success.

Nicholas DeBenedictis

Five Year Cumulative Total Return

COMPARISON OF FIVE YEAR CUMULATIVE TOTAL RETURN AMONG AQUA AMERICA, S&P 500 AND DOW JONES UTILITY INDEX

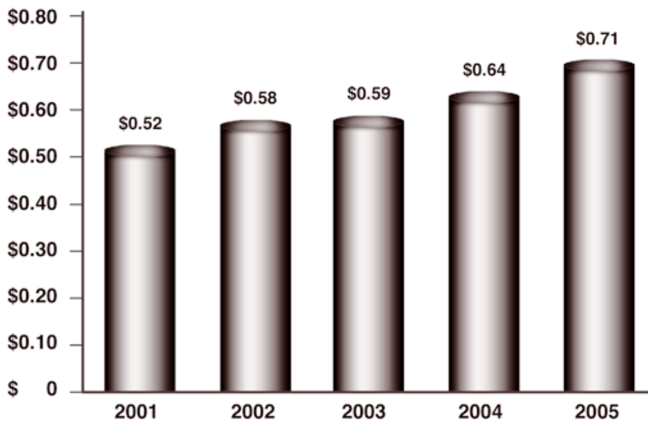


Common Stock and Dividend Highlights

- Increased cash dividend by 10 percent to $0.4276 on an annualized basis as of December 1, 2005
- 15 cash dividend increases in the last 14 years
- 4-for-3 stock split on December 1, 2005, the 6th stock split in 10 years
- Total return for 2005 more than 50 percent

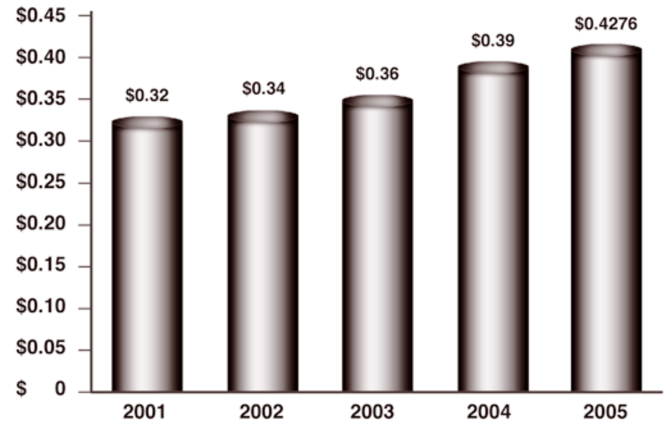
Earnings Per Share

(split-adjusted)

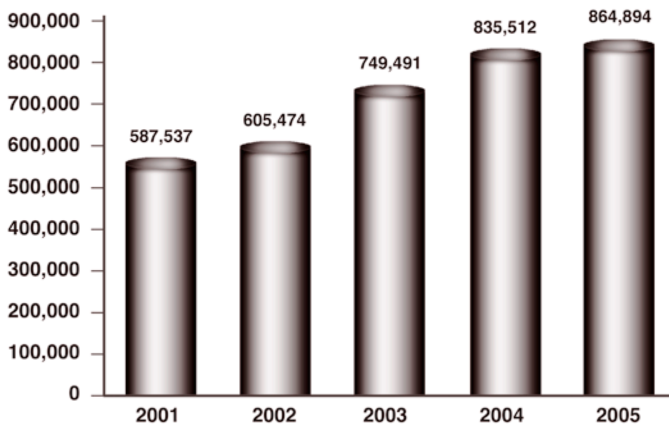


Dividends Per Share

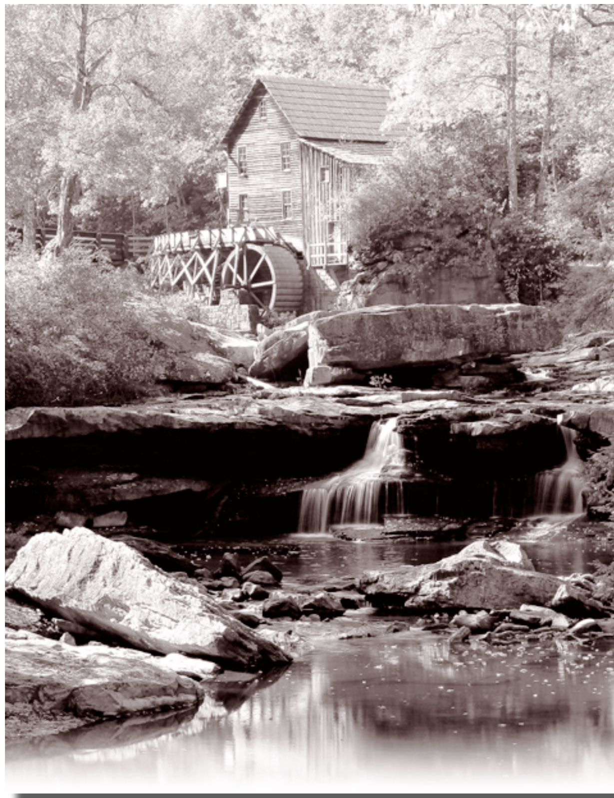
(split-adjusted)



Customer Count



Operating Revenues



120 Years

AT AQUA AMERICA, INC. (AQUA) we take our responsibility to provide quality, reliable drinking water to our customers seriously. We've been doing so for the last 120 years. Since the first pipe was laid in 1886, we've been dedicated to improving infrastructure and water supply, whether it meant building reservoirs and plants to service a growing community, or replacing pipe to strengthen aging systems.

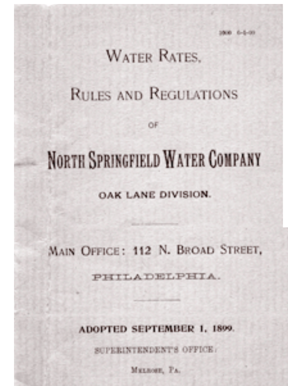
As our nation grew, so did our company. As early as the 1900s, Aqua established a growth strategy that is still the foundation of our company today. Our company is built on strength—strength of infrastructure, strength of service and strength to grow. Aqua's strength has remained during world wars, the Depression and massive storms that devastated parts of our service territory.

Over the years we've seen many changes, not only in our company name, but in our company's size and service territory. But no matter how much Aqua changes, we remain concerned citizens determined to provide our customers with quality water.

120 Years of Water. Pure and Simple.

1886 – 1900s

At a time when areas outside of Philadelphia (home to the nation's first municipal waterworks) began experimenting with their own waterworks, a group of concerned citizens in Delaware County decided to find an answer to their own water needs. These Swarthmore residents and engineering professors at Swarthmore College, who were worried about water quality, began operating a small water company in 1886. The citizens, whose names were lost in history, choose a local natural spring, build a pumping station and lay pipes to their homes. They share water privileges with their neighbors, and soon the operation grows too big to be run as a small association. So on January 4, 1886, the group incorporates and the Springfield Water Company is born.



Water Rates,
Rules and Regulations
of
North Springfield Water Company
Oak Lane Division.

Main Office: 112 N. Broad Street,
Philadelphia.

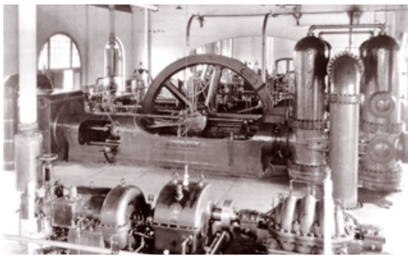
Adopted September 1, 1899.
Superintendent's Office:
Melrose, Pa.

Soon after, the company contracts with a major pipe manufacturer and begins pumping from Whiskey Run, a creek one mile from Swarthmore. But just three short years later, the company outgrows the Whiskey Run supply, and Crum Creek is selected as a new source. Pumping Station No. 1 is operational, powered by water and steam.

Over the years, Springfield Water Company grows and acquires six companies to extend into Upper Darby, Ridley, Tinicum and Darby townships and Sharon Hill and Darby boroughs. This marks the start of an aggressive expansion strategy that becomes the foundation of the company's success.

Over the next 20 years, many local water companies consolidate with Springfield Water Company leading the way with its numerous acquisitions. The company acquires Lansdowne Water Company in 1899, which not only delivers water, but also turns a profit.

1920s



Early in this decade, Indiana farm boy Clarence Geist is making a name for himself in the utility industry in the Midwest. Geist's focus changes when he meets and falls in love with Philadelphia student Florence Hewitt. Geist follows Hewitt to Philadelphia and begins building his empire. He, along with Harold S. Schutt and Carleton E. Davis, are determined to provide fresh and safe water to the sprawling suburban Philadelphia area.

And so, on January 1, 1925, Geist, also know as "Water Boy," purchases Springfield Consolidated Water Company (formerly Springfield Water Company). At this time, the company serves 45,396 customers. Later that year, the company changes its name to Philadelphia Suburban Water Company (PSW) to encapsulate the company's expansion strategy. The following year, the company installs its first steam-driven turbine and centrifugal pump at Crum Creek, which increases filter capacity to six million gallons per day.

1930s

Despite the Depression, the company continues to grow and offers its employees job security and the means to make ends meet in uncertain times.

A desperate need for additional emergency water supplies develops, driving the company to begin construction of the 3.5 billion gallon Geist Reservoir, later renamed the Springton Reservoir. Over the next several years, PSW adds 44 miles of main to its systems.

The Geist years end abruptly in 1938 when Geist dies at the age of 72. His protégé, Harold Schutt is named president. And even as war approaches, the company's financial standing stays strong and expansion plans move forward.

1940s

The nation is stunned by the Japanese attack on Peal Harbor on December 7, 1941. Between December 1941 and August 14, 1945, 16 million U.S. citizens are in uniform, and women hold jobs traditionally filled by men. At PSW, a lot of employees join the service or go to work at defense plants. So the company hires contractors, and soon women begin working as meter readers. In 1941, the company enters into an agreement with the International Brotherhood of Firemen, Oilers, Powerhouse Operators and Maintenance Men, Local 473, which represents 180 workers.

Four years later, the company honors long-time employees by organizing the 20-Year Club.

The year 1945 marks the beginning of the company's 60 consecutive years of paid dividends.

Though the war curtailed some expansion plans, the company continues to grow throughout this decade, and eventually introduces a modest advertising campaign to show how water was used throughout history.

1950s

The company grows considerably during this decade, and even builds its largest reservoir to meet the increasing demand. The Green Lane reservoir is built to hold 4.4 billion gallons.

A massive storm hits the area in 1950, filling the Geist Reservoir that was dry after 17 months of almost no precipitation.

In 1951, the company adds nearly 8,000 new customers and needs to change to postcard billing to save time, money and materials. Roadside signs advertise the company's extensive infrastructure improvements.

In 1958, Margaret Hogan is named the company's first female officer. A year later, Harold Schutt retires, and James H. Clarke is named chairman. Thomas W. Moses is named PSW's new president.

1960s

PSW continues to grow while experiencing change in upper management. After only three years as president, Moses leaves PSW, and James M. Ballengee takes over as president. Ballengee renews the company's feeling of family among employees.

That same year, the customer count grows to 187,271 as infrastructure improvements continue and a new public relations plan is put into effect. The plan includes speeches, news releases and public tours that further enhance the company's community involvement. Customers receive their first-ever account numbers in 1963, as customer information is now stored on computers.

In 1964, the company opens the most modern laboratory in the water industry at its Bryn Mawr facility.

As PSW celebrates its 80th anniversary in 1966, new records are set including an annual sendout exceeding 24 billion gallons and operating revenues near $1 million.

The Board of Directors approves the plan to create a holding company called Philadelphia Suburban Corporation (PSC) in 1968.

1970s

James H. Clarke is named chairman of PSC, while Ballengee is appointed chairman and CEO of PSW. George H. Dann, a former meter reader, takes over as president of PSW.

On July 22, 1971, PSC appears for the first time on the New York Stock Exchange with the ticker symbol, PSC. One year later, Hurricane Agnes rips through the company's service territory causing severe flooding at its Pickering Creek plant. The plant is offline for nearly five days as a result of the storm that many call the 300-year flood.

Earl H. Graham, who joined the company as a laborer in 1947, is elected PSW's new president in 1974. He introduces the Employee Stock Purchase Plan, and is also credited with moving the company forward despite a less-than-favorable regulatory and business climate.

Two years later, John W. Boyer is appointed chairman of PSC, a position he holds until May 1993.

The federal government issues the Safe Drinking Water Act in 1974, and follows with new Federal Interim Primary Drinking Water Regulations in 1977. These regulations set chemical, physical and bacteriological standards, establish monitoring schedules and require certification of laboratories.

In 1979, the company unveils its new logo.

1980s

PSW renovates and expands its laboratory; is granted several rate increases, including a 13.3 percent increase in 1980; streamlines and automates its operations and installs a transmission system to help in droughts.

Throughout the decade, the company continues to improve its plants, and also opens a new building at its Bryn Mawr headquarters.

In 1986, the year of the company's centential celebration, PSW acquires Great Valley Water Company to add 20 wells and 145 miles of main to its system.

The company introduces a new computer system called Supervisory Control and Data Acquisition (SCADA) from which needs for adjustments in the distribution system are identified and made electronically from a distribution control center at the Bryn Mawr headquarters.

1990s

In 1991, the new state-of-the-art Pickering plant comes online.

The company's current chairman and CEO Nicholas DeBenedictis, joins the company in 1992 and brings with him an aggressive growth-through-acquisition strategy. Within six months of his arrival, the company purchases the West Whiteland and Uwchlan water systems. He is named Chairman of PSC in 1993.

By the end of the decade, the company completes 46 growth ventures including the acquisition of the Bristol, West Chester and Bensalem water systems, which add more than 32,000 customer accounts.

In 1999, the company completes a major merger with Consumers Water Company, a company whose history also dates back to the late 1880s. This merger expands PSC's presence from one to five states and nearly doubles its customer count from 325,796 to 557,462.

2000s

Early in this decade (2002), the company receives news that long-time shareholder Vivendi Environnement (formerly Compaigne Generale de Eaux and now Veolia) intends to monetize its investment in PSC. Vivendi owns approximately 17 percent of PSC's outstanding common shares. PSC commits to buy two million shares, and a secondary offering of the remaining shares is a success. That same year, PSC announces another major acquisition. The company acquires AquaSource, which when closed in 2003, expands the company's footprint to 13 states.

Another big year follows. In 2004, PSC changes its name to Aqua America, Inc. (Aqua) and its ticker to WTR. The company's state subsidiaries also change their names to further unify this growing company. The company marks the event by ringing The Closing Bell™ at the New York Stock Exchange on January 14.

Later that year, the company announces two more major acquisitions—the operation of Florida Water Services Corporation and Heater Utilities. With the acquisition of Florida Water Services, the company adds 63 systems and more than 13,000 customers in the central part of Florida. Acquiring Heater Utilities in North Carolina makes the company the largest water provider in the state, serving more than 58,000 customers.

The company closes 2005 with a record number of acquisitions (30), increasing its 13-state customer base to approximately 865,000 accounts (2.6 million people).

Aqua receives much media attention in 2005. For the first time ever, the company is featured in *Forbes,* one of the country's leading financial magazines.

Other high profile media coverage included CNBC's *Squawk Box, The Wall Street Journal, Business Week, The New York Times* and *Kiplinger's.*

2005 FINANCIAL DATA

(This page intentionally left blank.)

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 and related funding requirements;
- 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;
- 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;
- 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 approximately 2.5 million people in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, Florida, Indiana, Virginia, Maine, Missouri, New York and South Carolina. Our largest operating subsidiary, Aqua Pennsylvania, Inc., accounts for approximately 56% of our operating revenues for 2005 and, as of December 31, 2005, provides water or wastewater services to approximately one-half of the total number of people we serve, located in the suburban areas north and west of the City of Philadelphia and in 22 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 close to our operating companies' service territories. We are the largest U.S.-based publicly-traded water utility based on number of people served.

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.

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. Often these utility investments are required by a changed federal or state environmental standard, to improve our ability to deliver quality customer service, or to assist in our ability to supply water in sufficient quantities for future demand or when experiencing drought conditions.

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. Accordingly, we maintain a rate case management capability to provide that the tariffs of the utility operations reflect, to the extent practicable, the timely recovery of increases in costs of operations, capital, taxes, energy, materials and compliance with environmental regulations. In assessing our rate case strategy, we consider the amount of utility plant additions and replacements made since the previous rate decision, the changes in the cost of capital, changes in the capital structure and changes in other costs. Based on these assessments, our utility operations periodically file rate increase requests with their respective state regulatory commissions.

Some of the states in which we acquired operations in 2004 and 2003 require separate filings for each of our local systems, as compared to a single state-wide rate filing. Between August 2003 and December 2005, we have filed rate filings in over 25 jurisdictions. 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 116 divisions within these recently acquired operations where we have not yet filed a rate request.

Revenue Surcharges - Five states in which we operate permit water utilities, and in some of these five 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 until such time as these costs are fully incorporated in base rates.

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

Customer and Business Services Projects - We are currently consolidating our customer service locations into three principal call centers, implementing a common customer information system, and upgrading our financial information systems. We expect to complete our primary customer service initiatives by the end of 2006. Consistent with prior practice, we have capitalized costs and services associated with these projects and expect to recover these costs in future rates. Certain information technology costs associated with these projects, such as software training, data conversion and business process reengineering costs, have been deferred in accordance with SFAS No. 71. Although we believe it is probable that the applicable public utility commissions will allow recovery of these costs, we can provide no assurances as to their full recoverability until the conclusion of the applicable rate proceeding. As of December 31, 2005, $3,952 of costs have been incurred and deferred as a regulatory asset since the last rate proceeding, and $251 has been expensed during the year ended December 31, 2005, in the jurisdictions where future recovery is unlikely.

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. This growth-through-acquisition strategy allows us to operate more efficiently and provides an important source 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. Please refer to the section captioned "Acquisitions" for an additional discussion of acquisitions.

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

Although not as fragmented as the water industry, the wastewater industry in the U.S. also presents opportunities for consolidation. According to the U.S. Environmental Protection Agency's (EPA) most recent survey of publicly-owned wastewater treatment facilities in 2000, there are approximately 16,000 such facilities in the nation serving approximately 72% of the U.S. population. The remaining population represents individual homeowners with their own treatment facilities; for example, community on-lot disposal systems and septic tank systems. The vast majority of wastewater facilities are government-owned rather than privately-owned. The EPA survey also indicated that there are approximately 6,600 wastewater facilities in operation or planned in the 13 states where we operate.

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

- 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.

Sendout

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

The geographic diversity of our customer base helps reduce our exposure to extreme or unusual weather conditions in any one area of our service territory. Our geographic diversity has continued to widen as a result of the 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, 2005, our operating revenues were derived principally from the following states: 56% in Pennsylvania, 8% in Ohio, 8% in Texas, 7% in Illinois, and 6% in North Carolina.

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.

Selected Financial and Operating Statistics

Our selected five-year financial and operating statistics follow:

Years ended December 31,	2005	2004 (a)	2003 (b)	2002 (c)	2001
Customers:					
Residential water	724,954	702,367	624,355	535,506	526,776
Commercial water	33,975	33,720	33,015	30,355	29,745
Industrial water	1,356	1,365	1,397	1,423	1,454
Other water	15,584	15,700	20,483	16,466	9,947
Wastewater	89,025	82,360	70,241	21,724	19,615
Total	864,894	835,512	749,491	605,474	587,537
Operating revenues:					
Residential water	$ 295,473	$ 264,910	$ 218,487	$ 197,190	$ 188,303
Commercial water	73,455	65,605	61,343	55,962	53,103
Industrial water	18,364	17,377	17,675	17,221	16,141
Other water	50,827	44,593	40,048	36,255	35,681
Wastewater	42,176	35,931	17,874	8,210	6,960
Other	16,484	13,623	11,806	7,190	7,092
Total	$ 496,779	$ 442,039	$ 367,233	$ 322,028	$ 307,280
Operations and maintenance expense	$ 203,088	$ 178,345	$ 140,602	$ 117,735	$ 111,885
Net income available to common stock	$ 91,156	$ 80,007	$ 70,785	$ 67,154	$ 60,005
Capital expenditures	$ 237,462	$ 195,736	$ 163,320	$ 136,164	$ 124,088
Operating Statistics					
Selected operating results as a percentage of operating revenues:					
Operations and maintenance	40.9%	40.3%	38.3%	36.6%	36.4%
Depreciation and amortization	13.2%	13.3%	14.0%	13.8%	13.1%
Taxes other than income taxes	6.4%	6.2%	5.9%	6.0%	6.8%
Interest expense, net	10.4%	11.0%	12.2%	12.5%	11.9%
Net income available to common stock	18.3%	18.1%	19.3%	20.9%	19.5%
Effective tax rates	38.4%	39.4%	39.3%	38.5%	39.3%

(a) 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.

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

(c) 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 nonfinancial measure and financial measures to be the fundamental basis by which we evaluate our performance: our number of customers, operating revenues, net income and dividend rate on common stock. In addition, we consider other key financial measures in evaluating our operating results: earnings per share, 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 as well as our operating budget as approved by the Aqua America, Inc. Board of Directors.

Our operating expense ratio is one measure that we use to evaluate our operating efficiency and management effectiveness. As reported in the table above, and as anticipated, our operating expense ratio increased for 2004 over 2003, and increased for 2003 over 2002 as a result of the additional operating costs associated with the AquaSource acquisition which closed in July 2003. Our 2004 results reflect a full twelve months of operating results for the acquisition, while our 2003 results reflect only five months of operating results for the acquisition. The business model of the acquired AquaSource operations, generally referred to as our Aqua South operations, is different from the rest of the Aqua America operations. The Aqua South operations are comprised of approximately 600 small systems, which are generally clustered in regions to achieve some level of operating efficiency. The small, separate systems of the Aqua South operations result in the operating revenues generated by the Aqua South operations being accompanied by a higher ratio of operations and maintenance expenses as compared to the rest of the pre-existing 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, resulting in higher fixed capital costs (utility plant investment) and lower operating costs per customer. For the twelve-month period ended June 30, 2003, the last reporting period before the July 31, 2003 closing of AquaSource, our operating expense ratio declined to 36.5%, from 36.6% for the year ended December 31, 2002. To a lesser extent, the 2005 and 2004 efficiency ratios increased over the previous years due to the influence of the mid-year 2004 acquisitions of Heater Utilities, Inc. and Florida Water Services Corporation, which have similar operating characteristics as our Aqua South operations. Our efficiency ratio in 2004 was reduced by approximately 53 basis-points for a $2,342 gain realized on the sale of our Geneva, Ohio water system that was reported in the 2004 consolidated statement of income as a reduction to operations and maintenance expense. Other factors that influence the efficiency ratio include regulatory lag, i.e., changes in operations and maintenance expenses without an immediate corresponding change in operating revenues, and operating revenues when accompanied by a dissimilar change in operations and maintenance expense, such as changes in water consumption as impacted by weather conditions. On January 1, 2006, we adopted 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 is expected to increase our 2006 operations and maintenance expense by approximately $3,500.

We continue to evaluate management initiatives to help control costs and improve efficiencies, but the effect of these acquisitions have been to increase our overall operating expense ratio from the levels experienced during the three years preceding the AquaSource acquisition. Consequently, our return on revenues in 2005 and 2004 was lower than 2003, 2002 and 2001 as a result of the impact of the higher cost of Aqua South's operations.

RESULTS OF OPERATIONS

Our net income has grown at an annual compound rate of approximately 11.5% during the five-year period ended December 31, 2005. During the past five years, operating revenues grew at a compound rate of 12.6% and total expenses, exclusive of income taxes, grew at a compound rate of 12.8%.

Operating Revenues

The growth in revenues over the past five years is a result of increases in both the customer base and in water rates. The number of customers increased at an annual compound rate of 8.9% in the past five years primarily as a result of acquisitions of water and wastewater systems, including the mid-year 2004 Heater and Florida Water Services acquisitions, and the AquaSource acquisition completed July 2003. Acquisitions made during the five-year period ended December 31, 2005 have provided water and wastewater revenues of approximately $114,176 in 2005, $87,919 in 2004 and $32,427 in 2003. Excluding the effect of acquisitions, our customer base increased at a five-year annual compound rate of 1.5%. Rate increases implemented during the past three years have provided additional operating revenues of approximately $25,500 in 2005, $15,800 in 2004 and $19,900 in 2003.

In November 2005, our Pennsylvania operating subsidiary filed an application with the Pennsylvania Public Utility Commission (PAPUC) requesting a $38,800 or 14.4% increase in annual revenues. The application is currently pending before the PAPUC and a final determination is anticipated by August 2006. 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 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, our operating subsidiary in Texas filed an application with the Texas Commission on Environmental Quality to increase rates by $11,920 over a multi-year period. The application seeks to increase annual revenues in phases and is accompanied by a plan to defer and amortize a portion of 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 Commission 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 Texas Commission on Environmental Quality in July 2004. The additional revenue billed and collected prior to the final ruling are 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. As of December 31, 2005, we have deferred $9,486 of expenses and recognized $5,202 of revenue that is subject to refund based on the outcome of the final commission order, which is not expected to be issued prior to December 2006. 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. Based on our review of the present circumstances, no additional reserve or change in estimate adjustments are required for the revenue recognized to date or for the impairment of our regulatory asset.

Our operating subsidiaries located in other states received rate increases representing estimated annualized revenues of $5,142 in 2005 resulting from twenty-three decisions, $6,673 in 2004 resulting from fourteen rate decisions, and $1,275 in 2003 resulting from eight rate decisions. Revenues from these increases realized in the year of grant were approximately $3,144 in 2005, $3,995 in 2004 and $839 in 2003. These operating subsidiaries currently have filed 18 rate requests which are being reviewed by the state regulatory commissions, proposing an aggregate increase of $9,202 in annual revenues. In addition, there were 14 rate awards received to date in 2006 for cases filed in 2005 in the amount of $1,961. During 2006, we intend to file 27 additional rate requests proposing an aggregate of approximately $17,029 of increased annual revenues.

Currently, Pennsylvania, Illinois, Ohio, 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 $10,186 in 2005, $7,817 in 2004 and $8,147 in 2003.

In addition to regulated water and wastewater operating revenues, we had other non-regulated revenues that were primarily associated with operating and maintenance contracts, and data processing service fees of $16,484 in 2005, $13,623 in 2004 and $11,806 in 2003. 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. The increase in 2004 over the previous year resulted primarily from the additional revenues from contract operations associated with the July 2003 AquaSource acquisition.

Operations and Maintenance Expenses

Operations and maintenance expenses totaled $203,088 in 2005, $178,345 in 2004 and $140,602 in 2003. Most elements of operating costs are subject to the effects of inflation, and changes in the number of customers served, and 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 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 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.

Operations and maintenance expenses increased in 2004 as compared to 2003 by $37,743 or 26.8% primarily due to added operating costs associated with acquisitions of $36,123, additional postretirement costs of $2,110, increased accounting expense of $1,496 for assessing internal control effectiveness under the Sarbanes-Oxley Act and higher water production expenses. Partially offsetting these increases were lower insurance costs due to the favorable settlement of insurance claims during 2004, and the gain on the sale of the Geneva, Ohio water system of $2,342. 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. The impact of acquisitions is primarily the result of the effect of AquaSource for the full twelve-month period versus five months in 2003, and the mid-year 2004 acquisitions of Heater and the Florida Water Services systems.

Depreciation and Amortization Expenses

Depreciation expense was $60,747 in 2005, $54,564 in 2004 and $48,522 in 2003, 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 systems.

Amortization expense was $4,741 in 2005, $4,300 in 2004 and $2,941 in 2003. The increase in 2005 and 2004 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 $4,100 or 14.9% in 2005 as compared to 2004 and $5,989 or 27.7% in 2004 as compared to 2003. The increase in both 2005 and 2004 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 July 2003 AquaSource acquisition for a twelve-month period in 2004 as compared to the five-month period in 2003, and the mid-year 2004 acquisitions of Heater Utilities and the systems of Florida Water.

Interest Expense, net

Net interest expense was $52,062 in 2005, $48,679 in 2004 and $44,662 in 2003. Interest income of $3,040 in 2005, $1,762 in 2004 and $395 in 2003 was netted against interest expense. Interest expense increased in 2005 and 2004 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 2004 was used to finance the acquisition of AquaSource in mid-year 2003, the Heater and Florida Water acquisitions in mid-year 2004, and capital expenditures. 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 by a reduction in our allowance for funds used during

construction. Interest income increased in 2004 due to $532 of interest income in connection with the arbitration award related to the final purchase price for the AquaSource acquisition received in 2004 and additional interest income associated with acquisitions. Interest expense during 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.

Allowance for Funds Used During Construction

The allowance for funds used during construction (AFUDC) was $2,447 in 2005, $2,304 in 2004 and $2,127 in 2003 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 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 in 2005 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. The increase in 2004 is due to an increase in the average balance of CWIP to which AFUDC is applied.

Gain on Sale of Other Assets

Gain on sale of other assets totaled $1,177 in 2005, $1,272 in 2004 and $5,692 in 2003 and consisted of gains on land and marketable securities sales. Gain on sale of land totaled $1,177 in 2005, $869 in 2004 and $5,153 in 2003. Gain on sale of marketable securities totaled $403 in 2004 and $539 in 2003.

Income Taxes

Our effective income tax rate was 38.4% in 2005, 39.4% in 2004 and 39.3% in 2003. The changes in the effective tax rates in 2005 and 2004 are due to differences between tax deductible expenses and book expenses and the recognition in 2005 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 $196,507 in 2005, $177,234 in 2004 and $153,561 in 2003 and net income available to common stock was $91,156 in 2005, $80,007 in 2004 and $70,785 in 2003. Diluted income per share was $0.71 in 2005, $0.64 in 2004, and $0.59 in 2004. The changes in the per share income in 2005 and 2004 over the previous years were due to the aforementioned changes in income and impacted by a 2.8% increase in the average number of common shares outstanding during 2005 and a 5.6% increase in the average number of common shares outstanding during 2004, respectively. 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. The increase in the number of shares outstanding in 2004 is primarily a result of the additional shares issued in common share offerings and the aforementioned factors for 2005.

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

Fourth Quarter Results

Net income available to common stock was $22,150 in the fourth quarter of 2005 and $22,474 in the same period of 2004. The change in net income is due to increased operations and maintenance expense of $6,717, increased depreciation of $2,585 and increased other taxes of $1,522, offset partially by a $7,466 increase in operating revenues. The higher operations and maintenance expense is due primarily to the gain on the December 2004 sale of the Geneva water system of $2,342 which reduced operations and maintenance expense in 2004, additional operating cots associated with acquisitions, higher water production costs and increased postretirement costs. The increased depreciation expense reflects the utility plant placed in service since the fourth quarter of 2004. Other taxes increased due to higher property taxes and additional local taxes incurred in the fourth quarter of 2005. The increase in operating revenues was a result of additional revenues of $2,131 resulting from an increase in water rates granted to our operating subsidiaries, additional infrastructure rehabilitation surcharge revenue of $2,377, and the additional revenue from acquisitions.

FINANCIAL CONDITION

Cash Flow and Capital Expenditures

Net operating cash flow, dividends paid on common stock, capital expenditures, including allowances for funds used during construction, and expenditures for acquiring water and wastewater systems for the five years ended December 31, 2005 were as follows:

	Net Operating Cash Flow	Common Dividends	Capital Expenditures	Acquisitions of Utility Systems
2001	$ 102,165	$ 34,234	$ 124,088	$ 9,517
2002	121,560	36,789	136,164	8,914
2003	143,373	39,917	163,320	192,331
2004	173,603	45,807	195,736	54,300
2005	199,674	51,139	237,462	11,633
	$ 740,375	$ 207,886	$ 856,770	$ 276,695

Included in capital expenditures for the five-year period are: expenditures for the modernization and replacement of existing treatment plants, new water mains and customer service lines, rehabilitation of existing water mains and hydrants, and water meters. During this five-year period, we received $52,619 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 $242,849, retired $1,760 of preferred stock, and have refunded $23,701 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 2006 capital program, exclusive of the costs of new mains financed by advances and contributions in aid of construction, is estimated to be $255,200 of which $64,790 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 2006 capital program, along with $24,645 of sinking fund obligations and debt maturities, and $93,626 of other contractual cash obligations, as reported in the section captioned "Contractual Obligations", is expected to be financed through internally-generated funds, our revolving credit facilities, the issuance of equity and the issuance of new long-term debt.

Future utility construction in the period 2007 through 2010, 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 $950,000. We anticipate that less than one-half of these expenditures will require external financing of debt and the additional issuance of common stock through our dividend reinvestment and stock purchase plans and possible future public equity offerings. We expect to refinance $115,166 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 $276,695 and issued 816,019 shares of common stock, valued at $8,781 at the time of the acquisition, related to the acquisitions of utility systems, primarily water utilities and some wastewater utilities. We included the operating results of these acquisitions in our consolidated financial statements beginning on the respective acquisition date.

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. Pursuant to our strategy to grow through acquisitions, 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. The acquired operation provides 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. For the fiscal year ended December 31, 2003, Heater had operating revenues of $19,489. The acquisition was accounted for as a purchase and accordingly, we recorded goodwill of $18,842. In 2004, 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 intend to pursue 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, if any.

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 $14,747 in cash. 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 will result in a reduction of the final purchase price that could be as much as approximately $2,000, which is not expected to result in the recognition of goodwill.

The acquisition 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 in May 2004. A portion of the short-term note was subsequently repaid by Aqua America with the proceeds from a November 2004 secondary equity offering, and a portion of the short-term note was refinanced through the February 2005 issuance of $30,000 of unsecured notes. In November 2004, we sold 2,606,667 shares of common stock in a public 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%.

Pursuant to our growth strategy, in July 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 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 water and wastewater systems, net. The acquisition was initially funded by a portion of the proceeds from the July 2003 issuance of $135,000 of unsecured notes due 2023, with an interest rate of 4.87%, and the issuance of a $90,000 unsecured note by Aqua America. In August 2003, the $90,000 unsecured note was repaid with the proceeds from the issuance of 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 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 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, which was in excess of the book value for these assets. The proceeds were used to pay-down short-term debt and the sale resulted in the recognition in the fourth quarter of 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 an operating contract that began upon the closing of the sale for a period through December 2006. 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.

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

- In July 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 October 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 December 2002, as a result of the settlement of a condemnation action, our Ohio operating subsidiary sold to Ashtabula County, Ohio the water utility assets in the unincorporated areas of Ashtabula County and the area within the Village of Geneva on the Lake for net proceeds of $12,118, which was in excess of the book value for these assets. The proceeds were used to pay down short-term debt, and the sale resulted in the recognition in 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 customer base. While we continue to discuss this matter with officials from the City of Fort Wayne, we continue to protect our interests in this proceeding. We believe that 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 $659,214 of long-term debt and obtained other short-term borrowings during the past five years. During the past five years, the Trustees held an aggregate $64,664 of the proceeds from certain long-term debt issuances pending completion of the projects financed with the issues. At December 31, 2005, we had short-term lines of credit and other credit facilities of $217,000, of which $78,495 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. No issuances have been completed to date under this shelf registration. During the last three years, we completed the following offerings of equity:

- 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 August 2003, we sold 6,666,667 shares of common stock in a public offering for proceeds of $90,100, net of expenses. The net proceeds were used to repay an unsecured note of $90,000. The indebtedness was incurred by Aqua America in connection with the acquisition of the operations that were purchased from AquaSource, Inc.
- In May 2003, we sold 2,491,667 shares of common stock in a public offering for proceeds of $33,100, net of expenses. The net proceeds were used to repay short-term debt, including the repayment of $22,000 of indebtedness incurred in connection with our repurchase of 2,017,700 shares of our common stock from affiliates of Veolia Environnement, S.A., formerly Vivendi Environnement, S.A., in October 2002.

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 2005, we issued 24,684 shares of common stock totaling $675 to acquire a water system. During 2004 and 2003, we did not issue any shares under the acquisition shelf registration. 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, 2005 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 2005 dividend payment, holders of 16.7% 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 2,484,207 original issue shares of common stock for net proceeds of $35,711 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.

Other Capital Transactions

In May 2002, Veolia Environnement, S.A., formerly Vivendi Environnement, S.A., which through its affiliates (collectively "VE") owned approximately 16.8% of our outstanding common stock, advised us of its decision to sell its investment in Aqua America. VE announced that its decision was part of its overall strategy to divest non-core assets and focus on other business strategies. In September 2002, in order to facilitate the orderly re-distribution of the shares held by VE into the market, we completed a secondary offering of 16,475,427 shares of Aqua America common stock held by VE. The number of outstanding shares of common stock was not changed and we did not receive any proceeds as a result of this secondary offering. In addition, in October 2002 we repurchased 2,017,700 shares of Aqua America common stock representing the remainder of the shares of Aqua America common stock held by VE. The repurchase of shares was funded with proceeds of $22,000 from a short-term credit facility. In May 2003, this $22,000 short-term credit facility was repaid with funds from the issuance of 2,491,667 shares of common stock through a shelf registration, providing proceeds of approximately $33,100, net of expenses. The balance of the net proceeds were used to repay other short-term debt.

The Board of Directors has authorized us to purchase our common stock, from time to time, in the open market or through privately negotiated transactions. We have not purchased any shares under this authorization since 2000. As of December 31, 2005, 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.

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, 2005:

	Payments Due By Period						
	2006	2007	2008	2009	2010	Thereafter	Total
Long-term debt (a)	$ 24,645	$ 30,959	$ 23,651	$ 6,672	$ 53,884	$ 763,272	$ 903,083
Interest on fixed-rate, long-term debt (b)	51,661	49,419	47,558	46,922	44,287	568,828	808,675
Operating leases (c)	3,482	3,033	2,559	1,218	969	15,264	26,525
Unconditional purchase obligations (d)	12,184	11,763	11,358	11,009	11,778	75,559	133,651
Other purchase obligations (e)	13,552	-	-	-	-	-	13,552
Postretirement benefit plans' obligations (f)	9,282	-	-	-	-	-	9,282
Other obligations (g)	3,465	400	400	257	-	-	4,522
Total	$ 118,271	$ 95,574	$ 85,526	$ 66,078	$ 110,918	$ 1,422,923	$ 1,899,290

(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.
(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 2007 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 2020 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.

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, 2005, the debt maturities by period and the weighted average interest rate for fixed-rate, long-term debt are as follows:

	2006	2007	2008	2009	2010	Thereafter	Total	Fair Value
Long-term debt (fixed rate)	$ 24,645	$ 30,959	$ 23,651	$ 6,672	$ 53,884	$ 763,272	$ 903,083	$ 950,479
Weighted average interest rate	5.74%	5.64%	5.63%	5.72%	5.44%	5.35%	5.74%	

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, 2005, we owned no marketable equity securities as we sold the balance of our securities during 2004.

Capitalization

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

December 31,	2005	2004	2003	2002	2001
Long-term debt*	52.7%	52.8%	52.8%	55.6%	52.9%
Preferred stock	0.0%	0.0%	0.0%	0.0%	0.1%
Common stockholders' equity	47.3%	47.2%	47.2%	44.4%	47.0%
	100.0%	100.0%	100.0%	100.0%	100.0%

*Includes current portion.

The changes in the capitalization ratios primarily resulted from the issuance of common stock over the past five years, and the issuance of debt to finance our acquisitions and capital program and the previously mentioned repurchase of common stock from Veolia Environnement in 2002. 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 61 years. Effective December 1, 2005, our Board of Directors authorized an increase of 9.6% 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 December 2005, the annual dividend rate increased to $0.4276 per share. We presently intend to pay quarterly cash dividends in the future, on March 1, June 1, September 1 and December 1, subject to our earnings and financial condition, regulatory requirements and such other factors as our Board of Directors may deem relevant. During the past five years, our common dividends paid have averaged 56.3% 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 review for impairment of our long-lived assets which consist primarily of Utility Plant in Service and regulatory assets, our accounting for pensions and other 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.

Impairment of Long-Lived 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.

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. During 2005, we undertook a comprehensive study of the key demographic assumptions which impact the obligations and expense for these plans. Based on the study, we updated the assumed retirement and turnover rates for the plans to better reflect the recent experience combined with our expectations of future patterns. In addition, we have updated the mortality assumptions to reflect a more recent actuarial study of mortality experience and an expectation of future mortality improvements. The net effect of the changes in these assumptions was a decrease of $1,600 in our pension and postretirement benefit obligation measured as of December 31, 2005.

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 2005 pension expense by $660 and the pension liabilities by $7,000. The present values of Aqua America's future pension and other postretirement obligations were determined using discount rates of 5.65% at December 31, 2005 and 5.75% at December 31, 2004. Our expense under these

plans is determined using the discount rate as of the beginning of the year, which was 5.75% for 2005, and will be 5.65% for 2006.

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 2005 pension expense by $280. For 2005, we used an 8.5% expected return on assets assumption, and will lower this assumption to 8.0% for the calculation of pension expense for 2006. This change was made to reflect a change in our expectations of long-term market returns given the recent decrease in bond yields. The expected return on assets is based on a targeted allocation of 65% equities and 35% fixed income. We believe that our actual long-term asset allocation on average will approximate the targeted allocation. Our targeted allocation is driven by the investment strategy to earn a reasonable rate of return while maintaining risk at acceptable levels through the diversification of investments across and with various asset categories.

As of December 31, 2005, we have an additional minimum liability of $10,909 associated with our defined benefit pension plans. The additional minimum liability is a result of the accumulated benefit obligation exceeding the fair value of plan assets. The portion of the additional minimum liability related to our employees in one of our rate jurisdictions results in the establishment of a regulatory asset of $6,167, as we expect recovery of the future, increased pension expense through customer rates. Since the balance of the additional minimum liability of $4,742 may not be recovered through rates, the accounting requirements for recording a regulatory asset are not met and as a result this amount is recorded as accumulated other comprehensive loss through aggregate charges to accumulated other comprehensive income in 2004 and 2005, net of income tax benefits of $1,660. The change in the additional minimum liability from December 31, 2004 of $6,820 to December 31, 2005 of $10,909 resulted from the effect of a decreased discount rate, offset partially by an increase in the pension plan assets during 2005 due to positive equity market performance and pension contributions. Although additional minimum liability does not directly impact net income or cash flow, in future years, our pension expense and cash funding requirements are anticipated to increase as a result of the decline in the plans' funded status. 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 2006 our required pension contribution is expected to be approximately $6,400. We do not expect our estimate for the 2006 funding amount to change as a result of the pending pension funding reform. Pension funding reform will impact future contributions, though we expect future changes in the amount of contributions and expense recognized will 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.

IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS

On October 22, 2004, the American Jobs Creation Act ("AJCA") was signed into law. Among other provisions, the AJCA creates a new deduction for qualified domestic production activities. Certain of our activities, such as our water treatment activity, are considered as qualifying production activities for purposes of determining the deduction for qualified production activities. In December 2004, the Financial Accounting Standards Board ("FASB") issued FSP 109-1, "Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004." In accordance with FSP 109-1, we treat the deduction for qualified domestic production activities as a reduction of the income tax provision in the period realized. We adopted this statement in the first quarter of 2005 and have recorded an estimate for the effect of the statement which reduced the provision for Federal and state income taxes by approximately $740 for the year ended December 31, 2005.

In November 2004, the FASB approved Statement of Financial Accounting Standards ("SFAS") No. 151, "Inventory Costs – An Amendment of ARB No. 43, Chapter 4." SFAS No. 151 requires the exclusion of certain costs from inventories and the allocation of fixed production overheads to inventories to be based on the normal capacity of the production facilities. The

standard is effective for Aqua America for costs incurred after December 31, 2005. We believe this statement will not have a material impact on our results of operations or financial position.

In November 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets – An Amendment of APB Opinion No. 29." SFAS No. 153 eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for fiscal periods beginning after June 15, 2005. We adopted this standard and it did not have a material impact on our results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment," which revises SFAS No. 123, "Accounting for Stock-based Compensation," and supersedes APB No. 25, "Accounting for Stock Issued to Employees." As noted in the footnotes to our consolidated financial statements, we currently provide pro forma disclosure of our compensation costs associated with the fair value of stock options that have been granted. We currently account for stock-based compensation associated with stock options using the intrinsic method, and accordingly, no compensation costs have been recognized in our consolidated financial statements. SFAS 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. We adopted this standard as required on January 1, 2006. We adopted this standard using the modified prospective method in which stock option awards that are granted, modified or cancelled after the date of adoption are measured and accounted for in accordance with SFAS No. 123R. Awards that are granted prior to the effective date will continue to be accounted for in accordance with SFAS No. 123 except that the stock option expense for unvested options will be recognized in the income statement. We intend to use the Black-Scholes option-pricing model as permitted under SFAS No. 123R. The impact of adoption of SFAS No. 123R on our earnings depends on a number of variables including the level of share-based payments granted in the future, the fair value of the options granted and the associated income tax benefits that we receive. Assuming we grant a comparable number of stock options in 2006 as compared to 2005 and the fair value approximates the value of recent stock option grants reported in the notes to our consolidated financial statements, the after-tax impact of SFAS No. 123R is expected to approximate $3,000 during the year ending December 31, 2006. We believe the adoption of this standard will have no impact on our overall financial position or cash flow, but will result in the reclassification of related tax benefits from operating cash flow to financing cash flow to the extent these tax benefits exceed the associated compensation cost recognized in the income statement.

In March 2005, the FASB issued FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations," which clarifies that an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value can be reasonably estimated. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. We adopted this standard as required on December 15, 2005 and it did not have a material effect on our results of operations or financial position.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3." SFAS No. 154 requires retrospective application to prior periods' financial statements for changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle should be recognized in the period of the accounting change. SFAS No. 154 further requires that a change in depreciation, amortization or depletion method for long-lived, nonfinancial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. Aqua America intends to adopt this standard as required in 2006.

AQUA AMERICA, INC. AND SUBSIDIARIES

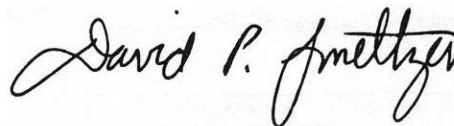
Management's Report On Internal Control Over Financial Reporting

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, 2005, 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.



Nicholas DeBenedictis
Chairman, President and Chief Executive Officer

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

March 13, 2006

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 2005 and 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005 and an audit of its 2003 consolidated financial statements 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

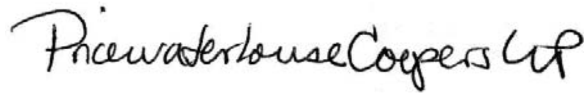
In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and comprehensive income, of capitalization, of common stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Aqua America, Inc. and its subsidiaries at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 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.

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, 2005 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, 2005, 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.



PricewaterhouseCoopers LLP
Philadelphia, PA
March 13, 2006

AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(In thousands, except per share amounts)
Years ended December 31, 2005, 2004 and 2003

	2005	2004	2003
Operating revenues	$ 496,779	$ 442,039	$ 367,233
Costs and expenses:			
Operations and maintenance	203,088	178,345	140,602
Depreciation	60,747	54,564	48,522
Amortization	4,741	4,300	2,941
Taxes other than income taxes	31,696	27,596	21,607
	300,272	264,805	213,672
Operating income	196,507	177,234	153,561
Other expense (income):			
Interest expense, net	52,062	48,679	44,662
Allowance for funds used during construction	(2,447)	(2,304)	(2,127)
Gain on sale of other assets	(1,177)	(1,272)	(5,692)
Income before income taxes	148,069	132,131	116,718
Provision for income taxes	56,913	52,124	45,923
Net income	91,156	80,007	70,795
Dividends on preferred stock	-	-	10
Net income available to common stock	$ 91,156	$ 80,007	$ 70,785
Net income	$ 91,156	$ 80,007	$ 70,795
Other comprehensive income (loss), net of tax:			
Minimum pension liability adjustment	(1,340)	(1,742)	-
Unrealized gains on securities	-	59	455
Reclassification adjustment for gains reported in net income	-	(230)	(347)
	(1,340)	(1,913)	108
Comprehensive income	$ 89,816	$ 78,094	$ 70,903
Net income per common share:			
Basic	$ 0.72	$ 0.64	$ 0.60
Diluted	$ 0.71	$ 0.64	$ 0.59
Average common shares outstanding during the period:			
Basic	127,364	124,329	117,700
Diluted	129,206	125,710	118,993

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, 2005 and 2004

	2005	2004
Assets		
Property, plant and equipment, at cost	$ 2,900,585	$ 2,626,151
Less: accumulated depreciation	620,635	556,339
Net property, plant and equipment	2,279,950	2,069,812
Current assets:		
Cash and cash equivalents	11,872	14,192
Accounts receivable and unbilled revenues, net	62,690	64,538
Inventory, materials and supplies	7,798	6,903
Prepayments and other current assets	7,596	5,570
Total current assets	89,956	91,203
Regulatory assets	130,953	122,935
Deferred charges and other assets, net	37,061	34,106
Funds restricted for construction activity	68,625	17,196
Goodwill	20,180	20,122
	$ 2,626,725	$ 2,355,374
Liabilities and Stockholders' Equity		
Common stockholders' equity:		
Common stock at $.50 par value, authorized 300,000,000 shares, issued 129,658,806 and 127,866,524 in 2005 and 2004	$ 64,829	$ 48,036
Capital in excess of par value	478,508	468,524
Retained earnings	285,132	245,115
Treasury stock, at cost, 688,625 and 686,747 shares in 2005 and 2004	(12,914)	(12,702)
Accumulated other comprehensive income	(3,082)	(1,742)
Unearned compensation	(550)	-
Total common stockholders' equity	811,923	747,231
Minority interest	1,551	1,237
Long-term debt, excluding current portion	878,438	784,461
Commitments	-	-
Current liabilities:		
Current portion of long-term debt	24,645	50,195
Loans payable	138,505	74,810
Accounts payable	55,455	34,915
Accrued interest	13,052	12,029
Accrued taxes	1,111	8,975
Other accrued liabilities	30,571	33,506
Total current liabilities	263,339	214,430
Deferred credits and other liabilities:		
Deferred income taxes and investment tax credits	250,346	223,887
Customers' advances for construction	74,828	73,095
Regulatory liabilities	11,751	11,942
Other	31,969	21,283
Total deferred credits and other liabilities	368,894	330,207
Contributions in aid of construction	302,580	277,808
	$ 2,626,725	$ 2,355,374

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, 2005 and 2004

	2005	2004
Common stockholders' equity:		
Common stock, $.50 par value	$ 64,829	$ 48,036
Capital in excess of par value	478,508	468,524
Retained earnings	285,132	245,115
Treasury stock, at cost	(12,914)	(12,702)
Accumulated other comprehensive income	(3,082)	(1,742)
Unearned compensation	(550)	-
Total common stockholders' equity	811,923	747,231
Long-term debt:		
Long-term debt of subsidiaries (substantially secured by utility plant):		
Interest Rate Range		
0.00% to 2.49%	21,574	20,051
2.50% to 2.99%	28,684	29,924
3.00% to 3.49%	17,380	17,546
3.50% to 3.99%	6,748	7,123
4.00% to 4.99%	30,695	9,435
5.00% to 5.49%	262,588	165,615
5.50% to 5.99%	79,000	89,260
6.00% to 6.49%	88,504	110,360
6.50% to 6.99%	32,000	42,000
7.00% to 7.49%	15,878	45,105
7.50% to 7.99%	25,012	25,231
8.00% to 8.49%	26,507	26,714
8.50% to 8.99%	9,000	9,000
9.00% to 9.49%	46,764	53,244
9.50% to 9.99%	40,933	42,088
10.00% to 10.50%	6,000	6,000
	737,267	698,696
Unsecured notes payable, 4.87%, maturing in various installments 2010 - 2023	135,000	135,000
Unsecured notes payable, 5.01%, due 2015	18,000	-
Unsecured notes payable, 5.20%, due 2020	12,000	-
Notes payable, 6.05%, maturing in 2006 through 2008	816	960
	903,083	834,656
Current portion of long-term debt	24,645	50,195
Long-term debt, excluding current portion	878,438	784,461
Total capitalization	$ 1,690,361	$ 1,531,692

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 Loss	Unearned Compensation on Restricted Stock	Total
Balance at December 31, 2002	$ 35,034	$ 317,871	$ 180,047	$ (40,421)	$ 63	$ -	$ 492,594
Net income	-	-	70,785	-	-	-	70,785
Other comprehensive income: unrealized gains on securities, net of income tax of $244	-	-	-	-	455	-	455
Reclassification adjustment for gains reported in net income, net of income tax of $186	-	-	-	-	(347)	-	(347)
Dividends	-	-	(39,917)	-	-	-	(39,917)
Stock split	9,244	(9,244)	-	-	-	-	-
Sale of stock (9,745,160 shares)	2,168	99,031	-	29,163	-	-	130,362
Repurchase of stock (60,646 shares)	-	-	-	(1,353)	-	-	(1,353)
Equity Compensation Plan (26,875 shares)	8	344	-	-	-	-	352
Exercise of stock options (579,777 shares)	181	4,283	-	-	-	-	4,464
Employee stock plan tax benefits	-	723	-	-	-	-	723
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

See accompanying notes to consolidated financial statements.

AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED CASH FLOW STATEMENTS
(In thousands of dollars)
Years ended December 31, 2005, 2004 and 2003

	2005	2004	2003
Cash flows from operating activities:			
Net income	$ 91,156	$ 80,007	$ 70,795
Adjustments to reconcile net income to net cash flows from operating activities:			
Depreciation and amortization	65,488	58,864	51,463
Deferred income taxes	26,027	40,577	26,741
Gain on sale of water system	-	(2,342)	-
Gain on sale of other assets	(1,177)	(1,272)	(5,692)
Net decrease (increase) in receivables, inventory and prepayments	7,572	(2,766)	(314)
Net increase in payables, accrued interest, accrued taxes and other accrued liabilities	12,933	863	7,777
Other	(2,325)	(328)	(7,397)
Net cash flows from operating activities	199,674	173,603	143,373
Cash flows from investing activities:			
Property, plant and equipment additions, including allowance for funds used during construction of $2,447, $2,304 and $2,127	(237,462)	(195,736)	(163,320)
Acquisitions of water and wastewater systems, net	(11,633)	(54,300)	(192,331)
Release of funds previously restricted for construction activity	56,137	14,015	16,339
Additions to funds restricted for construction activity	(107,566)	(2,772)	(1,025)
Net proceeds from the sale of water systems	-	4,716	4,000
Net proceeds from the sale of other assets	1,300	2,098	6,496
Other	102	(517)	(312)
Net cash flows used in investing activities	(299,122)	(232,496)	(330,153)
Cash flows from financing activities:			
Customers' advances and contributions in aid of construction	14,728	14,269	8,181
Repayments of customers' advances	(4,792)	(4,930)	(4,257)
Net proceeds (repayments) of short-term debt	63,695	(30,150)	(18,654)
Proceeds from long-term debt	147,012	130,258	154,537
Repayments of long-term debt	(83,235)	(55,928)	(44,204)
Change in cash overdraft position	(8,808)	(2,190)	5,200
Redemption of preferred stock	-	-	(172)
Proceeds from issuing common stock	21,416	56,193	134,826
Repurchase of common stock	(1,749)	(1,082)	(1,353)
Dividends paid on preferred stock	-	-	(10)
Dividends paid on common stock	(51,139)	(45,807)	(39,917)
Other	-	179	-
Net cash flows from financing activities	97,128	60,812	194,177
Net increase (decrease) in cash and cash equivalents	(2,320)	1,919	7,397
Cash and cash equivalents at beginning of year	14,192	12,273	4,876
Cash and cash equivalents at end of year	$ 11,872	$ 14,192	$ 12,273
Cash paid during the year for:			
Interest, net of amounts capitalized	$ 48,278	$ 45,261	$ 40,572
Income taxes	$ 30,734	$ 22,322	$ 19,168

See Summary of Significant Accounting Policies-Customers' Advances for Construction, Acquisitions and Employee Stock and 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, Florida, Indiana, Virginia, Maine, Missouri, New York and South Carolina. Our largest operating subsidiary, Aqua Pennsylvania, Inc., accounts for approximately 56% of our operating revenues for 2005 and provides water or wastewater services to customers in the suburban areas north and west of the City of Philadelphia and in 22 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 close to our operating companies' service territories. The company has identified thirteen operating segments that are based on the thirteen states where we provide water or wastewater 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.

Regulation—Most of the operating companies that are regulated public utilities are subject to regulation by the public utility commissions of the states in which they operate. The respective public utility commissions have jurisdiction with respect to rates, service, accounting procedures, issuance of securities, acquisitions and other matters. Some of the operating companies that are regulated public utilities are subject to rate regulation by county or city government. Regulated public utilities follow Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation." SFAS No. 71 provides for the recognition of regulatory assets and liabilities as allowed by regulators for costs or credits that are reflected in current rates or are considered probable of being included in future rates. The regulatory assets or liabilities are then relieved as the cost or credit is reflected in rates.

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

Recognition of Revenues—Revenues include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the latest billing to the end of the accounting period. Nonregulated revenues are recognized when services are performed and are primarily associated with operating and maintenance contracts and data processing service fees. Nonregulated revenues totaled $16,484 in 2005, $13,623 in 2004 and $11,806 in 2003.

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, 2005, utility plant includes a net credit acquisition adjustment of $64,165, which is generally being amortized from 0 to 20 years. Amortization of the acquisition adjustments totaled $3,674 in 2005, $3,961 in 2004 and $1,649 in 2003.

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, 2005, $15,788 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, 2005, $3,952 of costs have been incurred and 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 2005 was $1. There was no AFUDC related to equity funds in 2004 and 2003. No interest was capitalized by our nonregulated businesses.

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

The Company had a book overdraft for certain of its disbursement cash accounts of $2,573 and $11,381 at December 31, 2005 and 2004, 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.

Deferred Charges and Other Assets—Deferred charges and other assets consist of financing expenses, other costs and marketable securities. Deferred bond issuance expenses are amortized by the straight-line method over the life of the related issues. Call premiums related to the early redemption of long-term debt, along with the unamortized balance of the related issuance expense, are deferred and amortized over the life of the long-term debt used to fund the redemption. Other costs, for which the Company has received or expects to receive prospective rate recovery, are deferred and amortized over the period of rate recovery in accordance with SFAS No. 71.

Marketable securities are considered "available-for-sale" and accordingly, are carried on the balance sheet at fair market value. Unrecognized gains are included in other comprehensive income.

Goodwill—Goodwill represents the excess cost over the fair value of net tangible and identifiable intangible assets acquired, and a substantial portion of the goodwill balance is associated with the acquisition of Heater Utilities, Inc. in June 2004. Goodwill is not amortized but is tested for impairment annually, or more often, if certain 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, 2005, 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.

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 $15,729, $9,273 and $9,991 in 2005, 2004 and 2003, 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—The Company currently accounts for stock-based compensation using the intrinsic value method in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees". Accordingly, no compensation expense related to granting of stock options has been recognized in the financial statements for stock options that have been granted. Please refer to the Recent Accounting Pronouncements section of this footnote for information concerning changes to the Company's accounting for stock-based compensation, including the expected after-tax impact of adopting SFAS No. 123R, "Share-Based Payment." Pursuant to the current disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, pro forma net income available to common stock and earnings per share are presented in the following table as if compensation cost for stock options was determined as of the grant date under the fair value method:

	Years Ended December 31,		
	2005	2004	2003
Net income available to common stock, as reported	$ 91,156	$ 80,007	$ 70,785
Add: stock-based employee compensation expense included in reported net income, net of tax	290	266	224
Less: pro forma expense related to stock options granted, net of tax effects	(2,054)	(1,990)	(1,793)
Pro forma	$ 89,392	$ 78,283	$ 69,216
Basic net income per share:			
As reported	$ 0.72	$ 0.64	$ 0.60
Pro forma	0.70	0.63	0.59
Diluted net income per share:			
As reported	$ 0.71	$ 0.64	$ 0.59
Pro forma	0.69	0.62	0.58

The per share weighted-average fair value at the date of grant for stock options granted during 2005, 2004 and 2003 was $4.23, $4.07 and $3.50 per option, respectively. The fair value of options at the date of grant was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2005	2004	2003
Expected life (years)	6.0	4.5	5.6
Interest rate	4.1%	4.0%	3.7%
Volatility	23.4%	29.9%	32.4%
Dividend yield	2.4%	2.2%	2.6%

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

Reclassifications and Revisions—Certain prior year amounts have been changed to conform with current year's presentation. The changes include the presentation of regulatory assets and cash overdrafts. Regulatory assets were previously reported on a net basis. This presentation was changed to report regulatory assets and liabilities on a gross basis and regulatory liabilities have been reclassified to deferred credits and other liabilities. Cash overdrafts were previously reported as components of cash or loans payable. This presentation was changed to classify cash overdrafts as accounts payable. Accordingly, applicable historic balance sheet and cash flow amounts have been revised to conform to the new presentation and a new line has been added in the cash flow from financing activities section titled "change in cash overdraft position." This revision had no impact on the Company's net income, cash flows from operating activities or cash flows used in investing activities. The revision impacted the Company's net cash flows from financing activities from that which was previously reported, by a $440 decrease for the year ended December 31, 2004, and an increase of $2,555 for the year ended December 31, 2003.

Recent Accounting Pronouncements—On October 22, 2004, the American Jobs Creation Act ("AJCA") was signed into law. Among other provisions, the AJCA creates a new deduction for qualified domestic production activities. Certain activities of the Company, such as our water treatment activity, are considered as qualifying production activities for purposes of determining the deduction for qualified production activities. In December 2004, the Financial Accounting Standards Board ("FASB") issued FSP 109-1, "Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004." In accordance with FSP 109-1, the Company will treat the deduction for qualified domestic production activities as a reduction of the income tax provision in the period realized. The Company adopted this statement in the first quarter of 2005 and has recorded an estimate for the effect of the statement which reduced the provision for Federal and state income taxes by approximately $740 for the year ended December 31, 2005.

In November 2004, the FASB approved Statement of Financial Accounting Standards ("SFAS") No. 151, "Inventory Costs – An Amendment of ARB No. 43, Chapter 4." SFAS No. 151 requires the exclusion of certain costs from inventories and the allocation of fixed production overheads to inventories to be based on the normal capacity of the production facilities. The standard is effective for the Company for costs incurred after December 31, 2005. The Company believes this statement will not have a material impact on its results of operations or financial position.

In November 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets – An Amendment of APB Opinion No. 29." SFAS No. 153 eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for fiscal periods beginning after June 15, 2005. The Company adopted this statement and it did not have a material impact on the Company's results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment," which revises SFAS No. 123, "Accounting for Stock-based Compensation," and supersedes APB No. 25, "Accounting for Stock Issued to Employees." As noted in the section captioned "Stock-based Compensation" in the Summary of Significant Accounting Policies footnote, the Company currently provides pro forma disclosure of its compensation costs associated with the fair value of stock options that have been granted. The Company currently accounts for stock-based compensation associated with stock options using the intrinsic method, and accordingly, no compensation costs have been recognized in its consolidated financial statements. SFAS 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. The Company adopted this standard as required on January 1, 2006. The Company adopted this standard using the modified prospective method in which stock option awards that are granted, modified or cancelled after the date of adoption are measured and accounted for in accordance with SFAS No. 123R. Awards that are granted prior to the effective date will continue to be accounted for in accordance with SFAS No. 123 except that the stock option expense for unvested options will be recognized in the income statement. The Company intends to use the Black-Scholes option-pricing model as permitted under SFAS No. 123R. The impact of adoption of SFAS No. 123R on the Company's earnings depends on a number of variables including the level of share-based payments granted in the future, the fair value of the options granted and the associated income tax benefits that the Company receives. Assuming the Company grants a comparable number of stock options in 2006 as compared to 2005 and the fair value approximates the value of recent stock option grants reported in the notes to our consolidated financial statements, the after-tax impact of SFAS No. 123R is expected to approximate $3,000 during the year ending December 31, 2006. The Company believes that the adoption of this standard will have no impact on our overall financial position or cash flow, but will result in the reclassification of related tax benefits from operating cash flow to financing cash flow to the extent these tax benefits exceed the associated compensation cost recognized in the income statement.

In March 2005, the FASB issued FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations," which clarifies that an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value can be reasonably estimated. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. The Company adopted this standard as required on December 15, 2005 and it did not have a material effect on its results of operations or financial position.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3." SFAS No. 154 requires retrospective application to prior periods' financial statements for changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle should be recognized in the period of the accounting change. SFAS No. 154 further requires that a change in depreciation, amortization or depletion method for long-lived, nonfinancial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. The Company intends to adopt this standard as required in 2006.

Acquisitions

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. The acquired operation provides 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. For the fiscal year ended December 31, 2003, Heater had operating revenues of $19,489. The acquisition was accounted for as a purchase and accordingly, the purchase price is allocated to the net tangible and intangible assets based upon their estimated fair values at the date of the acquisition. The Company obtained a third-party valuation of these assets and liabilities, and it resulted in the recording of a purchase accounting fair value adjustment of $3,141 to increase the carrying-value of long-term debt assumed. The purchase price allocation is as follows:

	June 1, 2004
Property, plant and equipment, net	$ 96,779
Current assets	4,133
Other long-term assets	6,005
Goodwill	18,842
Total assets acquired	125,759
Current liabilities	3,063
Loans payable	8,500
Long-term debt	22,360
Other long-term liabilities	43,836
Total liabilities assumed	77,759
Net assets acquired	$ 48,000

The Company has recorded goodwill of $18,842, and a substantial portion of the goodwill is expected to be deductible for tax purposes. The purchase price was arrived at through arms-length negotiations with the seller and is consistent with the multiples paid in other comparable transactions. Aqua America considered important regulatory, strategic and valuation considerations in arriving at the final purchase price. During 2004, through the North Carolina Utilities Commission approval process, a mechanism has been developed 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 intends to pursue 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, if any.

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 $14,747 in cash. 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 will result in a reduction of the final purchase price that could be as much as approximately $2,000, which is not expected to result in the recognition of goodwill.

AquaSource—Pursuant to our strategy to grow through acquisitions, on July 31, 2003, the Company completed its acquisition of four operating water and wastewater subsidiaries of AquaSource, Inc. (a subsidiary of DQE, Inc.), including selected, integrated operating and maintenance contracts and related assets (individually and collectively the acquisition is referred to as "AquaSource") for $190,717 in cash, as adjusted pursuant to the purchase agreement based on working capital at closing. On August 27, 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 water and wastewater systems, net.

The results of AquaSource have been included in the Company's consolidated financial statements beginning August 1, 2003. The acquired operations of AquaSource serve over 130,000 water and wastewater customer accounts in 11 states (including the Connecticut and Kentucky operations which were subsequently sold to other parties). Please refer to the Dispositions footnote for a discussion of the AquaSource operations located in Connecticut and Kentucky. The AquaSource acquisition was initially funded by a portion of the proceeds from the July 2003 issuance of $135,000 of unsecured notes due 2023, with an interest rate of 4.87%, and the issuance of a $90,000 unsecured note by Aqua America. In August 2003, the $90,000 unsecured note was repaid with the proceeds from the issuance of 6,666,667 shares of common stock through a shelf registration.

Under the purchase method of accounting, the purchase price is allocated to AquaSource's net tangible and intangible assets based upon their estimated fair values at the date of the acquisition. The purchase price allocation, which reflects the effects of the August 2004 purchase price arbitration proceeding, is as follows:

	July 31, 2003
Property, plant and equipment, net	$ 197,719
Current assets	9,687
Other long-term assets	14,204
Assets held for sale, net	4,096
Total assets acquired	225,706
Current liabilities	8,214
Long-term debt	7,170
Other long-term liabilities	31,894
Total liabilities assumed	47,278
Net assets acquired	$ 178,428

The following supplemental pro forma information is presented to illustrate the effects of the AquaSource acquisition, which was completed on July 31, 2003, on the historical operating results for the year ended December 31, 2003 as if the acquisition had occurred at the beginning of the period (unaudited):

Operating revenues	$ 407,628
Net income	$ 74,436
Net income per common share:	
Basic	$ 0.61
Diluted	$ 0.60

The supplemental information is not necessarily representative of the actual results that may have occurred for this period or of the results that may occur in the future. This information does not reflect the effects of recent rate increases or cost savings that may result from the acquisition, such as the effects of a reduction in administrative costs. This information is based upon the historical operating results of AquaSource for periods prior to the acquisition date of July 31, 2003 as provided to the Company by AquaSource, Inc. and DQE, Inc. management.

***Other Acquisitions*—** 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 $2,145.

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 $1,281 in 2005 and $617 in 2004.

During 2003, in addition to the AquaSource acquisition, the Company completed 17 acquisitions or other growth ventures in the various states in which the Company operates for an aggregate purchase price of $1,614 in cash. Operating revenues included in the consolidated financial statements of the Company related to these systems were $976 in 2005, $860 in 2004 and $312 in 2003.

Dispositions

In December 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 the fourth quarter of 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 an operating contract that began upon the closing of the sale for a period through December 2006. The operating contract provides for an annual base operating fee of $135 and allows for additional fees to be earned commensurate with the services provided. These water utility assets represent less than 1% of Aqua America's total assets, and the total number of customers included in the water system sold represents less than 1% of our total customer base.

In July 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. In October 2003, the Company sold its only operation in Connecticut. The sale price of $4,000 approximates our investment in this operation. The operation represented approximately 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 customer base. While the Company continues to discuss this matter with officials from the City of Fort Wayne, the Company continues to protect its interests in this proceeding. 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.

Property, Plant and Equipment

	December 31, 2005	December 31, 2004	Approximate range of remaining lives
Utility plant and equipment:			
Mains and accessories	$ 1,187,597	$ 1,087,712	10 to 85 years
Services, hydrants, treatment plants and reservoirs	660,279	607,331	5 to 85 years
Operations structures and water tanks	222,107	218,888	15 to 77 years
Miscellaneous pumping and purification equipment	376,599	342,985	10 to 50 years
Meters, data processing, transportation and operating equipment	341,550	298,015	5 to 50 years
Land and other non-depreciable assets	73,346	67,260	-
Utility Plant and equipment	2,861,478	2,622,191	
Utility construction work in progress	98,898	63,754	-
Net utility plant acquisition adjustment	(64,165)	(63,347)	0 to 20 years
Non-utility plant and equipment	4,374	3,553	2 to 40 years
Total property, plant and equipment	$ 2,900,585	$ 2,626,151	

Accounts Receivable

	December 31, 2005	December 31, 2004
Billed utility revenue	$ 42,541	$ 39,783
Unbilled utility revenue	21,419	27,927
Other	3,136	1,677
	67,096	69,387
Less allowance for doubtful accounts	4,406	4,849
Net accounts receivable	$ 62,690	$ 64,538

The Company's customers are located principally in the following states: 48% in Pennsylvania, 10% in Ohio, 9% in North Carolina, 8% in Illinois, 6% in Texas, 6% in New Jersey, 4% in Florida, and 4% in Indiana. No single customer accounted for more than one percent of the Company's operating revenues during the years ended December 31, 2005, 2004 or 2003. The following table summarizes the changes in the Company's allowance for doubtful accounts:

	2005	2004	2003
Balance at January 1,	$ 4,849	$ 5,851	$ 3,580
Amounts charged to expense	3,116	3,695	2,643
Accounts written off	(4,113)	(5,460)	(2,715)
Recoveries of accounts written off	554	701	253
Allowance acquired through acquisitions	-	62	2,090
Balance at December 31,	$ 4,406	$ 4,849	$ 5,851

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:

	December 31, 2005		December 31, 2004	
	Regulatory Assets	Regulatory Liabilities	Regulatory Assets	Regulatory Liabilities
Income taxes	$ 69,531	$ 2,203	$ 68,990	$ 3,283
Utility plant retirement costs	17,421	8,368	14,729	8,184
Postretirement benefits	10,871	-	11,403	-
Texas rate filing expense deferral	9,486	-	3,365	-
CTC payment	5,733	-	6,879	-
Water tank painting	4,292	267	4,593	130
Fair value of long-term debt assumed in acquisition	2,804	-	3,015	-
Merger costs	1,641	-	2,170	-
Rate case filing expenses & other	9,174	913	7,791	345
	$ 130,953	$ 11,751	$ 122,935	$ 11,942

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, and in addition includes an additional minimum liability for pensions as a result of a decline in the discount rate assumed for pension obligations and a change in the fair market value of plan assets. The additional minimum liability equals the excess of the accumulated benefit obligation over the fair value of plan assets. The regulatory asset related to postretirement benefits other than pensions represents costs that were deferred between the time that the accrual method of accounting for these benefits was adopted in 1993 and the recognition of the accrual method in the Company's rates as prescribed in subsequent rate filings. Amortization of the amount deferred for postretirement benefits other than pensions began in 1994 and is currently being recovered in rates.

The regulatory asset 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.

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.

As a requirement of purchase accounting, the Company recorded a fair value adjustment for fixed-rate, long-term debt assumed in the Heater Utilities, Inc. acquisition in 2004. 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 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.

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,		
	2005	2004	2003
Current:			
Federal	$ 24,417	$ 2,042	$ 11,933
State	6,586	7,553	7,249
	31,003	9,595	19,182
Deferred:			
Federal	22,294	41,414	25,521
State	3,616	1,115	1,220
	25,910	42,529	26,741
Total tax expense	$ 56,913	$ 52,124	$ 45,923

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 2001 have been closed, and 2002 was closed as a result of the conclusion of a tax audit.

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,		
	2005	2004	2003
Computed Federal tax expense at statutory rate	$ 51,824	$ 46,245	$ 40,852
Increase in tax expense for depreciation expense to be recovered in future rates	806	1,376	1,125
Domestic Production Credit	(656)	-	-
Deduction for Aqua America common dividends paid under employee benefit plan	(321)	(245)	(241)
Amortization of deferred investment tax credits	(359)	(285)	(285)
Prior year rate reductions	(437)	(538)	(431)
State income taxes, net of federal tax benefit	6,631	5,634	5,505
Other, net	(575)	(63)	(602)
Actual income tax expense	$ 56,913	$ 52,124	$ 45,923

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, 2005	December 31, 2004
Deferred tax assets:		
Customers' advances for construction	$ 17,549	$ 17,057
Costs expensed for book not deducted for tax, principally accrued expenses	1,803	1,989
Utility plant acquisition adjustment basis differences	29,429	30,920
Minimum pension liability adjustment	1,660	938
Total gross deferred tax assets	50,441	50,904
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	267,835	243,953
Deferred taxes associated with the gross-up of revenues necessary to recover, in rates, the effect of temporary differences	25,796	23,670
Deferred investment tax credit	6,066	6,328
Unrealized gain on marketable securities	-	-
Other	1,090	840
Total gross deferred tax liabilities	300,787	274,791
Net deferred tax liability	$ 250,346	$ 223,887

On October 22, 2004, the American Jobs Creation Act ("AJCA") was signed into law. Among other provisions, the AJCA creates a new deduction for qualified domestic production activities. Certain activities of the Company, such as our water treatment activity, are considered as qualifying production activities for purposes of determining the deduction for qualified production activities. In December 2004, the FASB issued FSP 109-1, "Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004." In accordance with FSP 109-1, the Company will treat the deduction for qualified domestic production activities as a reduction of the income tax provision in the period realized. The Company adopted this statement in 2005 and has recorded an estimate for the effect of the statement which reduced the provision for Federal and state income taxes by approximately $740 for the year ended December 31, 2005.

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 2010 are expected to approximate $11,618 and $75,559 thereafter. The Company purchased approximately $10,603, $8,724 and $8,014 of water under these agreements during the years ended December 31, 2005, 2004 and 2003, respectively.

The Company leases motor vehicles, buildings and other equipment under operating leases that are noncancelable. The future annual minimum lease payments due are: $2,934 in 2006, $2,488 in 2007, $2,012 in 2008, $670 in 2009, $430 in 2010 and $256 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 2012 and 2052 and contain certain renewal provisions. Certain leases are subject to an adjustment every five years based on changes in the Consumer Price

Index. Subject to the aforesaid adjustment, during each of the next five years, approximately $545 of annual lease payments for land are due, and $15,009 thereafter. The Company leases treatment plants to other parties under lease agreements that require payments to the Company of $567 in 2006, $267 in 2007, $308 in 2008, $246 in 2009, $246 in 2010 and $3,430 thereafter.

Rent expense was $3,390, $3,267 and $2,993 for the years ended December 31, 2005, 2004 and 2003, respectively.

Long-term Debt and Loans Payable

The Consolidated Statements of Capitalization provide a summary of long-term debt as of December 31, 2005 and 2004. 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, 2005, approximately $281,000 of Aqua Pennsylvania's retained earnings and $69,000 of the retained earnings of certain other subsidiaries were free of these restrictions. Certain supplemental indentures also prohibit Aqua Pennsylvania and certain other subsidiaries of the Company from making loans to, or purchasing the stock of, the Company.

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	2006	2007	2008	2009	2010	Thereafter
0.00% to 2.49%	$ 1,320	$ 1,340	$ 1,354	$ 1,378	$ 1,395	$ 14,787
2.50% to 2.99%	6,502	1,489	1,534	1,583	1,657	15,919
3.00% to 3.49%	265	12,270	278	288	298	3,981
3.50% to 3.99%	675	685	695	706	717	3,270
4.00% to 4.99%	50	50	50	55	27,055	138,435
5.00% to 5.49%	-	-	-	-		292,588
5.50% to 5.99%	-	-	-	-	-	79,000
6.00% to 6.49%	144	644	10,172	-	-	78,360
6.50% to 6.99%	10,000	10,000	-	-	-	12,000
7.00% to 7.49%	2,499	2,540	2,585	634	687	6,933
7.50% to 7.99%	194	210	227	245	264	23,872
8.00% to 8.49%	139	152	167	184	202	25,663
8.50% to 8.99%	-	-	-	-	-	9,000
9.00% to 9.49%	663	584	594	604	20,615	23,704
9.50% to 9.99%	2,194	995	5,995	995	994	29,760
10.00% to 10.50%	-	-	-	-	-	6,000
Total	$ 24,645	$ 30,959	$ 23,651	$ 6,672	$ 53,884	$ 763,272

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, 2005, the Trustees for 12 issues held $68,625 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.

In May 2004, Aqua Pennsylvania issued $87,000 of First Mortgage Bonds secured by a supplement to its first mortgage indenture with a weighted-average interest rate of approximately 5.1% and a weighted-average maturity of 13.7 years. The proceeds from this issuance were used to refinance short-term debt and to fund long-term debt maturities. In May 2004, an unsecured note of $70,000 was issued by the Company. Interest under this note is based, at the borrower's option, on either a defined base rate or an adjusted London Interbank Offered Rate corresponding to the interest period selected. The proceeds of this financing were used to fund acquisitions and to refinance existing debt. In November 2004, $34,000 of the $70,000 unsecured note was repaid with the proceeds from an equity offering. The remaining balance of the note of $36,000 was repaid in May 2005. In connection with the acquisition of Heater Utilities, Inc. in 2004, the Company assumed $22,360 of long-term debt at interest rates ranging from 7.05% to 8.24% due 2012 to 2025, which includes the purchase accounting fair value adjustment of $3,141, increasing the carrying-value of long-term debt. In November 2004, Aqua Pennsylvania issued $14,000 tax-exempt bonds due 2039 at a rate of 5.05% and secured by a supplement to its first mortgage indenture. The proceeds from the bonds issued were used to retire previously issued tax-exempt bonds. At various times during 2004, Aqua Pennsylvania and other operating subsidiaries issued other notes payable and first mortgage bonds aggregating $31,239 at a weighted-average interest rate of 3.76% due at various times ranging from 2006 to 2037. 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 and to redeem $6,000 of first mortgage bonds with a weighted-average interest rate of 9.19%. The weighted average cost of long-term debt at December 31, 2005 and 2004 was 5.74% and 6.00%, respectively.

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, 2005 and 2004, funds borrowed under the Aqua Pennsylvania revolving credit agreements were $65,000 and $29,000, respectively, and $17,000 and $0 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 3.8% and 1.4%, and the average borrowing was $63,355 and $50,115, during 2005 and 2004, respectively. The maximum amount outstanding at the end of any one month was $85,000 in 2005 and $89,519 in 2004.

At December 31, 2005 and 2004, the Company had combined short-term lines of credit of $127,000 and $108,000, respectively. Funds borrowed under these lines are classified as loans payable and are used to provide working capital. As of December 31, 2005 and 2004, funds borrowed under the short-term lines of credit were $56,505 and $9,810, respectively. The average borrowing under the lines was $35,610 and $34,711 during 2005 and 2004, respectively. The maximum amount outstanding at the end of any one month was $56,505 in 2005 and $51,288 in 2004. 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 2005 and 2004 was 3.9% and 2.3%, respectively.

Interest income of $3,040, $1,762 and $395 was netted against interest expense on the consolidated statements of income for the years ended December 31, 2005, 2004 and 2003, respectively. The total interest cost was $55,102, $50,441 and $45,057 in 2005, 2004 and 2003, including amounts capitalized of $2,447, $2,304 and $2,127, 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,	
	2005	2004
Carrying amount	$ 903,083	$ 834,656
Estimated fair value	950,479	863,247

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 $74,828 and $73,095 at December 31, 2005 and 2004, 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 2020 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, 2005, the Company had 300,000,000 shares of common stock authorized; par value $0.50. Shares outstanding at December 31, 2005, 2004 and 2003 were 128,970,181, 127,179,777 and 123,452,053, respectively. Treasury shares held at December 31, 2005, 2004 and 2003 were 688,625, 686,747 and 681,384, respectively. At December 31, 2005, the Company had 1,770,819 shares of authorized but unissued Series Preferred Stock, $1.00 par value.

In August 2005, the Company's Board of Directors declared a 4-for-3 common stock split to be effected in the form of a 33 1/3% stock distribution for all common shares outstanding, to shareholders of record on November 17, 2005. Common shares outstanding do not include shares held by the Company in treasury. The new shares were distributed on December 1, 2005. The Company's par value of $0.50 per share remained unchanged and $16,095 was transferred from Capital in Excess of Par Value to Common Stock to record the split. All common share and per common share data for all periods presented have been restated to give effect to the stock split.

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. No issuances have been completed to date under this shelf registration. During the last three years, the Company completed the following offerings of equity:

- 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 our short-term debt. The indebtedness was incurred by Aqua America in connection with acquisitions.
- In August 2003, the Company issued 6,666,667 shares of common stock in a public offering for proceeds of $90,100, net of expenses. The net proceeds were used to repay an unsecured note of $90,000. The indebtedness was incurred by Aqua America in connection with the acquisition of the operations that were purchased from AquaSource, Inc.
- In May 2003, the Company issued 2,491,667 shares of common stock in a public offering for proceeds of $33,100, net of expenses. The net proceeds were used to repay short-term debt, including the repayment of $22,000 of indebtedness incurred in connection with the Company's repurchase of 2,017,700 shares of common stock from affiliates of Veolia Environnement, S.A. (formerly Vivendi Environnement, S.A.) in October 2002.

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, 2005 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 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, 2005, 548,278 shares remain available for repurchase.

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 2005, 2004 and 2003, under the dividend reinvestment portion of the Plan, 401,503, 512,609 and 527,473 original issue shares of common stock were sold providing the Company with proceeds of $8,516, $7,808 and $7,000, respectively.

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 securities and minimum pension liability adjustments as other comprehensive income or loss and accumulated other comprehensive income or loss.

Net Income per Common Share and Equity per Common Share

Basic net income per share is based on the weighted average number of common shares outstanding. Diluted net income per share is based on the weighted average number of common shares outstanding and potentially dilutive shares. The dilutive effect of employee stock options is included in the computation of Diluted net income per share. The following table summarizes the shares, in thousands, used in computing Basic and Diluted net income per share:

	Years ended December 31,		
	2005	2004	2003
Average common shares outstanding during the period for Basic computation	127,364	124,329	117,700
Dilutive effect of employee stock options	1,842	1,381	1,293
Average common shares outstanding during the period for Diluted computation	129,206	125,710	118,993

For the years ended December 31, 2005 and 2003, 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. For the year ended December 31, 2004, employee stock options outstanding to purchase 759,867 shares of common stock were excluded from the calculation of diluted net income per share as the options' exercise price was greater than the average market price of the Company's common stock.

Equity per common share was $6.30 and $5.88 at December 31, 2005 and 2004, 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

In May 2004, the 2004 Equity Compensation Plan ("the 2004 Plan") was approved by the shareholders to replace the 1994 Equity Compensation Plan ("the 1994 Plan"), the Company may grant qualified and non-qualified stock options to officers, key employees and consultants. Officers and key employees may also be granted dividend equivalents and restricted stock. Restricted stock may also be granted to non-employee members of the Board of Directors ("Board"). 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, and awards under the 1994 plan were, made by a committee of the Board of Directors.

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 following table summarizes stock option transactions for the plans:

	As of or For the Years Ended December 31,					
	2005		2004		2003	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options:						
Outstanding, beginning of year	4,066,983	$ 11.22	3,991,228	$ 9.98	3,773,511	$ 9.04
Granted	816,997	18.33	776,867	16.15	818,205	12.74
Terminated	(63,900)	15.22	(131,048)	12.47	(20,711)	11.09
Exercised	(1,327,717)	8.88	(570,064)	8.96	(579,777)	7.71
Outstanding, end of year	3,492,363	$ 13.70	4,066,983	$ 11.22	3,991,228	$ 9.98
Exercisable, end of year	1,957,079	$ 11.31	2,549,073	$ 9.32	2,341,733	$ 8.26

Options exercised during 2005 ranged in price from $3.42 per share to $16.15 per share. At December 31, 2005, 4,093,297 options under the 2004 Plan were still available for grant, 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 2004 Plan. The following table summarizes the price ranges of the options outstanding and options exercisable as of December 31, 2005:

	Options Outstanding			Options Exercisable	
	Shares	Weighted Average Remaining Life (years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Range of prices:					
$ 4.30 - 7.99	290,026	3.1	$ 6.40	290,026	$ 6.40
$ 8.00 - 9.99	250,963	2.8	8.35	250,963	8.35
$10.00 - 12.99	1,301,947	6.4	12.20	1,109,069	12.15
$13.00 - 15.99	160,270	7.4	13.75	106,102	13.76
$16.00 - 16.99	680,491	8.3	16.15	200,919	16.15
$17.00 - 18.33	808,666	9.2	18.33	-	-
	3,492,363	6.9	$ 13.70	1,957,079	$ 11.31

Under SFAS No. 123 "Accounting for Stock-Based Compensation" and SFAS No. 148 "Accounting for Stock-Based Compensation – Transition and Disclosure", the Company applied the provisions of APB Opinion No. 25 and provided the pro forma disclosure provisions of this statement. Accordingly, no compensation cost was recognized in the financial

statements for stock options that have been granted. Pursuant to the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, pro forma net income available to common stock and earnings per share are presented in the Summary of Significant Accounting Policies - Stock-Based Compensation as if compensation cost for stock options was determined as of the grant date under the fair value method. On January 1, 2006, the Company adopted SFAS No. 123R, "Share-Base Payment" which changes the accounting for the compensation costs for its stock options granted as described in the Summary of Significant Accounting Policies - Recent Accounting Pronouncements.

Restricted stock awards provide the grantee with the rights of a shareholder, including the right to receive dividends and to vote such shares, but not the right to sell or otherwise transfer the shares during the restriction period. During 2005, 2004 and 2003, 37,751, 45,535 and 26,875 shares of restricted stock were granted with a restriction period ranging from six to 36 months. The value of restricted stock awards, which are "compensatory", is equal to the fair market value of the stock on the date of the grant and is amortized ratably over the restriction period. The company recorded compensation expense related to restricted stock awards of $495, $439 and $369 during 2005, 2004 and 2003, respectively.

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.

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:		
2006	$ 6,866	$ 1,829
2007	7,076	1,950
2008	7,415	2,095
2009	7,911	2,261
2010	8,383	2,442
2011 - 2015	52,787	14,802

In May 2004, the FASB issued FASB Staff Position ("FSP") No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." FSP 106-2 supersedes FSP 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," which was issued in January 2004 and permitted a sponsor of a postretirement health care plan that provides a prescription drug benefit to make a one-time election to defer accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") until more authoritative guidance on the accounting for the federal subsidy was issued. The Company had elected the one-time deferral allowed under FSP 106-1 and as a result adopted FSP 106-2

as required in the third quarter of 2004 and it did not have a material impact on our results of operations or financial position.

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	
	2005	2004	2005	2004
Change in benefit obligation:				
Benefit obligation at January 1,	$ 171,076	$ 150,098	$ 32,804	$ 29,134
Service cost	4,847	4,312	1,223	1,112
Interest cost	9,805	9,512	1,882	1,825
Plan amendments	-	567	(7,047)	6
Actuarial loss	420	12,742	1,317	1,676
Plan participants' contributions	-	-	584	631
Benefits paid	(6,407)	(6,155)	(1,602)	(1,580)
Benefit obligation at December 31,	179,741	171,076	29,161	32,804
Change in plan assets:				
Fair value of plan assets at January 1,	115,292	108,731	16,606	14,391
Actual return on plan assets	7,790	8,535	675	641
Employer contributions	996	4,181	2,678	2,522
Benefits paid	(6,407)	(6,155)	(1,017)	(948)
Fair value of plan assets at December 31,	117,671	115,292	18,942	16,606
Funded status of plan:				
Funded status at December 31,	62,070	55,784	10,219	16,198
Unrecognized actuarial loss	(42,092)	(41,531)	(8,537)	(6,853)
Unrecognized prior service cost	(1,687)	(2,090)	7,517	527
Unrecognized net transition obligation	809	1,017	(5,624)	(6,428)
Net amount recognized	$ 19,100	$ 13,180	$ 3,575	$ 3,444

The Company's pension plans had an accumulated benefit obligation of $148,629 and $136,851 at December 31, 2005 and 2004, respectively. The following table provides the net liability recognized on the Consolidated Balance Sheets at December 31,:

	Pension Benefits		Other Postretirement Benefits	
	2005	2004	2005	2004
Prepaid benefits cost	$ -	$ -	$ 555	$ 762
Accrued benefit cost	(19,100)	(13,180)	(4,130)	(4,206)
Additional minimum liability	(12,726)	(8,928)	-	-
Intangible assets	1,817	2,108	-	-
Regulatory asset	6,167	4,140	-	-
Accumulated other comprehensive loss	4,742	2,680	-	-
Net liability recognized	$ (19,100)	$ (13,180)	$ (3,575)	$ (3,444)

At December 31, 2005 and 2004, 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	
	2005	2004
Projected benefit obligation	$ 179,741	$ 171,076
Fair value of plan assets	117,671	115,292

	Accumulated Benefit Obligation Exceeds the Fair Value of Plan Assets	
	2005	2004
Accumulated benefit obligation	$ 148,629	$ 136,851
Fair value of plan assets	117,671	115,292

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

	Pension Benefits			Other Postretirement Benefits		
	2005	2004	2003	2005	2004	2003
Service cost	$ 4,847	$ 4,312	$ 3,627	$ 1,223	$ 1,112	$ 987
Interest cost	9,805	9,512	8,999	1,882	1,825	1,703
Expected return on plan assets	(9,536)	(9,169)	(7,775)	(1,261)	(1,086)	(917)
Amortization of transition obligation (asset)	(209)	(209)	(209)	803	803	803
Amortization of prior service cost	403	419	395	(57)	(57)	(57)
Amortization of actuarial (gain) loss	1,606	1,009	1,282	219	125	62
Amortization of regulatory asset	-	-	-	136	144	136
Capitalized costs	(1,847)	(1,021)	(205)	(739)	(629)	(598)
Net periodic benefit cost	$ 5,069	$ 4,853	$ 6,114	$ 2,206	$ 2,237	$ 2,119

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. During 2005, the Company undertook a comprehensive study of the key demographic assumptions which impact the obligations and expense for its plans. Based on the study, the Company updated the assumed retirement and turnover rates for the plans to better reflect the recent experience combined with our expectations of future patterns. In addition, the Company has updated the mortality assumptions to reflect a more recent actuarial study of mortality experience and an expectation of future mortality improvements. The net effect of the changes in these assumptions was a decrease of $1,600 in the Company's pension and postretirement benefit obligation measured as of December 31, 2005.

The significant assumptions related to the Company's pension and other postretirement benefit plans are as follows:

	Pension Benefits		Other Postretirement Benefits	
	2005	2004	2005	2004
Weighted-average Assumptions Used to Determine Benefit Obligations as of December 31,				
Discount rate	5.65%	5.75%	5.65%	5.75%
Rate of compensation increase	4.0-5.0%	4.0-5.0%	4.0%	4.0%
Assumed Health Care Cost Trend Rates Used to Determine Benefit Obligations as of December 31,				
Health care cost trend rate	n/a	n/a	10%	10%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	n/a	n/a	5%	5%
Year that the rate reaches the ultimate trend rate	n/a	n/a	2011	2010
Weighted-average Assumptions Used to Determine Net Periodic Benefit Costs for Years Ended December 31,				
Discount rate	5.75%	6.25%	5.75%	6.25%
Expected return on plan assets	8.50%	8.50%	6.0-9.0%	6.0-9.0%
Rate of compensation increase	4.0-5.0%	4.0-5.0%	4.0%	4.0%
Assumed Health Care Cost Trend Rates Used to Determine Net Periodic Benefit Costs for Years Ended December 31,				
Health care cost trend rate	n/a	n/a	10%	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	2010	2009

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	$ 614	$ (689)
Effect on total service and interest cost components of net periodic postretirement health-care benefit cost	$ 70	$ (104)

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 2005 pension expense by $660 and the pension liabilities by $7,000.

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 2005 pension expense by $280. For 2005, the Company used an 8.5% expected return on assets assumption, and will lower this assumption to 8.0% for the calculation of pension expense for 2006. This change was made to reflect a change in the Company's expectations of long-term market returns given the recent decrease in bond yields. 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:

	2006 Target Allocation	Percentage of Plan Assets at December 31,	
		2005	2004
Asset Category:			
Equity securities	65%	60%	62%
Debt securities	35%	24%	27%
Cash	0%	16%	11%
Total	100%	100%	100%

Equity securities include Aqua America, Inc. common stock in the amounts of $11,121 or 9.5% of total plan assets and $7,373 or 6.4% of total plan assets as of December 31, 2005 and 2004, respectively.

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

	2006 Target Allocation	Percentage of Plan Assets at December 31,	
		2005	2004
Asset Category:			
Cash	65%	67%	60%
Equity securities	35%	33%	40%
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 2006 our pension contribution is expected to be $6,400. The Company's funding of its PBOP cost during 2006 is expected to approximate $2,882.

As of December 31, 2005, the Company has an additional minimum liability of $10,909 associated with our defined benefit plan. The additional minimum liability is a result of the accumulated benefit obligation exceeding the fair value of plan assets.

The portion of the additional minimum liability related to our employees in one of our rate jurisdictions results in the establishment of a regulatory asset of $6,167, as the Company expects recovery of the future, increased pension expense through customer rates. Since the balance of the additional minimum liability of $4,742 may not be recovered through rates, the accounting requirements for recording a regulatory asset are not met and as a result this amount is recorded as accumulated other comprehensive loss through aggregate charges to accumulated other comprehensive income in 2004 and 2005, net of income tax benefits of $1,660. The change in the additional minimum liability from December 31, 2004 to December 31, 2005 resulted from the effect of a decreased discount rate, offset partially by an increase in the pension plan assets during 2005 due to positive equity market performance and pension contributions.

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 $1,236, $1,160 and $921 for the years ended December 31, 2005, 2004 and 2003, respectively.

Water and Wastewater Rates

In November 2005, the Company's Pennsylvania operating subsidiary, Aqua Pennsylvania, Inc., filed an application with the Pennsylvania Public Utility Commission ("PAPUC") requesting a $38,800 or 14.4% increase in annual revenues. The application is currently pending before the PAPUC and a final determination is anticipated by August 2006. 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 to increase rates by $11,920 over a multi-year period. The application seeks to increase annual revenues in phases and is accompanied by a plan to defer and amortize a portion of the Company's depreciation, operating and other tax expense over a similar multi-year period, such that the impact on operating income approximates the requested amount during the first years that the new rates are in effect. The application is currently pending before the Commission 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 Texas Commission on Environmental Quality in July 2004. The additional revenue billed and collected prior to the final ruling are subject to refund based on the outcome of the ruling. The revenue recognized and the expenses deferred by the Company reflect an estimate of the final outcome of the ruling. As of December 31, 2005, we have deferred $9,486 of expenses and recognized $5,202 of revenue that is subject to refund based on the outcome of the final commission order, which is not expected to be issued prior to December 2006.

The Company's other operating subsidiaries were allowed annual rate increases of $5,142 in 2005, $6,673 in 2004 and $1,275 in 2003, represented by twenty-three, fourteen and eight rate decisions, respectively. Revenues from these increases realized in the year of grant were approximately $3,144, $3,995 and $839 in 2005, 2004 and 2003, respectively.

Five states in which the Company operates permit water utilities, and in some states wastewater utilities, to add a surcharge to their water or wastewater bills to offset the additional depreciation and capital costs related to infrastructure system replacement and rehabilitation projects completed and placed into service between base rate filings. Currently, Pennsylvania, Illinois, Ohio, 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 2005, 2004 and 2003 of $10,186, $7,817 and $8,147, respectively.

(In thousands of dollars, except per share amounts)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
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
2004					
Operating revenues	$ 99,768	$ 106,524	$ 120,305	$ 115,442	$ 442,039
Operations and maintenance expense	41,831	44,483	46,526	45,505	178,345
Operating income	36,444	40,473	50,997	49,320	177,234
Net income	15,575	17,871	24,087	22,474	80,007
Basic net income per common share	0.13	0.14	0.19	0.18	0.64
Diluted net income per common share	0.12	0.14	0.19	0.18	0.64
Dividend paid per common share	0.09	0.09	0.09	0.0975	0.3675
Dividend declared per common share	0.09	0.09	0.1875	-	0.3675
Price range of common stock					
- high	17.14	16.47	16.67	18.48	18.48
- low	15.00	14.24	14.18	15.58	14.18

All per share data as presented has been adjusted for the 2005 4-for-3 common stock split effected in the form of a 33 1/3% stock distribution. High and low prices of the Company's common stock are as reported on the New York Stock Exchange Composite Tape. The cash dividends paid in December 2005 of $0.1069 and December 2004 of $0.0975 were declared in August 2005 and August 2004, respectively.

(in thousands of dollars, except per share amounts)

Years ended December 31,	2005	2004 (a)	2003 (b)	2002	2001
PER COMMON SHARE:					
Net income					
Basic	$0.72	$0.64	$ 0.60	$ 0.59	$ 0.53
Diluted	0.71	0.64	0.59	0.58	0.52
Cash dividends declared and paid	0.40	0.37	0.34	0.32	0.30
Return on average stockholders' equity	11.7%	11.4%	12.3%	13.9%	13.3%
Book value at year end	$6.30	$5.88	$5.33	$4.35	$4.14
Market value at year end	27.30	18.44	16.58	12.36	13.53
INCOME STATEMENT HIGHLIGHTS:					
Operating revenues	$496,779	$442,039	$367,233	$322,028	$307,280
Depreciation and amortization	65,488	58,864	51,463	44,322	40,168
Interest expense, net (c)	49,615	46,375	42,535	39,007	38,637
Income before income taxes	148,069	132,131	116,718	109,252	99,087
Provision for income taxes	56,913	52,124	45,923	42,046	38,976
Net income available to common stock	91,156	80,007	70,785	67,154	60,005
BALANCE SHEET HIGHLIGHTS:					
Total assets	$2,626,725	$2,355,374	$2,071,252	$1,716,030	$1,554,483
Property, plant and equipment, net	2,279,950	2,069,812	1,824,291	1,486,703	1,364,282
Common stockholders' equity	811,923	747,231	658,118	492,594	471,930
Long-term debt, including current portion	903,083	834,656	736,052	617,175	531,455
Total debt	1,041,588	909,466	832,511	732,288	641,123
ADDITIONAL INFORMATION:					
Net cash flows from operating activities	$199,674	$173,603	$143,373	$121,560	$102,165
Capital additions	237,462	195,736	163,320	136,164	124,088
Net cash expended for acquisitions of utility systems	11,633	54,300	192,331	8,914	9,517
Dividends on common stock	51,139	45,807	39,917	36,789	34,234
Number of customers served	864,894	835,512	749,491	605,474	587,537
Number of shareholders of common stock	27,054	24,082	22,726	21,389	20,920
Common shares outstanding (000)	128,970	127,180	123,452	113,194	113,977
Employees (full-time)	1,489	1,442	1,260	971	951

All per share data as presented has been adjusted for the 2005 4-for-3 common stock split effected in the form of a 33 1/3% stock distribution.

(a) 2004 includes a partial year of finanical 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.

AQUA AMERICA, INC. AND SUBSIDIARIES
INVESTOR RELATIONS INFORMATION

Financial Reports and Investor Relations

Copies of the company's public financial reports, including annual reports and Forms 10–K and 10–Q, are available on line and can be downloaded from the investor relations section of our Web site at www.aquaamerica.com. You may also obtain these reports by writing to us at:

ATTN: Investor Relations
Aqua America, Inc.
762 W. Lancaster Avenue
Bryn Mawr, PA 19010-3489
www.aquaamerica.com

Corporate Governance

We are committed to maintaining high standards of corporate governance and have implemented the corporate governance rules of the Securities and Exchange Commission (SEC) and the New York Stock Exchange. Copies of our key corporate governance documents, including our Corporate Governance Guidelines, Code of Ethical Business Conduct, and the charters of each committee of our Board of Directors can be obtained from the corporate governance portion of the investor relations section of our Web site www.aquaamerica.com or requests may be directed to the address above. Amendments to the Code, and any grant of waiver from a provision of the Code requiring disclosure under applicable SEC rules will be disclosed on our Web site. As required under Section 302 of the Sarbanes–Oxley Act of 2002 and Rule 13a–14(a) under the Securities and Exchange Act of 1934, Aqua America's chief executive officer and chief financial officer have performed the required certification for 2005 without exception and their certifications were filed as Exhibits 31.1 and 31.2 to our Form 10-K for 2005. You may access this report and our other SEC filings from our Web site. In addition, in 2005 the company's chief executive officer provided to the New York Stock Exchange the Annual CEO certification regarding the company's compliance with the New York Stock Exchange's corporate governance listing standards.

Annual Meeting

10:00 A.M. Eastern Daylight Time
Wednesday, May 17, 2006
Drexelbrook Banquet Facility and Corporate Events Center
Drexelbrook Drive and Valley Road
Drexel Hill, PA 19026

Transfer Agent and Registrar

Computershare Trust Company, N.A.
P.O. Box 43010
Providence, RI 02940-3010
800.205.8314 or 781.575.3100
www.computershare.com/equiserve

Independent Registered Public Accounting Firm

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

Stock Exchanges

The Common Stock of the company is listed on the New York Stock Exchange and the Philadelphia Stock Exchange under the ticker symbol WTR. The daily closing price is printed in *The Wall Street Journal* as AquaAmer. Listings might vary in other major newspapers.

Dividend Reinvestment and Direct Stock Purchase Plan

The company's Dividend Reinvestment and Direct Stock Purchase Plan ("Plan") enables shareholders to reinvest all, or a designated portion of, dividends paid on up to 100,000 shares of Common Stock in additional shares of Common Stock at a five percent discount from a price based on the market value of the stock. In addition, shareholders may purchase additional shares of Aqua America Common Stock at any time with a minimum investment of $50, up to a maximum of $250,000 annually. Individuals may become shareholders by making an initial investment of at least $500. A Plan prospectus may be obtained by calling Computershare Trust Company at 800.205.8314 or by visiting www.computershare.com/equiserve. **Please read the prospectus carefully before you invest.**

AQUA AMERICA, INC. AND SUBSIDIARIES
INVESTOR RELATIONS INFORMATION

IRA, Roth IRA, Education IRA

An IRA, Roth IRA or Coverdell Education Savings Account may be opened through the Plan to hold shares of Common Stock of the company and to make contributions to the IRA to purchase shares of Common Stock. Participants in the Plan may roll over an existing IRA or other qualified plan distribution in cash into an IRA under the Plan to purchase the company's Common Stock. Participants may also transfer the company's Common Stock from an existing IRA into an IRA under the Plan. A prospectus, IRA forms and a disclosure statement may be obtained by calling Computershare Trust Company at 800.472.7428. **Please read the prospectus carefully before you invest.**

Direct Deposit

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

Delivery of voting materials to shareholders sharing an address

To reduce the expense of delivering duplicate voting materials to our shareholders who have more than one Aqua America stock account, we are delivering only one annual report and proxy statement to registered shareholders who share an address unless otherwise requested. A separate proxy card is included in the voting materials for each of these shareholders.

How to obtain a separate set of voting materials

If you are a registered shareholder who shares an address with another registered shareholder and have received only one set of voting materials for the 2006 annual meeting, you may write or call us to request a separate copy of this material at no cost to you at 610.645.1196 or Attn: Investor Relations, Aqua America, Inc., 762 W. Lancaster Avenue, Bryn Mawr, PA, 19010. For future annual meetings, you may request separate voting material by calling the Company's transfer agent at 800.205.8314.

Account Access

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

Dividends

Aqua America has paid dividends for 60 consecutive years. The normal Common Stock dividend dates for 2006 and the first six months of 2007 are:

Declaration Date	Ex-Dividend Date	Record Date	Payment Date
February 2, 2006	February 12, 2006	February 14, 2006	March 1, 2006
May 5, 2006	May 16, 2006	May 18, 2006	June 1, 2006
August 1, 2006	August 16, 2006	August 18, 2006	September 1, 2006
November 6, 2006	November 15, 2006	November 17, 2006	December 1, 2006
January 30, 2007	February 13, 2007	February 15, 2007	March 1, 2007
May 7, 2007	May 16, 2007	May 18, 2007	June 1, 2007

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

Only the Board of Directors may declare dividends and set record dates. Therefore, the payment of dividends and these dates may change at the discretion of the Board. Announcement of the dividend declaration is usually published in *The Wall Street Journal* and several other newspapers.

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

Lost Dividend Checks and Stock Certificates

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

Safekeeping of Stock Certificates

Under the Direct Stock Purchase Plan, shareholders may have their stock certificates deposited with the transfer agent for safekeeping free of charge. Stock certificates and written instructions should be forwarded to: Computershare Trust Company, N.A., P.O. Box 43010, Providence, RI 02940-3010.

Notes

Board of Directors

Nicholas DeBenedictis, 60
Chairman, President and CEO
Aqua America, Inc.
Director since 1992

Mary C. Carroll, 65
Consultant and
Community Volunteer
Director since 1981

Richard Glanton, 59
Senior Vice President
Exelon Corporation
Director since 1995

Lon R. Greenberg, 55
Chairman and CEO
UGI Corporation
Director since 2005

William P. Hankowsky, 54
Chairman, President and CEO
Liberty Property Trust
Director since 2004

***John F. McCaughan, 70**
Chairman (Retired)
Betz Laboratories, Inc.
Director since 1984

***John E. Menario, 70**
Assistant to the President (Retired)
Banknorth Group, Inc.
Director since 1999

Constantine Papadakis, 60
President, Drexel University
Director since 2005

Richard L. Smoot, 65
Regional Chairman,
Advisory Board (Retired)
PNC Financial Services Group
Philadelphia and
Southern New Jersey
Director since 1997

** Retired from Board March 2006*

Officers

Nicholas DeBenedictis, 60
Chairman, President and CEO

Richard D. Hugus, 56
Regional President
Aqua America – Southern Operations

Karl M. Kyriss, 55
Regional President
Aqua America – Mid-Atlantic Operations

Robert G. Liptak, 58
Regional President
Aqua America – Northern Operations

Richard R. Riegler, 59
Vice President
Engineering and
Environmental Affairs

David P. Smeltzer, 47
Senior Vice President
Finance and CFO

Roy H. Stahl, Esq., 53
Executive Vice President,
General Counsel
and Corporate Secretary

Photo: Sarah Wray

AQUA America℠

762 West Lancaster Avenue • Bryn Mawr, PA 19010-3489 • T: 610.525.1400 • F: 610.645.1061

w w w . a q u a a m e r i c a . c o m