

VII. RATE OF RETURN

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.1

Pennsylvania-American Water Company
Coatesville Wastewater Operations
VII. Rate of Return

1. Provide capitalization and capitalization ratios for the last five-year period and projected through the next two years (with short-term debt and without short-term debt) for the Company, Parent and Consolidated System.
 - a. Provide year-end interest coverage before and after taxes for the last three years and at latest date, including Indenture and Securities and Exchange Commission (SEC) bases, for the Company, Parent and Consolidated System.
 - b. Provide year-end preferred stock dividend coverage for the last three years and at latest date, including Charter and SEC bases.

Answer:

Please refer to schedule 2 of Exhibit 9-A. For 2009 and 2010 capitalization and capitalization ratios, please see attached.

- a. Please refer to schedule 2 of Exhibit 9-A.
- b. Please refer to schedule 2 of Exhibit 9-A.

Pennsylvania American Water Company
Capital Structure

| Total Company | Actual at December 31, 2009 | | | Proforma at December 31, 2010 | | |
|-------------------------|-----------------------------|-----------|-----------|-------------------------------|-----------|-----------|
| | Amount Outstanding | Ratios | | Amount Outstanding | Ratios | |
| | | Excl. S-T | Incl. S-T | | Excl. S-T | Incl. S-T |
| Long term debt | \$ 998,447,759 | 51.02% | 50.82% | \$ 1,013,055,512 | 50.40% | 49.88% |
| Preferred Stock | 14,171,700 | 0.72% | 0.72% | 14,171,700 | 0.70% | 0.70% |
| Common Equity | | | | | | |
| Common Stock | 21,506,887 | | | 21,506,887 | | |
| Paid in Capital | 607,873,322 | | | 623,873,322 | | |
| Retained Earnings | 315,033,637 | | | 337,607,637 | | |
| Total Common Equity | 944,413,846 | 48.26% | 48.07% | 982,987,846 | 48.90% | 48.40% |
| Total Permanent Capital | \$ 1,957,033,305 | 100.00% | 99.61% | \$ 2,010,215,058 | 100.00% | 98.98% |
| ST Debt | 7,496,277 | | 0.39% | 20,900,266 | | 1.02% |
| Total Capital Employed | \$ 1,964,529,582 | | 100.00% | \$ 2,031,115,324 | | 100.00% |
| CWIP | 36,926,000 | | | 38,235,000 | | |
| GENERAL LEDGER | 1,964,529,582 | | | | | |

| Total Company Excluding Coatesville Wastewater PEDFA - Specific Project Financing (Northeast, Claysville and Clarion Filing) | | | | | | |
|------------------------------------------------------------------------------------------------------------------------------|-----------------------------|-----------|-----------|-------------------------------|-----------|-----------|
| | Actual at December 31, 2009 | | | Proforma at December 31, 2010 | | |
| | Amount Outstanding | Ratios | | Amount Outstanding | Ratios | |
| | | Excl. S-T | Incl. S-T | | Excl. S-T | Incl. S-T |
| Long term debt | \$ 951,447,759 | 49.82% | 49.62% | \$ 966,055,512 | 49.21% | 48.69% |
| Preferred Stock | 14,171,700 | 0.74% | 0.74% | 14,171,700 | 0.72% | 0.71% |
| Common Equity | | | | | | |
| Common Stock | 21,506,887 | | | 21,506,887 | | |
| Paid in Capital | 607,873,322 | | | 623,873,322 | | |
| Retained Earnings | 315,033,637 | | | 337,607,637 | | |
| Total Common Equity | 944,413,846 | 49.44% | 49.25% | 982,987,846 | 50.07% | 49.54% |
| Total Permanent Capital | \$ 1,910,033,305 | 100.00% | 99.61% | \$ 1,963,215,058 | 100.00% | 98.95% |
| ST Debt | 7,496,277 | | 0.39% | 20,900,266 | | 1.05% |
| Total Capital Employed | \$ 1,917,529,582 | | 100.00% | \$ 1,984,115,324 | | 100.00% |
| CWIP | \$ 36,926,000 | | | 38,235,000 | | |
| General Ledger | \$ 1,964,529,582 | | | | | |
| WW Coatesville Pedfa | 47,000,000 | | | | | |

| Coatesville Wastewater including PEDFA - Specific Project Financing | | | | |
|--------------------------------------------------------------------------------------|-----------------------------|---------|-------------------------------|---------|
| | Actual at December 31, 2009 | | Proforma at December 31, 2010 | |
| | Amount Outstanding | Ratios | Amount Outstanding | Ratios |
| Long term debt | \$ 10,176,723 | 17.00% | \$ 15,071,763 | 19.42% |
| LTD PEDFA Financing | 39,455,802 | 65.89% | 47,000,000 | 60.55% |
| Preferred Stock | 151,160 | 0.25% | 220,518 | 0.28% |
| Common Equity | 10,099,101 | 16.86% | 15,335,159 | 19.75% |
| Total Permanent Capital | \$ 59,882,786 | 100.00% | \$ 77,627,439 | 100.00% |
| Rate Base | \$ 59,882,786 | | \$ 77,627,439 | |
| LTD PEDFA Financing | 39,455,802 | | 47,000,000 | |
| Amount financed by overall Company capital structure excluding PEDFA financing | \$ 20,426,984 | | \$ 30,627,439 | |

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.2

Pennsylvania-American Water Company
Coatesville Wastewater Operations
VII. Rate of Return

2. Provide latest Prospectus for the Company and the Parent.

Answer: Please refer to the Investor Relations / Financial Reporting section of the American Water internet site (<http://amwater.com>).

Pennsylvania-American Water Company
 Coatesville Wastewater Operations
 Data Requirements of the Pennsylvania Public Utility Commission

FR VII.3

Pennsylvania-American Water Company
Coatesville Wastewater Operations

VII. Rate of Return

3. Supply projected capital requirements and the sources of Company, Parent and Consolidated System for the historic test year and each of three (3) comparable future years.

Answer: Following are the historic and projected capital requirements for PAWC:

| Description | 2009 | 2010 | 2011 | 2012 |
|------------------------|--------------------|----------------------|----------------------|----------------------|
| Bank Loans | 7,496,277 | 20,900,266 | 43,049,000 | 48,346,000 |
| Long Term Debt | 998,447,759 | 1,013,055,512 | 1,076,946,000 | 1,136,946,000 |
| Preferred Stock | 14,171,700 | 14,171,700 | 14,171,700 | 14,171,700 |
| Common Equity | 944,413,846 | 982,987,846 | 1,092,817,000 | 1,153,530,000 |

*The Company is currently in the process of updating the projections for 2011 & 2012 through its normal annual budgeting process.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.4

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

4. Provide a schedule of debt and preferred stock of Company, Parent and Consolidated System as of historic test year-end and latest date, detailing for each issue (if applicable):
- a. Date of issue
 - b. Date of maturity
 - c. Amount issued
 - d. Amount outstanding
 - e. Amount retired
 - f. Amount required
 - g. Gain on reacquisition
 - h. Coupon rate
 - i. Discount or premium at issuance
 - j. Issuance expenses
 - k. Net proceeds
 - l. Sinking Fund requirements
 - m. Effective interest rate
 - n. Dividend rate
 - o. Effective cost rate
 - p. Total average weighted effective Cost Rate

Answer: Please see attached for the requested information as of December 31, 2009 and 2010.

PA AMERICAN WATER - TOTAL COMPANY
 SCHEDULE OF DEBT AT DECEMBER 31, 2009

| DATE OF ISSUE | DATE OF MATURITY | AMOUNT ISSUED | AMOUNT OUTSTANDING | COUPON RATE | ANNUAL INTEREST | NOTE # | ISSUANCE EXPENSE | NET PROCEEDS | NET PROCEEDS Ratio | PERCENT TO TOTAL | EFFECTIVE COST RATE | WEIGHTED COST RATE |
|----------------------------------|------------------|---------------|--------------------|-------------|-----------------|--------|------------------|-----------------|--------------------|------------------|---------------------|--------------------|
| Bonds and Notes | | | | | | | | | | | | |
| 1-Nov-1993 | 1-Nov-2033 | 38,000,000 | 38,000,000 | 6.780% | 2,576,400 | | 174,946 | 37,825,054 | 99.54% | 3.81% | 6.81% | 0.26% |
| 1-Sep-1996 | 1-Sep-2026 | 150,000,000 | 150,000,000 | 7.800% | 11,700,000 | | 2,069,648 | 147,930,352 | 98.62% | 15.02% | 7.92% | 1.19% |
| 24-Aug-1989 | 1-Aug-2019 | 15,500,000 | 15,500,000 | 9.710% | 1,505,050 | | 165,469 | 15,334,531 | 98.93% | 1.55% | 9.82% | 0.15% |
| 15-Feb-1991 | 15-Jan-2021 | 20,000,000 | 20,000,000 | 9.690% | 1,938,000 | | 116,061 | 18,883,939 | 99.42% | 2.00% | 9.75% | 0.20% |
| 1-Nov-1991 | 1-Nov-2031 | 10,000,000 | 10,000,000 | 8.820% | 882,000 | | 88,352 | 9,911,648 | 99.12% | 1.00% | 8.90% | 0.09% |
| 15-Aug-1995 | 1-Aug-2025 | 10,000,000 | 10,000,000 | 8.150% | 815,000 | | 60,119 | 9,939,881 | 99.40% | 1.00% | 8.20% | 0.08% |
| 1-Nov-1997 | 1-Nov-2017 | 33,000,000 | 33,000,000 | 7.060% | 2,336,400 | | 551,693 | 32,448,317 | 98.33% | 3.31% | 7.24% | 0.24% |
| 1-Jul-1996 | 1-Jul-2031 | 16,700,000 | 16,700,000 | 6.750% | 1,127,250 | 21 | 1,305,312 | 15,364,688 | 92.00% | 1.67% | 7.39% | 0.12% |
| 1-Sep-1998 | 1-Sep-2018 | 18,250,000 | 18,250,000 | 6.000% | 1,095,000 | 21 | 908,630 | 17,343,370 | 95.03% | 1.83% | 6.37% | 0.12% |
| 30-Sep-1991 | 15-Mar-2019 | 17,950,000 | 17,950,000 | 6.100% | 1,094,950 | 21 | 957,808 | 16,992,192 | 94.66% | 1.80% | 6.52% | 0.12% |
| 1-Apr-2001 | 29-Mar-2011 | 47,000,000 | 6,800,000 | 6.870% | 467,160 | 3 | 320,648 | 46,679,352 | 99.32% | 0.68% | 6.97% | 0.05% |
| 31-Dec-2006 | 21-Dec-2016 | 13,800,000 | 13,800,000 | 5.520% | 761,760 | | 45,774 | 13,754,226 | 99.67% | 1.38% | 5.56% | 0.08% |
| 31-Dec-2006 | 21-Dec-2016 | 65,900,000 | 65,900,000 | 5.620% | 3,703,560 | | 218,587 | 65,681,413 | 99.67% | 6.60% | 5.68% | 0.37% |
| 31-Dec-2006 | 21-Dec-2021 | 100,300,000 | 100,300,000 | 5.770% | 5,787,310 | | 332,850 | 99,967,310 | 99.67% | 10.05% | 5.80% | 0.58% |
| 31-Mar-2007 | 29-Mar-2022 | 80,000,000 | 80,000,000 | 4.750% | 3,800,000 | 19 | 261,178 | 79,738,822 | 99.67% | 8.01% | 4.76% | 0.38% |
| 15-May-2008 | 15-May-2018 | 81,000,000 | 81,000,000 | 6.250% | 5,062,500 | | 293,994 | 80,706,006 | 99.64% | 8.11% | 6.36% | 0.51% |
| 1-Jun-1999 | 1-Jun-2029 | 24,030,000 | 23,455,000 | 5.050% | 1,184,478 | | 1,191,706 | 22,838,294 | 95.04% | 3.35% | 5.39% | 0.13% |
| 1-Aug-2004 | 1-Aug-2034 | 40,000,000 | 39,190,000 | 4.800% | 1,881,120 | | 2,216,014 | 37,783,986 | 94.46% | 3.93% | 5.17% | 0.20% |
| 23-Sep-2004 | 1-Sep-2034 | 19,000,000 | 18,098,000 | 4.850% | 940,500 | | 1,355,440 | 17,644,560 | 92.87% | 1.90% | 5.43% | 0.10% |
| 23-Sep-2004 | 1-Sep-2034 | 30,000,000 | 30,000,000 | 5.100% | 1,530,000 | | 2,566,355 | 27,433,645 | 91.45% | 3.00% | 5.70% | 0.17% |
| 1-Dec-2009 | 1-Dec-2039 | 80,000,000 | 80,000,000 | 5.900% | 4,400,000 | 22 | 1,308,669 | 78,693,331 | 98.37% | 8.01% | 5.61% | 0.45% |
| 1-Dec-2009 | 1-Dec-2039 | 13,165,000 | 13,165,000 | 5.500% | 724,075 | 22 | 347,489 | 12,817,511 | 97.36% | 1.32% | 5.68% | 0.07% |
| 1-Apr-2009 | 1-Apr-2039 | 80,000,000 | 80,000,000 | 6.200% | 4,960,000 | | 1,032,348 | 78,967,652 | 98.71% | 8.01% | 6.30% | 0.50% |
| Water Facility Restoration Loans | | | | | | | | | | | | |
| 1-Mar-1996 | 1-Nov-2012 | 1,955,878 | 537,246 | 3.450% | 18,535 | | 27,563 | 1,928,315 | 98.59% | 0.05% | 3.56% | 0.00% |
| Pennvest Loans | | | | | | | | | | | | |
| 1-Jun-1998 | 1-Apr-2011 | 263,442 | 23,250 | 1.000% | 233 | 4 | 0 | 263,442 | 100.00% | 0.00% | 1.00% | 0.00% |
| 1-Aug-2001 | 1-May-2018 | 6,556,389 | 2,857,912 | 1.364% | 39,554 | 6 | 110,635 | 6,545,764 | 98.34% | 0.29% | 1.50% | 0.00% |
| 1-Jan-2000 | 1-Jan-2018 | 1,391,436 | 677,967 | 2.566% | 17,397 | 5 | 69,942 | 1,321,494 | 94.97% | 0.07% | 2.93% | 0.00% |
| 1-Jul-2000 | 1-Feb-2018 | 2,926,847 | 1,462,552 | 2.905% | 42,487 | 7 | 29,069 | 2,897,778 | 99.01% | 0.15% | 2.97% | 0.00% |
| 1-Jan-2003 | 1-Dec-2022 | 3,945,656 | 2,588,215 | 2.774% | 71,797 | 13 | 8,480 | 3,937,176 | 98.79% | 0.26% | 2.79% | 0.01% |
| 1-Oct-2000 | 1-Oct-2019 | 1,728,997 | 1,146,375 | 2.795% | 32,041 | 8 | 0 | 1,728,997 | 100.00% | 0.11% | 2.80% | 0.00% |
| 1-Oct-2001 | 1-Feb-2020 | 3,470,505 | 2,029,604 | 1.84% | 24,031 | 10 | 17,155 | 3,453,350 | 98.51% | 0.20% | 1.21% | 0.00% |
| 1-Apr-2000 | 1-Mar-2022 | 3,366,155 | 2,228,332 | 3.237% | 72,131 | 9 | 56,803 | 3,308,352 | 98.31% | 0.22% | 3.56% | 0.01% |
| 1-Apr-2000 | 1-Mar-2022 | 3,623,800 | 2,398,091 | 3.237% | 77,626 | 11 | 25,430 | 3,598,370 | 98.30% | 0.24% | 3.28% | 0.01% |
| 30-Aug-2000 | 1-Sep-2022 | 4,322,665 | 2,884,040 | 3.237% | 93,356 | 12 | 25,445 | 4,297,220 | 99.41% | 0.29% | 3.27% | 0.01% |
| 1-Jul-2004 | 1-Jul-2024 | 1,559,205 | 965,901 | 2.774% | 26,794 | 16 | 13,749 | 1,545,456 | 99.12% | 0.10% | 2.83% | 0.00% |
| 01-Jun-05 | 1-Nov-2024 | 5,721,348 | 4,198,767 | 1.000% | 41,988 | 17 | 29,484 | 5,691,864 | 98.48% | 0.42% | 1.03% | 0.00% |
| 1-Jan-2006 | 1-Dec-2025 | 5,386,606 | 3,977,295 | 1.365% | 55,096 | 18 | 34,130 | 5,352,476 | 98.37% | 0.40% | 1.42% | 0.01% |
| 1-Sep-2004 | 1-Aug-2024 | 5,240,631 | 3,908,589 | 2.774% | 108,425 | 14 | 7,951 | 5,232,680 | 98.85% | 0.39% | 2.78% | 0.01% |
| 1-Nov-2004 | 1-Oct-2024 | 3,099,441 | 2,339,505 | 2.432% | 96,987 | 15 | 5,660 | 3,083,781 | 98.82% | 0.23% | 2.44% | 0.01% |
| 1-Oct-2009 | 1-Sep-2029 | 2,241,702 | 2,214,108 | 1.274% | 28,208 | 20 | 0 | 2,241,702 | 100.00% | 0.22% | 1.27% | 0.00% |
| | | | | | | | | \$1,060,495,713 | \$996,447,759 | \$61,079,119 | 100.00% | 6.25% |
| | | | | | | | | \$18,376,416 | \$1,042,119,297 | | | |

PA AMERICAN WATER - TOTAL COMPANY EXCLUDING WASTEWATER SPECIFIC FINANCING
SCHEDULE OF DEBT AT DECEMBER 31, 2009

| DATE OF ISSUE | DATE OF MATURITY | AMOUNT ISSUED | AMOUNT OUTSTANDING | COUPON RATE | ANNUAL INTEREST | NOTE # | ISSUANCE EXPENSE | NET PROCEEDS | NET PROCEEDS Ratio | PERCENT TO TOTAL | EFFECTIVE COST RATE | WEIGHTED COST RATE |
|----------------------------------|------------------|---------------|--------------------|-------------|-----------------|--------|------------------|-----------------|--------------------|------------------|---------------------|--------------------|
| Bonds and Notes | | | | | | | | | | | | |
| 1-Nov-1993 | 1-Nov-2033 | 38,000,000 | 38,000,000 | 6.780% | 2,576,400 | | 174,946 | 37,825,054 | 99.54% | 3.98% | 6.81% | 0.27% |
| 1-Sep-1996 | 1-Sep-2026 | 150,000,000 | 150,000,000 | 7.800% | 11,700,000 | | 2,069,648 | 147,930,352 | 98.62% | 15.77% | 7.92% | 1.25% |
| 24-Aug-1989 | 1-Aug-2019 | 15,500,000 | 15,500,000 | 9.710% | 1,505,050 | | 165,469 | 15,334,531 | 98.93% | 1.63% | 9.82% | 0.16% |
| 15-Feb-1991 | 15-Jan-2021 | 20,000,000 | 20,000,000 | 9.680% | 1,938,000 | | 116,061 | 19,883,939 | 98.42% | 2.10% | 9.75% | 0.20% |
| 1-Nov-1991 | 1-Nov-2031 | 10,000,000 | 10,000,000 | 8.820% | 882,000 | | 88,352 | 9,911,648 | 99.12% | 1.05% | 8.90% | 0.09% |
| 15-Aug-1995 | 1-Aug-2025 | 10,000,000 | 10,000,000 | 8.150% | 815,000 | | 60,119 | 9,938,881 | 99.40% | 1.05% | 8.20% | 0.08% |
| 1-Nov-1997 | 1-Nov-2017 | 33,000,000 | 33,000,000 | 7.080% | 2,336,400 | | 551,693 | 32,446,317 | 98.33% | 3.47% | 7.24% | 0.25% |
| 1-Jul-1996 | 1-Jul-2031 | 16,700,000 | 16,700,000 | 6.755% | 1,127,250 | 21 | 1,335,312 | 15,364,688 | 92.00% | 1.76% | 7.38% | 0.13% |
| 1-Sep-1988 | 1-Sep-2018 | 18,250,000 | 18,250,000 | 6.000% | 1,095,000 | 21 | 906,630 | 17,343,370 | 93.03% | 1.92% | 6.37% | 0.12% |
| 30-Sep-1991 | 15-Mar-2019 | 17,950,000 | 17,950,000 | 6.100% | 1,094,950 | 21 | 957,808 | 16,992,192 | 94.66% | 1.89% | 6.52% | 0.12% |
| 1-Apr-2001 | 29-Mar-2011 | 47,000,000 | 6,800,000 | 6.870% | 467,160 | 3 | 320,648 | 46,679,352 | 98.32% | 0.71% | 6.97% | 0.05% |
| 31-Dec-2006 | 21-Dec-2016 | 13,800,000 | 13,800,000 | 5.520% | 761,760 | | 45,774 | 13,754,226 | 98.67% | 1.45% | 5.56% | 0.08% |
| 31-Dec-2006 | 21-Dec-2021 | 65,900,000 | 65,900,000 | 5.620% | 3,703,560 | | 218,587 | 65,681,413 | 99.67% | 6.93% | 5.66% | 0.39% |
| 31-Mar-2007 | 29-Mar-2022 | 80,000,000 | 80,000,000 | 5.770% | 5,767,310 | | 332,660 | 99,967,310 | 99.64% | 10.54% | 5.80% | 0.61% |
| 15-May-2008 | 15-May-2018 | 81,000,000 | 81,000,000 | 4.750% | 3,860,000 | 19 | 261,178 | 79,738,822 | 98.67% | 8.41% | 4.78% | 0.40% |
| 1-Jun-1999 | 1-Jun-2029 | 24,000,000 | 23,455,000 | 5.050% | 1,191,706 | | 233,994 | 22,838,294 | 95.04% | 2.47% | 6.30% | 0.54% |
| 1-Aug-2004 | 1-Aug-2024 | 40,000,000 | 39,190,000 | 4.800% | 1,881,120 | | 2,216,014 | 37,783,986 | 94.46% | 4.12% | 5.17% | 0.21% |
| 23-Sep-2004 | 1-Sep-2034 | 19,000,000 | 19,000,000 | 4.950% | 940,500 | | 1,355,440 | 17,644,560 | 92.87% | 2.00% | 5.43% | 0.11% |
| 23-Sep-2004 | 1-Sep-2034 | 30,000,000 | 30,000,000 | 5.100% | 1,550,000 | | 2,566,355 | 27,433,645 | 91.45% | 3.15% | 5.70% | 0.18% |
| 1-Dec-2009 | 1-Dec-2039 | 80,000,000 | 80,000,000 | 5.500% | 4,400,000 | 22 | 1,306,659 | 78,693,331 | 98.37% | 8.41% | 5.61% | 0.47% |
| 1-Dec-2009 | 1-Dec-2039 | 13,165,000 | 13,165,000 | 5.500% | 724,075 | 22 | 347,489 | 12,817,511 | 97.36% | 1.36% | 5.68% | 0.08% |
| 1-Apr-2009 | 1-Apr-2039 | 33,000,000 | 33,000,000 | 6.200% | 2,046,000 | | 425,844 | 32,574,156 | 98.71% | 3.47% | 6.30% | 0.22% |
| Water Facility Restoration Loans | | | | | | | | | | | | |
| 1-Mar-1996 | 1-Nov-2012 | 1,955,878 | 537,246 | 3.450% | 18,535 | | 27,563 | 1,928,315 | 98.59% | 0.09% | 3.56% | 0.00% |
| Pennvest Loans | | | | | | | | | | | | |
| 1-Jun-1998 | 1-Apr-2011 | 263,442 | 23,250 | 1.000% | 233 | 4 | 0 | 263,442 | 100.00% | 0.00% | 1.00% | 0.00% |
| 1-Aug-2001 | 1-May-2018 | 6,656,399 | 2,657,912 | 1.384% | 38,654 | 6 | 110,635 | 6,545,764 | 98.34% | 0.30% | 1.50% | 0.00% |
| 1-Jan-2000 | 1-Jan-2018 | 1,391,436 | 677,967 | 2.566% | 17,397 | 5 | 69,942 | 1,321,494 | 94.97% | 0.07% | 2.93% | 0.00% |
| 1-Jun-2000 | 1-Feb-2019 | 2,926,847 | 1,462,552 | 2.905% | 42,487 | 7 | 28,069 | 2,897,778 | 98.01% | 0.15% | 2.97% | 0.00% |
| 1-Jan-2003 | 1-Dec-2022 | 3,945,656 | 2,568,215 | 2.774% | 71,797 | 13 | 8,480 | 3,937,176 | 99.79% | 0.27% | 2.79% | 0.01% |
| 1-Oct-2000 | 1-Oct-2019 | 1,728,997 | 1,146,375 | 2.795% | 32,041 | 8 | 0 | 1,728,997 | 100.00% | 0.12% | 2.80% | 0.00% |
| 1-Oct-2000 | 1-Feb-2020 | 3,470,505 | 2,029,604 | 1.184% | 24,031 | 10 | 17,155 | 3,453,350 | 98.51% | 0.21% | 1.21% | 0.00% |
| 1-Apr-2000 | 1-Mar-2022 | 3,366,155 | 2,228,332 | 3.237% | 72,131 | 9 | 58,803 | 3,308,352 | 96.31% | 0.23% | 3.35% | 0.01% |
| 1-Apr-2000 | 1-Mar-2022 | 3,623,800 | 2,398,091 | 3.237% | 77,626 | 11 | 25,430 | 3,598,370 | 98.30% | 0.25% | 3.28% | 0.01% |
| 30-Aug-2000 | 1-Sep-2022 | 4,322,665 | 2,864,040 | 2.774% | 93,356 | 12 | 25,445 | 4,297,220 | 98.41% | 0.30% | 3.27% | 0.01% |
| 1-Aug-2004 | 1-Jul-2024 | 1,559,205 | 965,901 | 2.774% | 26,794 | 16 | 13,749 | 1,545,456 | 98.12% | 0.10% | 2.89% | 0.00% |
| 1-Jun-2005 | 1-Nov-2024 | 5,721,348 | 4,198,767 | 1.000% | 41,888 | 17 | 29,484 | 5,691,864 | 99.48% | 0.44% | 1.03% | 0.00% |
| 1-Jan-2006 | 1-Dec-2025 | 5,386,606 | 3,877,295 | 1.385% | 55,086 | 18 | 34,130 | 5,352,476 | 99.37% | 0.42% | 1.42% | 0.01% |
| 1-Aug-2004 | 1-Aug-2024 | 5,240,631 | 2,338,599 | 2.774% | 108,425 | 14 | 7,951 | 5,232,680 | 98.85% | 0.41% | 2.78% | 0.01% |
| 1-Nov-2004 | 1-Oct-2024 | 3,088,441 | 2,338,505 | 2.432% | 56,897 | 15 | 5,660 | 3,083,781 | 98.82% | 0.25% | 2.44% | 0.01% |
| 1-Oct-2009 | 1-Sep-2029 | 2,241,702 | 2,214,108 | 1.274% | 28,208 | 20 | 0 | 2,241,702 | 100.00% | 0.23% | 1.27% | 0.00% |
| | | | | | | | | \$1,013,495,713 | | 100.00% | | 6.25% |
| | | | | | | | | \$951,447,759 | | | | |
| | | | | | | | | \$58,165,119 | | | | |
| | | | | | | | | \$17,769,912 | | | | |
| | | | | | | | | \$995,725,801 | | | | |

PA AMERICAN WATER - TOTAL COMPANY
SCHEDULE OF DEBT AT DECEMBER 31, 2010

| DATE OF ISSUE | DATE OF MATURITY | AMOUNT ISSUED | AMOUNT OUTSTANDING | COUPON RATE | ANNUAL INTEREST | NOTE # | ISSUANCE EXPENSE | NET PROCEEDS | NET PROCEEDS Ratio | PERCENT TO TOTAL | EFFECTIVE COST RATE | WEIGHTED COST RATE | |
|----------------------------------|------------------|---------------|--------------------|-------------|-----------------|--------|------------------|-----------------|--------------------|------------------|---------------------|--------------------|--|
| Bonds and Notes | | | | | | | | | | | | | |
| 1-Nov-1993 | 1-Nov-2033 | 38,000,000 | 38,000,000 | 6.750% | 2,576,400 | | 174,946 | 37,825,054 | 99.54% | 3.75% | 6.81% | 0.26% | |
| 1-Sep-1996 | 1-Sep-2026 | 150,000,000 | 150,000,000 | 7.800% | 11,700,000 | | 2,069,648 | 147,930,352 | 98.62% | 14.81% | 7.92% | 1.17% | |
| 24-Aug-1989 | 1-Aug-2019 | 15,500,000 | 15,500,000 | 9.710% | 1,505,050 | | 165,469 | 14,334,531 | 98.93% | 1.53% | 9.82% | 0.19% | |
| 15-Feb-1991 | 15-Jan-2021 | 20,000,000 | 20,000,000 | 9.690% | 1,938,000 | | 116,061 | 19,883,939 | 99.42% | 1.97% | 9.75% | 0.19% | |
| 1-Nov-1991 | 10,000,000 | 10,000,000 | 8.820% | 882,000 | 882,000 | | 88,352 | 9,911,648 | 99.12% | 0.99% | 8.90% | 0.09% | |
| 15-Aug-1995 | 1-Aug-2025 | 10,000,000 | 10,000,000 | 8.150% | 815,000 | | 60,119 | 9,939,881 | 99.40% | 0.99% | 8.20% | 0.08% | |
| 1-Nov-1997 | 1-Nov-2017 | 33,000,000 | 33,000,000 | 7.080% | 2,336,400 | | 551,683 | 32,448,317 | 98.33% | 3.26% | 7.24% | 0.24% | |
| 1-Jul-1998 | 1-Jul-2008 | 16,700,000 | 16,700,000 | 6.750% | 1,127,250 | 21 | 1,335,312 | 15,364,688 | 92.00% | 1.65% | 7.39% | 0.12% | |
| 1-Sep-1998 | 1-Sep-2018 | 18,250,000 | 18,250,000 | 6.000% | 1,095,000 | 21 | 906,630 | 17,343,370 | 1.80% | 1.80% | 6.37% | 0.11% | |
| 30-Sep-1991 | 15-Mar-2019 | 17,950,000 | 17,950,000 | 6.100% | 1,094,950 | 21 | 957,808 | 16,992,192 | 94.66% | 1.77% | 6.52% | 0.12% | |
| 1-Apr-2001 | 29-Mar-2011 | 47,000,000 | 3,400,000 | 6.870% | 233,580 | 3 | 320,648 | 46,679,352 | 99.32% | 0.34% | 6.97% | 0.02% | |
| 31-Dec-2006 | 21-Dec-2016 | 13,800,000 | 13,800,000 | 5.520% | 761,760 | | 45,774 | 13,754,226 | 99.67% | 1.36% | 5.56% | 0.08% | |
| 31-Dec-2006 | 21-Dec-2016 | 63,900,000 | 63,900,000 | 5.620% | 3,703,580 | | 218,587 | 65,681,413 | 99.67% | 6.51% | 5.66% | 0.37% | |
| 31-Dec-2006 | 21-Dec-2021 | 100,300,000 | 100,300,000 | 5.770% | 5,787,310 | | 332,890 | 99,967,310 | 99.67% | 9.90% | 5.80% | 0.57% | |
| 31-Mar-2007 | 29-Mar-2022 | 80,000,000 | 80,000,000 | 4.750% | 3,800,000 | 19 | 281,178 | 79,738,822 | 99.67% | 7.90% | 4.78% | 0.39% | |
| 15-May-2008 | 15-May-2018 | 81,000,000 | 81,000,000 | 6.250% | 5,062,500 | | 263,994 | 80,706,006 | 99.64% | 8.00% | 6.30% | 0.50% | |
| 1-Jun-1999 | 1-Jun-2029 | 24,030,000 | 23,455,000 | 5.050% | 1,184,478 | | 1,191,706 | 22,838,294 | 95.04% | 2.32% | 5.39% | 0.12% | |
| 1-Aug-2004 | 1-Aug-2034 | 40,000,000 | 38,590,000 | 4.800% | 1,852,320 | | 2,216,014 | 37,783,986 | 94.46% | 3.81% | 5.17% | 0.20% | |
| 23-Sep-2004 | 1-Sep-2034 | 19,000,000 | 19,000,000 | 4.950% | 940,500 | | 1,355,440 | 17,644,560 | 92.87% | 1.88% | 5.43% | 0.10% | |
| 23-Sep-2004 | 1-Sep-2004 | 30,000,000 | 30,000,000 | 5.100% | 1,530,000 | | 2,566,355 | 27,433,645 | 91.45% | 2.96% | 5.70% | 0.17% | |
| 1-Dec-2009 | 1-Dec-2039 | 80,000,000 | 80,000,000 | 5.500% | 4,400,000 | 22 | 1,306,668 | 78,693,331 | 98.37% | 7.90% | 5.61% | 0.44% | |
| 1-Dec-2009 | 1-Dec-2039 | 13,165,000 | 13,165,000 | 5.500% | 724,075 | 22 | 347,469 | 12,817,511 | 97.36% | 1.30% | 5.68% | 0.07% | |
| 1-Apr-2009 | 1-Apr-2039 | 80,000,000 | 80,000,000 | 6.200% | 4,960,000 | | 1,032,348 | 78,967,652 | 98.71% | 7.90% | 6.30% | 0.50% | |
| Water Facility Restoration Loans | | | | | | | | | | | | | |
| 1-Mar-1996 | 1-Nov-2012 | 1,955,878 | 359,098 | 3.450% | 12,389 | | 27,563 | 1,928,315 | 96.59% | 0.04% | 3.56% | 0.00% | |
| Pennvest Loans | | | | | | | | | | | | | |
| 1-Jun-1998 | 1-Apr-2011 | 263,442 | 5,799 | 1.000% | 58 | 4 | 0 | 263,442 | 100.00% | 0.00% | 1.00% | 0.00% | |
| 1-Aug-2001 | 1-May-2018 | 6,656,399 | 2,535,516 | 1.384% | 35,092 | 6 | 110,635 | 6,545,764 | 98.34% | 0.25% | 1.50% | 0.00% | |
| 1-Jan-2000 | 1-Jan-2018 | 1,391,436 | 601,509 | 2.566% | 15,435 | 5 | 69,942 | 1,321,494 | 94.37% | 0.06% | 2.93% | 0.00% | |
| 1-Jul-2000 | 1-Feb-2019 | 2,926,847 | 1,321,239 | 2.905% | 38,382 | 7 | 29,069 | 2,897,778 | 98.01% | 0.13% | 2.97% | 0.00% | |
| 1-Jan-2003 | 1-Dec-2022 | 3,945,656 | 2,420,518 | 2.774% | 67,145 | 13 | 8,480 | 3,937,176 | 98.79% | 0.24% | 2.79% | 0.01% | |
| 1-Oct-2000 | 1-Oct-2019 | 1,728,997 | 1,043,638 | 2.795% | 29,170 | 8 | | 1,728,997 | 100.00% | 0.10% | 2.80% | 0.00% | |
| 1-Feb-2020 | 1-Feb-2020 | 3,470,505 | 1,840,623 | 1.184% | 21,793 | 10 | 17,155 | 3,453,350 | 99.51% | 0.18% | 1.21% | 0.00% | |
| 1-Apr-2000 | 1-Mar-2022 | 3,665,155 | 2,077,651 | 3.237% | 67,254 | 9 | 56,803 | 3,309,352 | 98.31% | 0.21% | 3.35% | 0.01% | |
| 1-Apr-2000 | 1-Mar-2022 | 3,623,800 | 2,235,931 | 3.237% | 72,377 | 11 | 25,430 | 3,598,370 | 99.30% | 0.22% | 3.28% | 0.01% | |
| 30-Aug-2000 | 1-Sep-2022 | 4,322,665 | 2,698,277 | 3.237% | 87,343 | 12 | 25,445 | 4,297,220 | 99.41% | 0.27% | 3.27% | 0.01% | |
| 1-Jul-2004 | 1-Jul-2024 | 1,595,205 | 911,399 | 2.774% | 25,282 | 16 | 13,749 | 1,545,456 | 99.12% | 0.09% | 2.83% | 0.00% | |
| 01-Jun-05 | 1-Nov-2024 | 5,721,348 | 3,936,440 | 1.196% | 45,505 | 17 | 29,484 | 5,691,864 | 99.48% | 0.39% | 1.19% | 0.00% | |
| 1-Jan-2005 | 1-Dec-2025 | 5,386,606 | 3,461,279 | 1.385% | 47,939 | 18 | 34,130 | 5,352,476 | 99.37% | 0.34% | 1.42% | 0.00% | |
| 1-Sep-2004 | 1-Aug-2024 | 5,240,631 | 3,689,575 | 2.774% | 102,349 | 14 | 7,951 | 5,232,680 | 98.85% | 0.36% | 2.78% | 0.01% | |
| 1-Oct-2004 | 1-Oct-2024 | 3,099,441 | 2,206,898 | 2.432% | 53,672 | 15 | 5,660 | 3,033,781 | 98.82% | 0.22% | 2.44% | 0.01% | |
| 1-Oct-2008 | 1-Sep-2029 | 2,241,702 | 2,310,839 | 1.274% | 29,440 | 20 | 0 | 2,241,702 | 100.00% | 0.23% | 1.27% | 0.00% | |
| 1-Apr-2010 | 31-Mar-2035 | 12,150,000 | 12,150,000 | 1.559% | 189,419 | 23 | 0 | 12,150,000 | 100.00% | 0.21% | 1.56% | 0.02% | |
| 1-Jul-2010 | 30-Jun-2035 | 2,125,000 | 2,125,000 | 1.799% | 38,229 | 24 | 0 | 2,125,000 | 100.00% | 0.21% | 1.80% | 0.00% | |
| 1-Jul-2010 | 30-Jun-2035 | 2,125,000 | 2,125,000 | 1.599% | 33,979 | 25 | 0 | 2,125,000 | 100.00% | 0.21% | 1.60% | 0.00% | |
| 1-Jul-2010 | 30-Jun-2035 | 2,170,000 | 2,170,000 | 2.376% | 51,599 | 26 | 0 | 2,170,000 | 100.00% | 0.21% | 2.38% | 0.01% | |
| 1-Apr-2010 | 31-Mar-2040 | 2,819,283 | 2,819,283 | 1.000% | 28,193 | 27 | 0 | 2,819,283 | 100.00% | 0.28% | 1.00% | 0.00% | |
| | | | | | | | \$1,061,984,996 | \$1,013,055,512 | | 100.00% | | 6.17% | |
| | | | | | | | \$18,376,416 | \$1,063,508,580 | | | | | |

PA AMERICAN WATER - TOTAL COMPANY EXCLUDING WASTEWATER SPECIFIC FINANCING
 SCHEDULE OF DEBT AT DECEMBER 31, 2010

| DATE OF ISSUE | DATE OF MATURITY | AMOUNT ISSUED | AMOUNT OUTSTANDING | COUPON RATE | ANNUAL INTEREST | NOTE # | ISSUANCE EXPENSE | NET PROCEEDS | NET PROCEEDS Ratio | PERCENT TO TOTAL | EFFECTIVE COST RATE | WEIGHTED COST RATE | |
|----------------------------------|------------------|---------------|--------------------|-------------|-----------------|--------|------------------|-----------------|--------------------|------------------|---------------------|--------------------|--|
| Bonds and Notes | | | | | | | | | | | | | |
| 1-Nov-1993 | 1-Nov-2033 | 35,000,000 | 38,000,000 | 6.780% | 2,576,400 | | 174,946 | 37,825,054 | 99.54% | 3.83% | 6.81% | 0.27% | |
| 1-Sep-1996 | 1-Sep-2026 | 150,000,000 | 150,000,000 | 7.800% | 11,700,000 | | 2,069,648 | 147,930,352 | 98.62% | 15.53% | 7.92% | 1.23% | |
| 24-Aug-1969 | 1-Aug-2019 | 15,500,000 | 15,500,000 | 9.710% | 1,505,050 | | 165,469 | 15,334,531 | 98.93% | 1.60% | 9.82% | 0.16% | |
| 15-Feb-1991 | 15-Jan-2021 | 20,000,000 | 20,000,000 | 9.690% | 1,938,000 | | 116,061 | 19,883,939 | 99.42% | 2.07% | 9.75% | 0.20% | |
| 1-Nov-1991 | 1-Nov-2031 | 10,000,000 | 10,000,000 | 8.820% | 882,000 | | 88,352 | 9,911,648 | 99.12% | 1.04% | 8.90% | 0.09% | |
| 15-Aug-1995 | 1-Aug-2025 | 10,000,000 | 10,000,000 | 8.150% | 815,000 | | 60,119 | 9,939,881 | 99.40% | 1.04% | 8.20% | 0.08% | |
| 1-Nov-1997 | 1-Nov-2017 | 33,000,000 | 33,000,000 | 7.080% | 2,336,400 | | 551,683 | 32,448,317 | 98.33% | 3.42% | 7.24% | 0.25% | |
| 1-Jul-1996 | 1-Jul-2001 | 16,700,000 | 16,700,000 | 6.750% | 1,127,250 | 21 | 1,335,312 | 15,364,688 | 92.00% | 1.73% | 7.39% | 0.13% | |
| 1-Sep-1988 | 1-Sep-2018 | 18,250,000 | 18,250,000 | 6.000% | 1,095,000 | 21 | 906,630 | 17,343,370 | 95.03% | 1.85% | 6.37% | 0.12% | |
| 30-Sep-1991 | 15-Mar-2019 | 17,950,000 | 17,950,000 | 6.100% | 1,094,950 | 21 | 957,808 | 16,992,192 | 94.66% | 1.86% | 6.52% | 0.12% | |
| 1-Apr-2001 | 29-Mar-2011 | 47,000,000 | 3,400,000 | 6.870% | 233,580 | 3 | 320,648 | 46,679,352 | 99.32% | 0.35% | 6.97% | 0.02% | |
| 31-Dec-2006 | 21-Dec-2016 | 13,800,000 | 13,800,000 | 5.520% | 761,760 | | 45,774 | 13,754,226 | 99.67% | 1.43% | 5.56% | 0.08% | |
| 31-Dec-2006 | 21-Dec-2016 | 65,900,000 | 65,900,000 | 5.620% | 3,703,580 | | 218,587 | 65,681,413 | 99.67% | 6.82% | 5.66% | 0.39% | |
| 31-Dec-2006 | 21-Dec-2021 | 100,300,000 | 100,300,000 | 5.770% | 5,787,310 | | 332,690 | 99,967,310 | 99.67% | 10.36% | 5.80% | 0.60% | |
| 31-Mar-2007 | 29-Mar-2022 | 80,000,000 | 80,000,000 | 4.750% | 3,800,000 | 19 | 261,178 | 79,738,822 | 99.67% | 8.28% | 4.78% | 0.40% | |
| 15-May-2008 | 15-May-2018 | 81,000,000 | 81,000,000 | 6.250% | 5,062,500 | | 293,994 | 80,706,006 | 99.64% | 8.38% | 6.30% | 0.53% | |
| 1-Jun-1999 | 1-Jun-2029 | 24,030,000 | 23,455,000 | 5.050% | 1,184,478 | | 1,191,705 | 22,838,294 | 95.04% | 2.43% | 5.39% | 0.13% | |
| 1-Aug-2004 | 1-Aug-2034 | 40,000,000 | 38,580,000 | 4.800% | 1,852,320 | | 2,216,014 | 37,783,986 | 94.46% | 3.99% | 5.17% | 0.21% | |
| 23-Sep-2004 | 1-Sep-2034 | 19,000,000 | 19,000,000 | 4.950% | 940,500 | | 1,355,440 | 17,644,560 | 92.87% | 1.97% | 5.43% | 0.11% | |
| 23-Sep-2004 | 1-Sep-2034 | 30,000,000 | 30,000,000 | 5.100% | 1,530,000 | | 2,566,355 | 27,433,645 | 91.45% | 3.11% | 5.70% | 0.18% | |
| 1-Dec-2009 | 1-Dec-2039 | 80,000,000 | 80,000,000 | 5.500% | 4,400,000 | 22 | 1,306,669 | 78,693,331 | 98.37% | 8.28% | 5.61% | 0.46% | |
| 1-Dec-2009 | 1-Dec-2039 | 13,165,000 | 13,165,000 | 5.500% | 724,075 | 22 | 347,489 | 12,817,511 | 97.36% | 1.36% | 5.68% | 0.08% | |
| 1-Apr-2009 | 1-Apr-2039 | 35,000,000 | 33,000,000 | 6.200% | 2,046,000 | | 425,844 | 32,574,155 | 98.71% | 3.42% | 6.30% | 0.22% | |
| | | | | | | | | \$17,769,912 | | 100.00% | | 6.16% | |
| Water Facility Restoration Loans | | | | | | | | \$58,188,157 | | 100.00% | | | |
| 1-Mar-1996 | 1-Nov-2012 | 1,955,878 | 359,098 | 3.450% | 12,389 | | 27,553 | 1,928,315 | 98.59% | 0.04% | 3.56% | 0.00% | |
| Pennvest Loans | | | | | | | | | | | | | |
| 1-Jun-1988 | 1-Apr-2011 | 263,442 | 5,799 | 1.000% | 58 | 4 | 0 | 263,442 | 100.00% | 0.00% | 1.00% | 0.00% | |
| 1-Aug-2001 | 1-May-2018 | 6,656,399 | 2,595,516 | 1.364% | 35,092 | 6 | 110,635 | 6,545,764 | 96.34% | 0.26% | 1.50% | 0.00% | |
| 1-Jan-2000 | 1-Jan-2018 | 1,391,436 | 601,509 | 2.566% | 15,435 | 5 | 69,942 | 1,321,494 | 94.97% | 0.05% | 2.93% | 0.00% | |
| 1-Jul-2000 | 1-Feb-2019 | 2,926,847 | 1,321,239 | 2.905% | 38,382 | 7 | 29,069 | 2,897,778 | 98.01% | 0.14% | 2.97% | 0.00% | |
| 1-Jan-2003 | 1-Dec-2022 | 3,945,656 | 2,420,516 | 2.774% | 67,145 | 13 | 8,480 | 3,937,176 | 98.78% | 0.25% | 2.79% | 0.01% | |
| 1-Oct-2000 | 1-Oct-2019 | 1,728,987 | 1,043,638 | 2.795% | 29,170 | 8 | 0 | 1,728,987 | 100.00% | 0.11% | 2.80% | 0.00% | |
| 1-Feb-2020 | 1-Feb-2020 | 3,470,505 | 1,840,623 | 1.184% | 21,793 | 10 | 17,155 | 3,453,350 | 98.51% | 0.19% | 1.21% | 0.00% | |
| 1-Apr-2000 | 1-Mar-2022 | 3,366,155 | 2,077,651 | 3.237% | 67,254 | 9 | 56,803 | 3,309,352 | 98.31% | 0.22% | 3.35% | 0.01% | |
| 1-Apr-2000 | 1-Mar-2022 | 3,623,800 | 2,235,931 | 3.237% | 72,377 | 11 | 25,430 | 3,598,370 | 98.30% | 0.23% | 3.28% | 0.01% | |
| 30-Aug-2000 | 1-Sep-2022 | 4,322,665 | 2,698,277 | 3.237% | 87,343 | 12 | 25,445 | 4,297,220 | 98.41% | 0.28% | 3.27% | 0.01% | |
| 1-Aug-2004 | 1-Jul-2024 | 1,593,205 | 911,399 | 2.774% | 25,282 | 16 | 13,749 | 1,583,456 | 99.12% | 0.09% | 2.83% | 0.00% | |
| 1-Jun-2005 | 1-Nov-2024 | 5,721,348 | 3,936,440 | 1.156% | 45,505 | 17 | 29,484 | 5,696,956 | 99.48% | 0.41% | 1.19% | 0.00% | |
| 1-Jan-2006 | 1-Dec-2025 | 5,366,606 | 3,461,279 | 1.385% | 47,939 | 18 | 34,130 | 5,332,149 | 99.37% | 0.36% | 1.42% | 0.01% | |
| 1-Sep-2004 | 1-Aug-2024 | 5,240,631 | 3,689,575 | 2.774% | 102,349 | 14 | 7,951 | 5,232,680 | 98.85% | 0.39% | 2.78% | 0.01% | |
| 1-Nov-2004 | 1-Oct-2024 | 3,099,441 | 2,206,868 | 2.432% | 53,672 | 15 | 5,660 | 3,083,781 | 99.82% | 0.23% | 2.44% | 0.01% | |
| 1-Oct-2009 | 1-Sep-2029 | 12,241,702 | 2,310,839 | 1.274% | 29,440 | 0 | 0 | 2,241,702 | 100.00% | 0.24% | 1.27% | 0.00% | |
| 1-Apr-2010 | 31-Mar-2035 | 12,150,000 | 12,150,000 | 1.559% | 189,419 | 23 | 0 | 12,150,000 | 100.00% | 1.26% | 1.56% | 0.02% | |
| 1-Apr-2010 | 31-Mar-2035 | 2,125,000 | 2,125,000 | 1.799% | 38,229 | 24 | 0 | 2,125,000 | 100.00% | 0.22% | 1.80% | 0.00% | |
| 1-Jul-2010 | 30-Jun-2035 | 2,125,000 | 2,125,000 | 1.599% | 33,979 | 25 | 0 | 2,125,000 | 100.00% | 0.22% | 1.60% | 0.00% | |
| 1-Jul-2010 | 30-Jun-2035 | 2,170,000 | 2,170,000 | 2.376% | 51,559 | 26 | 0 | 2,170,000 | 100.00% | 0.22% | 2.38% | 0.01% | |
| 1-Apr-2010 | 31-Mar-2040 | 2,819,283 | 2,819,283 | 1.000% | 28,193 | 27 | 0 | 2,819,283 | 100.00% | 0.28% | 1.00% | 0.00% | |
| | | | | | | | | \$966,055,512 | | 100.00% | | 6.16% | |
| | | | | | | | | \$1,017,115,084 | | 100.00% | | | |

PENNSYLVANIA AMERICAN WATER COMPANY
SCHEDULE OF PREFERRED STOCK AT DECEMBER 2009

| SERIES | DATE OF ISSUE | AVG TERM (YRS) | PRINCIPAL AMOUNT ISSUED | AMOUNT OUTSTANDING | EXPENSE | NET PROCEEDS | PERCENT TO TOTAL | EFFECTIVE COST RATE | WEIGHTED COST RATE |
|--------|---------------|----------------|-------------------------|--------------------|---------|--------------|------------------|---------------------|--------------------|
| | | | | | | | | | |
| 4.50% | 2-Dec-40 | (3) | 2,000,000 | 1,720,200 | - | 2,000,000 | 12.14% | 4.50% | 0.55% |
| 9.75% | 23-Apr-71 | 19.5 | 300,000 | 178,000 | 5,473 | 294,527 | 1.26% | 9.96% | 0.13% |
| 9.35% | 23-Apr-71 | 22.5 | 425,000 | 273,500 | 7,275 | 417,725 | 1.93% | 9.53% | 0.18% |
| 8.49% | 21-Nov-91 | 25.5 | 12,000,000 | 12,000,000 | 82,714 | 11,917,286 | 84.68% | 8.56% | 7.25% |
| | | | 14,725,000 | 14,171,700 | 95,462 | 14,629,538 | 100.00% | | 8.11% |

Notes:

- (1) Determined by taking into account the effect of the annual sinking fund requirements which are met by the retirement of stock which reduce the term of each issue
- (2) The effective cost for each issue is the yield to maturity using as inputs the average term of issue, stated dividend rate, and net proceeds ratio.
- (3) Series without sinking fund requirements are outstanding in perpetuity. For those series, the effective cost rate is the stated dividend rate divided by the net proceeds ratio.

**PENNSYLVANIA AMERICAN WATER COMPANY
SCHEDULE OF PREFERRED STOCK AT DECEMBER 2010**

| SERIES | DATE OF ISSUE | AVG TERM (YRS) | PRINCIPAL AMOUNT ISSUED | AMOUNT OUTSTANDING | EXPENSE | NET PROCEEDS | PERCENT TO TOTAL | (2) | |
|--------|---------------|----------------|-------------------------|--------------------|---------|--------------|------------------|---------------------|--------------------|
| | | | | | | | | EFFECTIVE COST RATE | WEIGHTED COST RATE |
| 4.50% | 2-Dec-40 | (3) | 2,000,000 | 1,720,200 | - | 2,000,000 | 12.14% | 4.50% | 0.55% |
| 9.75% | 23-Apr-71 | 19.5 | 300,000 | 178,000 | 5,473 | 294,527 | 1.26% | 9.96% | 0.13% |
| 9.35% | 23-Apr-71 | 22.5 | 425,000 | 273,500 | 7,275 | 417,725 | 1.93% | 9.53% | 0.18% |
| 8.49% | 21-Nov-91 | 25.5 | 12,000,000 | 12,000,000 | 82,714 | 11,917,286 | 84.68% | 8.56% | 7.25% |
| | | | 14,725,000 | 14,171,700 | 95,462 | 14,629,538 | 100.00% | | 8.11% |

Notes:

(1) Determined by taking into account the effect of the annual sinking fund requirements which are met by the retirement of stock which reduce the term of each issue

(2) The effective cost for each issue is the yield to maturity using as inputs the average term of issue, stated dividend rate, and net proceeds ratio.

(3) Series without sinking fund requirements are outstanding in perpetuity. For those series, the effective cost rate is the stated dividend rate divided by the net proceeds ratio.

Pennsylvania-American Water Company
 Coatesville Wastewater Operations
 Data Requirements of the Pennsylvania Public Utility Commission

FR VII.5

Pennsylvania-American Water Company
Coatesville Wastewater Operations
VII. Rate of Return

5. Supply financial data of Company and/or Parent for last five years:
- a. Earnings-price ratio (average)
 - b. Earnings-book value ratio (per share basis) (avg. book value)
 - c. Dividend yield (average)
 - d. Earnings per share (dollar)
 - e. Dividends per share (dollars)
 - f. Average book value per share yearly
 - g. Average yearly market price per share (monthly high-low basis)
 - h. Pre-tax funded debt interest coverage
 - i. Post-tax funded debt interest coverage
 - j. Market price-book value ratio

Answer:

Below is Financial data of the Parent, American Water Works Co, Inc. for the last 5 years

| | 2005 | 2006 | 2007 | 2008 | 2009 |
|-------------------------------------------------------------------|---------------|---------------|---------------|---------------|---------------|
| a. Earnings-price ratio (average) | - | - | - | - | \$(14.50) |
| b. Earnings-book value ratio (per share basis) (avg. book value) | - | - | - | - | \$(16.41) |
| c. Dividend yield (average) | - | - | - | - | 3.8% |
| d. Earnings per share (dollar) | - | - | - | \$(3.52) | \$(1.39) |
| e. Dividends per share (dollars) Note 1 | - | - | - | \$0.40 | \$0.82 |
| f. Average book value per share yearly Note 4 | 18.54 | 20.69 | 26.12 | 27.01 | \$22.81 |
| g. Average yearly market price per share (monthly high-low basis) | n/a | n/a | n/a | \$20.71 | \$20.16 |
| h. Pre-tax funded debt interest coverage | Note 2 | Note 2 | Note 2 | Note 2 | Note 2 |
| i. Post-tax funded debt interest coverage | Note 2 | Note 2 | Note 2 | Note 2 | Note 2 |
| j. Market price-book value ratio Note 3 | n/a | n/a | n/a | 0.766753 | 0.883823 |

Note 1 – 2008 dividends paid twice @ \$.20 ea.

Note 2 – For interest coverage of the company, please see Paul Moul Exhibit No.9-A, schedule 2.

Note 3 – Calculated as follows: item g. divided by item f.

Note 4 - Average of quarterly ending prices.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.6

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

6. Provide AFUDC charged by company at historic test year-end and latest date, explain method by which rate was calculated and provide workpaper showing derivation of the Company's current AFUDC rate.

Answer: The Company is using the AFUDC methodology proposed by the OTS and adopted by the Commission in PAWC's rate proceeding at Docket No. R-922428. Attachment A contains a memo dated May 7, 1993, which explains the calculations necessary to derive the AFUDC rate. Attachment B sets forth the detailed calculation for the month of December 2009.

In addition, for the portion of the new wastewater treatment plant funded by the \$47 million PEDFA financing, the applicable portion of the PEDFA interest expense less interest earned on the restricted funds during the period of construction was recorded as AFUDC.

ATTACHMENT A

Pennsylvania-American Water Company

800 West Hershey Park Drive • P.O. Box 888 • Hershey, PA 17033-0888
(717) 533-5000

TO: J. L. Nader
FROM: Pete Mecca
DATE: May 7, 1993
RE: Revised Calculation of AFUDC

In order to comply with a recent PUC order, it will be necessary to modify the method of calculating AFUDC for inclusion into rate base.

The new calculation shall be as follows:

Short Term Debt Portion

A. Daily Short Term Debt Outstanding + Beginning Balance
Number Of Days In Month + 1

÷

B. Average Balance In CWIP Prior To Transfers To Plant For The Month

X

C. Federal Funds Rate At Month End + Applicable Basis Points

Other Capital Portion

+

D. 1 - % Calculated In A. Above

X

E. Cost Of Capital Allowed In Latest Rate Case



ATTACHMENT B

PENNSYLVANIA-AMERICAN WATER COMPANY
 AFUDC CALCULATION BASED ON SHORT TERM DEBT
 FOR: December 2009

| | | | |
|---|---------------------------------------------------------|-----------------------------------------------|-----------------------|
| A | Average Daily Borrowing : (Provided by Cash Management) | | <u>62,636,958</u> |
| B | Beginning balance of CWIP | 41,831,000 | |
| | Ending Balance prior to Transfer | 61,303,372 | |
| | Average CWIP balance | | <u>51,567,186</u> |
| | Short term debt % (A / B) | | 100.00% |
| | | WA Debt Rate | |
| C | AMERICAN WATER CAPITAL CORPORATION | 0.003437 | |
| | Weighted Debt Rate | | 0.003437 |
| | Short term debt % X Adj Fed Funds Rate | | <u>0.3437% DEBT</u> |
| D | 1 - % calculated in B | | 0.000000 |
| E | Cost of Capital allowed in latest rate case | Latest RRD Statement - Rate Case 11/06/09-per | 8.56% |
| F | Other capital % (D X E) | | <u>0.0000% EQUITY</u> |
| G | AFUDC Rate per annum (C + F) | | <u>0.3437%</u> |
| | | DEBT | EQUITY |
| | AFUDC rate per month | 0.0286% | 0.0000% |
| | AFUDC rate per half-month | 0.0143% | 0.0000% |
| | AFUDC rate per quarter-month | 0.0072% | 0.0000% |
| | | | TOTAL |
| | | | 0.0286% |
| | | | 0.0143% |
| | | | 0.0072% |

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.7

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

7. Set forth provisions of Company's and Parent's charter and indentures, if applicable, which describe coverage requirements, limits on proportions of types of capital outstanding, and restrictions on dividend payouts.

Answer: Coverage Requirements:

The Twenty-Fifth Supplemental Indenture dated as of June 1, 1999, supplemental to The Indenture of Mortgage dated May 1, 1968, states that so long as any of the bonds of the 1999 Series A are outstanding, without the consent of the registered owners of at least sixty-six and two-thirds per cent (66-2/3%) in principal amount of the bonds of the 1999 Series A then outstanding, the Company shall not issue and the Trustee shall not authenticate additional bonds under Section 2.03 and Section 2.04 of the Original Indenture unless the net income of the Company has been equal to at least one and one-half times the aggregate annual interest charges on all Long Term Debt outstanding immediately after such bonds are issued.

The Company shall meet the requirements of this Section by delivering to the Trustee (together with the resolutions, opinions, certificates and instruments provided for in Section 2.03 and section 2.04) a "Certificate of Required Net Income for Debt" which shall state in substance that the net income of the Company, calculated as hereinafter provided, for a period of twelve consecutive calendar months within the fifteen calendar months immediately preceding the first day of the month in which the additional bonds are to be issued by the Trustee has been equal to at least one and one-half times the aggregate annual interest charges on all Long Term Debt of the Company to be outstanding immediately after such bonds are issued; provided, however, that in all calculations of such net income effect shall be given to the issue or retirement of any indebtedness that will be accomplished prior to or on the date of such issue and there shall be excepted from such Long Term Debt any thereof for the payment or redemption of which moneys in the necessary amounts have been

irrevocably set aside by the Company or deposited with the Trustee or other holder of a mortgage or other lien securing any such Long Term Debt.

Limits:

The Twenty-Fifth Supplemental Indenture dated as of June 1, 1999, supplemental to The Indenture of Mortgage dated May 1, 1968, limits the issuance of bonds, so that the principal amount of all the outstanding long-term debt does not exceed 65% of the total capitalization of the Company.

Dividend Restriction:

The Twenty-Fifth Supplemental Indenture dated as of June 1, 1999, states that so long as any bonds of the 1999 Series A are outstanding, without the consent of the registered owners of a least sixty-six and two-thirds per cent ($66\frac{2}{3}\%$) in principal amount of the bonds of the 1999 Series A then outstanding, if any, no dividends shall be declared or paid on any shares of Common Stock of the Company (except dividends payable solely in the shares of its Common Stock), nor shall any shares of Common Stock of the Company be purchased or otherwise acquired by the Company, if immediately after or as the result of any such declaration, payment, purchase or other acquisition, the sum of the aggregate of the capital of the Company attributable to its Common Stock plus the amount of all surplus accounts of the Company would be reduced to less than \$ 42,000,000. In determining the aggregate of the capital of the Company attributable to its Common Stock and the amount of all surplus accounts for the purpose hereof, any write-up or write-down of assets or write-off of the excess over original cost of property made on the books of the Company subsequent to December 31, 1980, shall be disregarded.

Pennsylvania-American Water Company
 Coatesville Wastewater Operations
 Data Requirements of the Pennsylvania Public Utility Commission

FR VII.8

**Pennsylvania-American Water Company
 Coatesville Wastewater Operations**

VII. Rate of Return

8. Attach copies of the summaries of the Company's projected revenues, expenses and capital budgets for the next two years.

Answer: Please see below for a summary of the total Company's projected revenues, expenses and capital budget for 2010 and 2011.

| DESCRIPTION | 2010 | 2011 |
|-------------------------------|-------------|-------------|
| Revenues | 503,353 | 517,488 |
| Operating Expenses | 224,596 | 245,128 |
| Depreciation and Amortization | 59,087 | 60,280 |
| Taxes Other Than Income | 13,926 | 13,256 |
| Income Taxes | 58,070 | 54,438 |
| Utility Operating Income | 147,674 | 144,386 |
| Income Deductions | 60,077 | 62,806 |
| Net Income to Common | 87,597 | 81,580 |

| DESCRIPTION | 2010 | 2011 |
|----------------------------------|-------------|-------------|
| Gross | 204,012 | 264,952 |
| Refunds /Contributions/ Advances | 11,567 | 13,000 |
| Net | 192,445 | 251,952 |

The amounts above are based upon budget information that was prepared in 2009. It includes wastewater operations along with other forward looking assumptions that are subject to change.

*The Company is currently in the process of updating the projections for 2011 through its normal annual budgeting process.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.9

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

9. Describe long-term debt reacquisitions by Company and Parent as follows:
- a. Reacquisitions by issue by year.
 - b. Total gain on reacquisitions by issue by year.
 - c. Accounting of gain for income tax and book purposes.

Answer: Pennsylvania-American Water did not reacquire any long term debt in 2007 or 2008. Pennsylvania-American Water had \$52.9M in 3 variable rate tax-exempt bonds that it was unable to remarket. The Company was required to purchase and hold these bonds in house and remarketed them to fixed rates in 2009.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.10

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

10. Provide the following information concerning compensating bank balances requirements for the actual test year:
- a. Name of each bank
 - b. Address of each bank
 - c. Type of accounts with each bank (checking, savings, escrow, other services, etc.)
 - d. Average Daily Balance in each account
 - e. Amount and percentage requirements for compensating bank balances at each bank
 - f. Average daily compensating bank balance at each bank
 - g. Documents from each bank explaining compensating bank balance requirements
 - h. Interest earned on each type of account

Answer: The only bank account with potential compensating balances is the lockbox account noted below:

- a. Bank of New York Mellon
- b. BNY Mellon Client Service Center
500 Ross Street, Suite 1260
Pittsburgh, PA 15262-0001
- c. Lockbox account
- d. Average Daily Balance - \$1,050,261.
- e-h. No compensating bank balances were required during the test year.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.11

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

11. Provide the following information concerning bank notes payable for the actual per book test year:
- a. Line of Credit at each bank.
 - b. Average daily balances of notes payable to each bank, by name of bank.
 - c. Interest rate charged on each bank note (Prime rate, formula)
 - d. Purpose of each bank note (for example, construction, fuel storage, working capital, debt retirement).
 - e. Prospective future need for this type of financing.

Answer:

- a. Pennsylvania-American has a short-term credit facility with American Water Capital Corp (AWCC) that is renewed each year. The authorized limit for 2009/2010 borrowing year is \$134M.
- b. The Average daily balance for 2009 was \$94,251,180.
- c. The blended weighted average interest on short-term borrowings was 0.360% at 12/31/09.
- d. Pennsylvania-American uses the short-term credit facility with AWCC to finance its day-to-day working capital needs.
- e. Pennsylvania-American will require this type of borrowing in the foreseeable future to meet working capital needs.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.12

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

12. Submit details on Company or Parent common stock offerings for the past five year to present as follows:
- a. Date of Prospectus.
 - b. Date of offering.
 - c. Record date.
 - d. Offering period including dates and number of days.
 - e. Amount and number of shares of offering.
 - f. Offering ratio, if rights offering.
 - g. Percent subscribed.
 - h. Offering price.
 - i. Gross proceeds per share.
 - j. Expenses per share.
 - k. Net proceeds per share in i and j above.
 - l. Market price per share.
 - (1) At record date
 - (2) At offering date
 - (3) One month after close of offering
 - m. Average market price during offering.
 - (1) Price per share
 - (2) Rights per share--average value of rights
 - n. Latest reported earnings per share at time of offering.
 - o. Latest reported dividends at time of offering.

Answer:

| | | | |
|----|---------------------------------------------------------|-------------------------------|------------|
| a | Date of Prospectus/supplement | 4/24/2008 | 5/1/2009 |
| b. | Date of offering. | 4/22/2008 | 6/4/2009 |
| c. | Record date. | n/a | n/a |
| d. | Offering period including dates and number of days. | n/a | n/a |
| e. | Amount and number of shares of offering. | 63,173,300 | 11,500,000 |
| f. | Offering ratio, if rights offering. | n/a | n/a |
| g. | Percent subscribed. | n/a | 100% |
| h. | Offering price. | \$21.50 | \$17.25 |
| i. | Gross proceeds per share. | \$21.50-No Proceeds to AWK | \$17.25 |
| j. | Expenses per share. | \$0.65 | \$0.52 |
| k. | Net proceeds per share in i and j above. | \$20.855-No Proceeds to AWK | |
| l. | Market price per share. | | |
| | 1 At record date | n/a | n/a |
| | 2 At offering date | \$21.50 | \$17.49 |
| | 3 One month after close of offering | \$20.80 | \$18.62 |
| m. | Average market price during offering. | n/a | n/a |
| | 1 Price per share | n/a | n/a |
| | 2 Rights per share--average value of rights | n/a | n/a |
| n. | Latest reported earnings per share at time of offering. | n/a - Initial Public Offering | |
| o. | Latest reported dividends at time of offering. | n/a - Initial Public Offering | \$0.20 |

There were three secondary offerings of the Company's stock but those were sold by RWE, Ag., the former parent company of American Water Works Company, Inc. and provided no benefit to the Company.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.13

Pennsylvania-American Water Company
Coatesville Wastewater Operations
VII. Rate of Return

13. Attach chart explaining Company's corporate relationship to its affiliates showing System Structure.

Answer: Please see attached.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.14

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

14. If the utility plans to make a formal claim for a specified allowable rate of return, provide the following data in statement or exhibit form:
- a. Claimed capitalization and capitalization ratios with supporting data.
 - b. Claimed cost of long-term debt with supporting data.
 - c. Claimed cost of short-term debt with supporting data.
 - d. Claimed cost of total debt with supporting data.
 - e. Claimed cost of preferred stock with supporting data.
 - f. Claimed cost of common equity with supporting data.

Answer:

- a.– e.) Please see attached
- f. Please refer to Exhibit No. 9-A to support the testimony of Paul R. Moul, the Company's return on equity witness.

Coatesville Wastewater Including PEDFA - Specific Project Financing
 Pennsylvania American Water
 Proforma at December 31, 2010

| | Amount Outstanding | Ratios | Cost Rate | Weighted Cost |
|-------------------------|-----------------------|---------|-----------|---------------|
| Long term debt | \$ 15,071,763 | 19.42% | 6.16% | 1.20% |
| LTD PEDFA Financing | 47,000,000 | 60.55% | 6.30% | 3.81% |
| Preferred Stock | 220,518 | 0.28% | 8.11% | 0.02% |
| Common Equity | 15,335,158 | 19.75% | 11.50% | 2.27% |
| Total Permanent Capital | \$ 77,627,439 | 100.00% | | 7.30% |

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.15

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

15. Supply copies of the following documents for the Company and, if applicable, its parent:
- a. Most recent Annual Report to shareholders including any statistical supplements;
 - b. Most recent SEC Form 10K;
 - c. All SEC Form 10Q reports issued within the preceding 12 months of the date of submittal of the rate increase request.

- Answer:**
- a. Please see attached for the 2009 PA annual report. The Parent company annual report can be accessed through the Investor Relations section of the American Water internet site (<http://amwater.com>).
 - b. Parent company - the Investor Relations / Financial Reporting section of the American Water internet site (<http://amwater.com>).
 - c. See response to part b.

Pennsylvania-American Water Company

**(a wholly-owned subsidiary of
American Water Works Company, Inc.)**

Financial Statements

As of and for the years ended December 31, 2009 and 2008

Report of Independent Auditors

To the Board of Directors and Stockholder of
Pennsylvania-American Water Company

In our opinion, the accompanying balance sheets and statements of capitalization and the related statements of income, of changes in common stockholder's equity and of cash flows present fairly, in all material respects, the financial position of Pennsylvania-American Water Company (a wholly-owned subsidiary of American Water Works Company, Inc.) at December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. 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 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.



March 22, 2010

PENNSYLVANIA-AMERICAN WATER COMPANY
Balance Sheets
December 31, 2009 and 2008
(Dollars in thousands)

| Assets | | |
|-------------------------------------------------------------------------------------------------------------------------------------------|---------------------|---------------------|
| | <u>2009</u> | <u>2008</u> |
| Property, plant and equipment | | |
| Utility plant - at original cost, net of accumulated depreciation of \$695,667 at December 31, 2009 and \$643,430 at December 31, 2008 | \$ 2,356,219 | \$ 2,218,446 |
| Utility plant acquisition adjustments | 14,978 | 16,739 |
| Non-utility property, net of accumulated depreciation of \$776 at December 31, 2009 and \$710 at December 31, 2008 | 321 | 368 |
| Total property, plant and equipment | <u>2,371,518</u> | <u>2,235,553</u> |
| Current assets | | |
| Cash and cash equivalents | 1,179 | 975 |
| Restricted funds | 22,321 | - |
| Customer accounts receivable | 37,448 | 35,304 |
| Allowance for uncollectible accounts | (7,177) | (4,703) |
| Unbilled revenues | 27,766 | 25,381 |
| Taxes receivable | 9,230 | - |
| Accounts receivable - associated companies | 70 | 85 |
| Other accounts receivable, net | 2,190 | 2,433 |
| Materials and supplies | 4,846 | 4,239 |
| Prepaid taxes | 1,608 | 1,560 |
| Other | 513 | 638 |
| Total current assets | <u>99,994</u> | <u>65,912</u> |
| Regulatory and other long-term assets | | |
| Regulatory assets | 181,471 | 168,394 |
| Restricted funds | 16,252 | - |
| Goodwill | 40,223 | 39,973 |
| Other | 57 | 1,173 |
| Total regulatory and other long-term assets | <u>238,003</u> | <u>209,540</u> |
| Total assets | <u>\$ 2,709,515</u> | <u>\$ 2,511,005</u> |

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

PENNSYLVANIA-AMERICAN WATER COMPANY
Balance Sheets
December 31, 2009 and 2008
(Dollars in thousands)

| Capitalization and liabilities | | |
|----------------------------------------------------------------------------|---------------------|---------------------|
| | 2009 | 2008 |
| Capitalization | | |
| Common stockholder's equity | \$ 943,551 | \$ 868,173 |
| Preferred stock without mandatory redemption requirements | 1,720 | 1,720 |
| Long-term debt, excluding current portion | | |
| Redeemable preferred stock at redemption value | 12,451 | 12,451 |
| Long-term debt | 992,058 | 864,226 |
| Total capitalization | <u>1,949,780</u> | <u>1,746,570</u> |
| Current liabilities | | |
| Notes payable - associated companies | 10,939 | 90,611 |
| Current portion of long-term debt | 6,390 | 59,331 |
| Accounts payable | 27,795 | 19,503 |
| Accounts payable - associated companies | 2,554 | 1,839 |
| Accrued interest | 13,708 | 11,209 |
| Accrued taxes, including income taxes of \$3,348 in 2009 and \$132 in 2008 | 4,184 | 1,282 |
| Accrued expenses | 7,705 | 12,307 |
| Other | 15,886 | 17,677 |
| Total current liabilities | <u>89,161</u> | <u>213,759</u> |
| Regulatory and other long-term liabilities | | |
| Deferred income taxes | 444,388 | 341,740 |
| Advances for construction | 88,307 | 83,040 |
| Deferred investment tax credits | 6,774 | 7,008 |
| Accrued pension expense | 10,820 | 10,224 |
| Accrued postretirement benefit expense | 4,016 | 3,642 |
| Regulatory liability - debt extinguishment | 2,061 | 2,546 |
| Regulatory liability - gain on acquisition | 781 | - |
| Other tax liabilities | 8,785 | - |
| Other | 223 | 238 |
| Total regulatory and other long-term liabilities | <u>566,155</u> | <u>448,438</u> |
| Contributions in aid of construction | 104,419 | 102,238 |
| Commitments and contingencies (See Note 18) | - | - |
| Total capitalization and liabilities | <u>\$ 2,709,515</u> | <u>\$ 2,511,005</u> |

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

PENNSYLVANIA-AMERICAN WATER COMPANY
Statements of Income
December 31, 2009 and 2008
(Dollars in thousands)

| | <u>2009</u> | <u>2008</u> |
|-------------------------------------------------------|------------------|------------------|
| Operating revenues | \$ 459,813 | \$ 447,917 |
| Operating expenses | | |
| Operation and maintenance | 204,516 | 199,507 |
| Depreciation | 56,376 | 53,258 |
| Amortization | 384 | 153 |
| General taxes | 11,962 | 12,123 |
| Gain on disposition of property | (35) | (26) |
| Total operating expenses, net | <u>273,203</u> | <u>265,015</u> |
| Operating income | <u>186,610</u> | <u>182,902</u> |
| Other income (deductions) | | |
| Interest on long-term debt | (55,667) | (52,220) |
| Interest on short-term debt | (705) | (1,905) |
| Other interest, net | 55 | 48 |
| Allowance for other funds used during construction | 25 | 670 |
| Allowance for borrowed funds used during construction | 247 | 577 |
| Amortization of debt issuance costs | (2,028) | (2,043) |
| Other, net | (117) | (67) |
| Total other deductions | <u>(58,190)</u> | <u>(54,940)</u> |
| Income before income taxes | 128,420 | 127,962 |
| Provision for income taxes | <u>51,693</u> | <u>52,204</u> |
| Net income | 76,727 | 75,758 |
| Dividends on preferred stock | 77 | 77 |
| Net income available to common stockholder | <u>\$ 76,650</u> | <u>\$ 75,681</u> |

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

PENNSYLVANIA-AMERICAN WATER COMPANY
Statements of Cash Flows
December 31, 2009 and 2008
(Dollars in thousands)

| | <u>2009</u> | <u>2008</u> |
|-----------------------------------------------------------------------------------------------------------------------|------------------|------------------|
| Cash flows from operating activities | | |
| Net income | \$ 76,727 | \$ 75,758 |
| Adjustments | | |
| Depreciation and amortization | 56,760 | 53,411 |
| Amortization of removal costs, net of salvage | 5,004 | 4,919 |
| Amortization of debt issuance costs | 2,028 | 2,043 |
| Provision for deferred income taxes | 100,190 | 41,013 |
| Amortization of deferred investment tax credits | (233) | (233) |
| Provision for losses on accounts receivable | 7,550 | 3,942 |
| Allowance for other funds used during construction | (25) | (670) |
| Gain on disposition of property | (35) | (26) |
| Pension and non-pension postretirement benefits | 22,317 | 11,484 |
| Other, net | (2,648) | 11,364 |
| Changes in assets and liabilities | | |
| Accounts receivable and unbilled revenues | (9,605) | (8,168) |
| Other current assets | (295) | (568) |
| Pension and non-pension postretirement benefit contributions | (21,721) | (18,698) |
| Accounts payable | (3,416) | (2,129) |
| Accrued taxes, including federal income | 2,457 | (25,471) |
| Other current liabilities | 321 | 1,545 |
| Net cash provided by operating activities | <u>235,376</u> | <u>149,516</u> |
| Cash flows from investing activities | | |
| Capital expenditures | (169,643) | (202,277) |
| Acquisitions | (6,935) | (8,243) |
| Removal costs from property, plant and equipment retirements, net of salvage | (9,135) | (7,399) |
| Proceeds from the disposition of property, plant and equipment | 40 | 27 |
| Net restricted funds released | 41,427 | - |
| Net cash used in investing activities | <u>(144,246)</u> | <u>(217,892)</u> |
| Cash flows from financing activities | | |
| Proceeds from issuance of long-term debt | 55,142 | 85,941 |
| Repayment of long-term debt | (60,251) | (11,998) |
| Debt issuance costs | (4,104) | (293) |
| Net (repayments) borrowings of notes payables - associated companies | (79,672) | 11,603 |
| Advances and contributions for construction, net of refunds net of refunds of \$5,112 in 2009 and \$10,689 in 2008 | (333) | 3,673 |
| Capital contribution | 53,700 | 33,000 |
| Dividends paid | (55,408) | (54,744) |
| Net cash (used in) provided by financing activities | <u>(90,926)</u> | <u>67,182</u> |
| Net increase (decrease) in cash and cash equivalents | 204 | (1,194) |
| Cash and cash equivalents at beginning of period | 975 | 2,169 |
| Cash and cash equivalents at end of period | <u>\$ 1,179</u> | <u>\$ 975</u> |
| Cash paid during the year for: | | |
| Interest, net of capitalized amount | \$ 54,464 | \$ 54,277 |
| Income taxes, net of refunds of \$74 in 2009 and \$0 in 2008 | \$ 66,885 | \$ 37,397 |
| Non-cash investing activity | | |
| Capital expenditures acquired on account but unpaid as of year end | \$ 23,450 | \$ 18,823 |
| Non-cash financing activity | | |
| Long-term debt | \$ 80,000 | \$ - |
| Capital contribution by stockholder | \$ 359 | \$ 330 |

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

PENNSYLVANIA-AMERICAN WATER COMPANY
Statements of Capitalization
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

| | Call Price Per Share | 2009 | 2008 |
|----------------------------------------------------------------------------------------------------------------------------|-------------------------|----------------|----------------|
| Stockholder's equity | | | |
| Common stock - \$5.50 par value, authorized 10,000,000 shares, 3,910,343 shares issued and outstanding in 2009 and 2008 | \$ | 21,507 | \$ 21,507 |
| Paid-in capital | | 607,873 | 553,814 |
| Retained earnings | | 314,171 | 292,852 |
| Total common stockholder's equity | | <u>943,551</u> | <u>868,173</u> |
| Preferred stocks - \$100 par value, authorized 367,200 shares | | | |
| Cumulative preferred stocks, without mandatory redemption requirements: | | | |
| 4 1/2% series, 17,202 shares outstanding in 2009 and 2008 | \$ 103.50 | 1,720 | 1,720 |
| Long-term debt | | | |
| Cumulative preferred stocks, with mandatory redemption requirements: | | | |
| 8.49% series, 120,000 shares outstanding in 2009 and 2008 due 11/1/2036 | \$ 100.00 | 12,000 | 12,000 |
| 9.35% series, 2,735 shares outstanding in 2009 and 2008 due 01/15/2024 | | 273 | 273 |
| 9.75% series, 1,780 shares outstanding in 2009 and 2008 due 01/15/2019 | | 178 | 178 |
| | | <u>12,451</u> | <u>12,451</u> |
| Notes payable to affiliate | | | |
| 6.87% due 2011 | | 6,800 | 10,200 |
| 6.00% due 2018 (variable rate in 2008 with effective rate 1.15% at December 31, 2008) | | 18,250 | 18,250 |
| 6.10% due 2019 (variable rate in 2008 with effective rate 2.20% at December 31, 2008) | | 17,950 | 17,950 |
| 6.75% due 2031 (variable rate in 2008 with effective rate 2.20% at December 31, 2008) | | 16,700 | 16,700 |
| 5.52% due 2016 | | 13,800 | 13,800 |
| 6.25% due 2018 | | 81,000 | 81,000 |
| 5.62% due 2018 | | 65,900 | 65,900 |
| 5.77% due 2021 | | 100,300 | 100,300 |
| 5.77% due 2022 | | 80,000 | 80,000 |
| General mortgage bonds | | | |
| 7.08% due 2017 | | 33,000 | 33,000 |
| 9.71% due 2019 | | 15,500 | 15,500 |
| 9.69% due 2021 | | 20,000 | 20,000 |
| 8.15% due 2025 | | 10,000 | 10,000 |
| 7.80% due 2026 | | 150,000 | 150,000 |
| 5.05% due 2029 | | 23,455 | 23,780 |
| 3.60% due 2032 | | - | 13,165 |
| 3.60% due 2033 | | - | 80,000 |
| 5.50% due 2039 | | 13,165 | - |
| 5.50% due 2039 | | 80,000 | - |
| 8.82% due 2031 | | 10,000 | 10,000 |

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

PENNSYLVANIA-AMERICAN WATER COMPANY
Statements of Capitalization
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

| | <u>2009</u> | <u>2008</u> |
|-------------------------------------------|---------------------|---------------------|
| Long-term debt (continued) | | |
| 6.78% due 2033 | 38,000 | 38,000 |
| 4.95% due 2034 | 19,000 | 19,000 |
| 5.10% due 2034 | 30,000 | 30,000 |
| 4.80% due 2034 | 39,190 | 39,770 |
| 6.20% due 2039 | 80,000 | - |
| Water facility loans: | | |
| 3.25% due 2009 | - | 34 |
| 4.19% due 2009 | - | 78 |
| 4.19% due 2009 | - | 58 |
| 1.00% due 2011 | 23 | 41 |
| 3.45% due 2012 | 537 | 709 |
| 1.38% due 2018 | 2,858 | 3,176 |
| 2.57% due 2018 | 678 | 752 |
| 2.80% due 2019 | 1,146 | 1,246 |
| 2.91% due 2019 | 1,463 | 1,600 |
| 1.18% due 2020 | 2,030 | 2,216 |
| 3.24% due 2022 | 2,398 | 2,555 |
| 3.24% due 2022 | 2,884 | 3,064 |
| 3.24% due 2022 | 2,228 | 2,374 |
| 2.77% due 2022 | 2,588 | 2,751 |
| 2.77% due 2024 | 3,909 | 4,139 |
| 2.43% due 2024 | 2,340 | 2,479 |
| 2.77% due 2024 | 966 | 1,023 |
| 1.39% due 2025 | 3,977 | 4,486 |
| 1.00% due 2024 | 4,199 | 4,461 |
| 1.27% due 2029 | 2,214 | - |
| | <u>998,448</u> | <u>923,557</u> |
| Less: Current portion of long-term debt | <u>(6,390)</u> | <u>(59,331)</u> |
| Long-term debt, net of current maturities | <u>992,058</u> | <u>864,226</u> |
| Total capitalization | <u>\$ 1,949,780</u> | <u>\$ 1,746,570</u> |

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

PENNSYLVANIA-AMERICAN WATER COMPANY
Statements of Changes in Common Stockholder's Equity
For the Years Ended December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

| | Common Stock | | Paid-in Capital | Retained Earnings | Total |
|-------------------------------------|--------------|-----------|--------------------|----------------------|------------|
| | Shares | Par Value | | | |
| Balance at December 31, 2007 | 3,910,343 | \$ 21,507 | \$ 520,484 | \$ 271,838 | \$ 813,829 |
| Net income | - | - | - | 75,758 | 75,758 |
| Capital contributions | - | - | 33,330 | - | 33,330 |
| Dividends paid | | | | | |
| Preferred stock | - | - | - | (77) | (77) |
| Common stock | - | - | - | (54,667) | (54,667) |
| Balance at December 31, 2008 | 3,910,343 | \$ 21,507 | \$ 553,814 | \$ 292,852 | \$ 868,173 |
| Net income | - | - | - | 76,727 | 76,727 |
| Capital contributions | - | - | 54,059 | - | 54,059 |
| Dividends paid | | | | | |
| Preferred stock | - | - | - | (77) | (77) |
| Common stock | - | - | - | (55,331) | (55,331) |
| Balance at December 31, 2009 | 3,910,343 | \$ 21,507 | \$ 607,873 | \$ 314,171 | \$ 943,551 |

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

PENNSYLVANIA-AMERICAN WATER COMPANY

Notes to Financial Statements

December 31, 2009 and 2008

(Dollars in thousands, except per-share amounts)

Note 1: Organization and Operation

Pennsylvania-American Water Company (the "Company") provides water service to approximately 637,000 (unaudited) customers and wastewater service to 23,100 (unaudited) customers. These services are provided in 382 (unaudited) municipalities located in 35 (unaudited) counties in the Commonwealth of Pennsylvania. As a public utility operating in Pennsylvania, the Company functions under rules and regulations prescribed by the Pennsylvania Public Utility Commission (the "Commission"). The Company is a wholly-owned subsidiary of American Water Works Company, Inc. ("AWW").

Note 2: Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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 these estimates. The Company considers benefit plan assumptions, the carrying value of long-lived assets, including regulatory assets and liabilities, revenue recognition and accounting for income taxes to be its critical accounting estimates. The Company's significant estimates that are particularly sensitive to change in the near term are amounts reported for pension and other postemployment benefits, and contingency-related obligations.

Regulation

The Company is subject to regulation by the Commission and the state government of the Commonwealth of Pennsylvania (collectively the "Regulators"). These Regulators have allowed recovery of costs and credits which the Company has recorded as regulatory assets and liabilities. Accounting for future recovery of costs and credits as regulatory assets and liabilities is in accordance with authoritative guidance provided by U.S. GAAP. Regulated utilities defer costs and credits on the balance sheet as regulatory assets and liabilities when it is probable that those costs and credits will be recognized in the rate making process in a period different from the period in which they would have been reflected in operations by a non-regulated company. These deferred regulatory assets and liabilities are then reflected in the statement of income in the period in which the costs and credits are reflected in the rates charged for service.

Property, Plant and Equipment

Property, plant and equipment consist primarily of utility plant. Additions to utility plant and replacements of retirement units of property are capitalized. Costs include material, direct labor and such indirect items as engineering and supervision, payroll taxes and benefits, transportation and an allowance for funds used during construction. Repairs and maintenance are charged to current operations.

PENNSYLVANIA-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

Note 2 (continued)

Property, Plant and Equipment (continued)

When units of property are replaced, retired or abandoned, the recorded value thereof is credited to the asset account and charged to accumulated depreciation. To the extent the Company recovers cost of removal or other retirement costs through rates, a regulatory asset or liability may occur where timing differences exist between when the Company incurs costs of removal and when the Company recovers such costs in rates. Removal costs, net of salvage, are recorded as reductions to the regulatory liability or an increase to the regulatory asset, as applicable.

The cost of property, plant and equipment is depreciated using the straight-line average remaining life method using the composite method.

Computer software is either purchased or internally developed and their costs capitalized as a unit of property. The carrying value of these costs amounted to \$8,758 and \$8,856 at December 31, 2009 and 2008, respectively.

Utility plant acquisition adjustments represent the difference between the fair value of plant at the date of purchase and its original cost when first devoted to public service (less accumulated depreciation) and are amortized over predetermined amortization periods. Amortization of utility plant adjustments was \$180 and \$402 for 2009 and 2008, respectively. The remaining lives range from 1 to 44 years.

Cash and Cash Equivalents

Substantially all of the Company's cash is invested in interest-bearing accounts. The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. There were no cash equivalents held at December 31, 2009 or 2008.

Restricted Funds

Restricted funds primarily represent proceeds received from financings for the construction and capital improvement of facilities. The proceeds of these financings are held in escrow until the designated expenditures are incurred. Restricted funds expected to be released within 12 months subsequent to year-end are classified as current. The Company held restricted cash of \$38,573 and \$0 at December 31, 2009 and 2008, respectively.

Accounts Receivable

The majority of the Company's accounts receivable is due from utility customers. Customer accounts receivable represent amounts billed to the Company's water and wastewater customers on a cycle basis. Credit is extended based on the guidelines of the applicable Regulators and generally, collateral is not required.

Allowance for Uncollectible Accounts

Allowance for uncollectible accounts is maintained for estimated probable losses resulting from the Company's inability to collect receivables from customers. Accounts that are

PENNSYLVANIA-AMERICAN WATER COMPANY

Notes to Financial Statements

December 31, 2009 and 2008

(Dollars in thousands, except per-share amounts)

Note 2 (continued)

outstanding longer than the payment terms are considered past due. A number of factors are considered in determining the allowance for uncollectible accounts, including the length of time receivables are past due and previous loss history. The Company writes off accounts when they become uncollectible.

The following table summarizes the changes in the Company's allowance for uncollectible accounts:

| | <u>2009</u> | <u>2008</u> |
|-----------------------------------------------|-----------------|-----------------|
| Balance as of January 1 | \$ 4,703 | \$ 6,508 |
| Provision charged to expense | 7,550 | 3,942 |
| Accounts written-off | (5,775) | (6,398) |
| Recoveries of accounts previously written-off | <u>699</u> | <u>651</u> |
| Balance as of December 31 | <u>\$ 7,177</u> | <u>\$ 4,703</u> |

Materials and Supplies

Materials and supplies are stated at the lower of cost or net realizable value. Cost is determined using the average cost method.

Advances and Contributions in Aid of Construction

The Company may receive advances and contributions from customers, home builders, real estate developers, and others to fund construction necessary to extend service to new areas. Advances for construction are refundable for limited periods of time as new customers begin to receive service or other contractual obligations are fulfilled. Advances which are no longer refundable are reclassified to contributions in aid of construction. Contributions in aid of construction are permanent collections of plant assets or cash for a particular construction project. For ratemaking purposes, the amount of such advances and contributions generally serves as a rate base reduction, since they represent non-investor-supplied funds.

The Company depreciates utility plant funded by advances and contributions. The Company amortizes these balances as a reduction to depreciation expense, producing a result which is functionally equivalent to reducing the original cost of the utility plant for advances and contribution. Amortization of advances and contributions in aid of construction was \$3,178 and \$2,990 for the years ended December 31, 2009 and 2008, respectively. For the years ended December 31, 2009 and 2008, non-cash advances and contributions received were \$5,930 and \$3,181, respectively.

PENNSYLVANIA-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

Note 2 (continued)

Recognition of Revenues

Revenues are recognized as water and wastewater services are provided, and include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the date of the latest meter reading to the end of the accounting period. Other operating revenues are recognized when services are performed.

Income Taxes

AWW and its subsidiaries participate in a consolidated federal income tax return for U.S. tax purposes. Members of the consolidated group are charged with the amount of federal income tax expense determined as if they filed separate returns. Federal income tax expense for financial reporting purposes is provided on a separate return basis.

Certain income and expense items are accounted for in different time periods for financial reporting than for income tax reporting purposes. Deferred income taxes have been provided on the difference between the tax bases of assets and liabilities and the amounts at which they are carried in the financial statements. These deferred income taxes are based on the enacted tax rates anticipated to be in effect when such temporary differences are projected to reverse. Anticipated tax rates are the currently enacted tax rates, as the Company is not aware of any tax rate changes. In addition, regulatory assets and liabilities are recognized for the effect on revenues expected to be realized, as the tax effects of temporary differences previously flowed through to customers reverse.

Investment tax credits have been deferred and are being amortized to income over the average estimated service lives of the related assets.

The Company recognizes accrued interest and penalties related to tax positions as a component of income tax expense.

The Company accounts for sales tax collected from customers and remitted to taxing authorities on a net basis.

Allowance for Funds Used During Construction ("AFUDC")

AFUDC is a non-cash credit to income with a corresponding charge to utility plant, which represents the cost of borrowed funds and a return on equity funds devoted to plant under construction. AFUDC is recorded to the extent permitted by the Regulators.

Environmental Costs

The Company's water and wastewater operations are subject to federal, state, and local requirements relating to environmental protection, and as such the Company periodically becomes subject to environmental claims in the normal course of business. Environmental expenditures that relate to current operations or provide a future benefit are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated. There were no remediation costs accrued at December 31, 2009 and 2008.

PENNSYLVANIA-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

Note 2 (continued)

Long-Lived Assets

Long-lived assets and certain identifiable intangible assets held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If the sum of the future cash flows expected to result from the use of the assets and their eventual disposition is less than the carrying amount of the assets, an impairment loss is recognized. Measurement of an impairment loss would be based on the fair value of the assets. A regulatory asset is charged to earnings if and when future recovery in rates of that asset is no longer probable.

Goodwill

The Company uses a two-step impairment test to identify potential goodwill impairment and to measure the amount of a goodwill impairment loss to be recognized (if any). The step 1 calculation used to identify potential impairment compares the calculated fair value of the Company to its net carrying value (book value), including goodwill, on the measurement date. If the fair value is less than the carrying value, then step 2 is performed to measure the amount of the impairment loss (if any).

The step 2 calculation of the impairment test compares the implied fair value of the goodwill to the carrying value of goodwill. The implied fair value of goodwill is equal to the excess of the fair value above the fair value of identified assets and liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill, an impairment loss is recognized in an amount equal to the excess (not to exceed the carrying value of goodwill).

For the November 30, 2009 impairment test, the estimated fair value of the Company for step 1 was based on a combination of the following valuation techniques:

- observable trading prices of comparable equity securities of publicly-traded water utilities considered by management to be the Company's peers; and
- discounted cash flow models developed from the Company's internal forecasts.

The first valuation technique applies average peer multiples to the Company's historic and forecasted cash flows. The peer multiples are calculated using the average trading prices of comparable equity securities of publicly-traded water utilities, their published cash flows and forecasts of market price and cash flows for those peers.

The second valuation technique forecasts the Company's five-year cash flows using an estimated long-term growth rate and discounts those cash flows at its estimated weighted average cost of capital.

If step 2 of the impairment test is required, the Company determines the fair value of the Company's applicable assets and liabilities. The fair values for the majority of such assets and liabilities are equal to their carrying values; however, the fair values of the Company's debts are highly dependent upon market conditions surrounding the measurement date. For the step 2 calculations of the fair value of debt, the Company uses observable prices of instruments and indices that have risks similar to those instruments being valued, adjusted to compensate for

PENNSYLVANIA-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

Note 2 (continued)

differences in credit profile, collateral, tax treatment and call features, to calculate the fair value of the Company's debt.

The Company completed its step 1 calculations and, as a result of the comparison of the calculated fair value of the Company to its net carrying value (book value), including goodwill, on the measurement date, the Company determined that no impairment existed as of November 30, 2009.

The components of goodwill at December 31 are as follows:

| | <u>Cost</u> | <u>Accumulated Impairment</u> | <u>Total net</u> |
|-------------------------------------|------------------|-----------------------------------|------------------|
| Balance at January 1, 2008 | \$ 40,105 | \$ - | \$ 40,105 |
| Reclassification and other activity | (132) | - | (132) |
| Balance at December 31, 2008 | <u>\$ 39,973</u> | <u>\$ -</u> | <u>\$ 39,973</u> |
| Goodwill from acquisitions | 440 | - | 440 |
| Reclassification and other activity | (190) | - | (190) |
| Balance at December 31, 2009 | <u>\$ 40,223</u> | <u>\$ -</u> | <u>\$ 40,223</u> |

New Accounting Standards

Fair Value Measurements

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

In August 2009, the FASB issued authoritative guidance clarifying the measurement of the fair value of liabilities. The amendments reduce potential ambiguity in financial reporting when measuring the fair value of liabilities and help to improve consistency in the application of authoritative guidance. This update is effective for the first reporting period, including interim

PENNSYLVANIA-AMERICAN WATER COMPANY

Notes to Financial Statements

December 31, 2009 and 2008

(Dollars in thousands, except per-share amounts)

Note 2 (continued)

periods, beginning after issuance, which for the Company was October 1, 2009. The adoption of this guidance did not have an impact on the Company's results of operations, financial position or cash flows.

In April 2009, the FASB provided additional guidance on fair value measurements in inactive markets when the volume and level of activity for the asset and liability have significantly decreased. This amendment also includes guidance on identifying circumstances that indicate a transaction is not orderly. This guidance is effective for interim reporting periods ending after June 15, 2009. The adoption of this guidance did not have an impact on the Company's results of operations, financial position or cash flows.

In February 2008, the FASB issued guidance that allowed a one-year deferral of adoption of the guidance for nonfinancial assets and nonfinancial liabilities (such as intangible assets, property, plant and equipment and goodwill) that are required to be measured at fair value on a periodic basis (such as at acquisition or impairment). The Company elected to use this deferral option and accordingly, adopted this guidance for the Company's nonfinancial assets and liabilities valued on a non-recurring basis on January 1, 2009. The adoption of this guidance did not have a significant impact on the Company's results of operations, financial position or cash flows.

Accounting Standards Codification

In June 2009, the FASB issued authoritative guidance that establishes the FASB Accounting Standards Codification ("Codification") as the source of authoritative U.S. GAAP recognized by the FASB to be applied by non-governmental entities. Rules and interpretive releases of the Securities and Exchange Commission ("SEC") under authority of federal securities laws are also sources of authoritative U. S. GAAP for SEC registrants. All other non-grandfathered, non-SEC accounting literature not included in the Codification is non-authoritative. This guidance is effective for interim and annual periods ending after September 15, 2009. The adoption of this guidance did not have an impact on the Company's results of operations, financial position or cash flows.

Consolidation of Variable Interest Entities

In June 2009, the FASB issued authoritative guidance that replaces the quantitative-based risk and rewards calculation for determining which reporting entity has a controlling financial interest in a variable interest entity with a qualitative approach. This revised guidance also requires additional disclosures about a reporting entity's involvement in variable interest entities. This guidance is effective for the Company beginning January 1, 2010. The Company does not believe the adoption of this update to have a significant impact on the Company's results of operations, financial position or cash flows.

Subsequent Events

In May 2009 and clarified in February 2010, the FASB issued authoritative guidance that establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This

PENNSYLVANIA-AMERICAN WATER COMPANY

Notes to Financial Statements

December 31, 2009 and 2008

(Dollars in thousands, except per-share amounts)

Note 2 (continued)

standard sets forth: (i) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions, (ii) the circumstances under which an entity should recognize events or transactions and (iii) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. This guidance is effective for interim and annual periods ending after June 15, 2009. The adoption of this guidance did not have an impact on the Company's results of operations, financial position or cash flows. The Company performed an evaluation of subsequent events for the accompanying financial statements through March 22, 2010, the date this Report was issued, to determine whether the circumstances warranted recognition and disclosure of those events or transactions in the financial statements as of December 31, 2009.

Recognition and Presentation of Other-Than-Temporary Impairments

In April, 2009, the FASB amended authoritative guidance related to the impairment of certain debt securities and will require an entity to assess whether it (i) has the intent to sell the debt security or (ii) more likely than not will be required to sell the debt security before its anticipated recovery. If either of these conditions is met, the entity must recognize an other-than-temporary impairment. If an entity is able to meet the criteria to assert that it will not have to sell the security before recovery, impairment charges related to credit losses would be recognized in earnings, while impairment charges related to non-credit losses (for example, liquidity risk) would be reflected in other comprehensive income. The amended guidance is effective for interim reporting periods ending after June 15, 2009. The adoption of this guidance did not have an impact on the Company's results of operations, financial position or cash flows.

Contingencies Acquired in a Business Combination

In April 2009, the FASB amended and clarified the authoritative guidance related to accounting for the initial recognition and measurement, subsequent measurement and accounting, and related disclosures arising from contingencies in a business combination. Assets acquired and liabilities assumed in a business combination that arise from contingencies should be recognized at fair value on the acquisition date if fair value can be determined during the measurement period. If fair value can not be determined, companies should account for the acquired contingencies using existing guidance. This guidance is effective for the Company for business combinations finalized after January 1, 2009.

Reclassifications

Certain reclassifications have been made to conform previously reported data to the current presentation.

Note 3: Acquisitions

During 2009, the Company completed acquisitions of the assets of four water systems for an aggregate purchase price of \$6,935. The acquired operations provided services to approximately 1,390 (unaudited) customers in aggregate at the time of their acquisitions. The acquisitions were accounted for as business purchases, and the difference between the purchase

PENNSYLVANIA-AMERICAN WATER COMPANY

Notes to Financial Statements

December 31, 2009 and 2008

(Dollars in thousands, except per-share amounts)

Note 3 (continued)

price and the fair value of assets acquired, less liabilities assumed were recorded at the date of the acquisitions. For three of the acquisitions, purchase price exceeded fair value and the difference of \$781 was recorded as a regulatory liability. For the fourth acquisition, goodwill of \$440 was recorded. The acquired assets have been recorded to utility plant as of December 31, 2009.

During 2008, the Company completed acquisitions of the assets of two water, one wastewater, and one water and wastewater systems for an aggregate purchase price, including the costs to acquire, of \$8,243. The acquired operations provided services to approximately 3,500 (unaudited) customers in aggregate at the time of their acquisitions. As of December 31, 2008, acquisitions of a water and wastewater system with a total purchase price of \$5,620, were recorded to utility plant pending completion of original cost studies. Based on completion of the studies during 2009, \$1,722 was recorded as credit to utility plant acquisition adjustment.

Note 4: Utility Plant

The components of utility plant by category at December 31 are as follows:

| | <u>Range of remaining useful lives</u> | <u>2009</u> | <u>2008</u> |
|---------------------------------------|--------------------------------------------|---------------------|---------------------|
| Land and other non-depreciable assets | - | \$ 25,143 | \$ 23,633 |
| Sources of supply | 32 to 78 Years | 94,184 | 90,729 |
| Treatment and pumping | 17 to 47 Years | 511,886 | 507,574 |
| Transmission and distribution | 12 to 78 Years | 1,584,420 | 1,480,447 |
| Services, meters and fire hydrants | 11 to 55 Years | 557,371 | 525,214 |
| General structures and equipment | 13 to 44 Years | 117,597 | 117,559 |
| Wastewater | 6 to 69 Years | 124,359 | 76,787 |
| Construction work in progress | - | 36,926 | 39,933 |
| | | <u>3,051,886</u> | <u>2,861,876</u> |
| Less: Accumulated depreciation | | <u>(695,667)</u> | <u>(643,430)</u> |
| | | <u>\$ 2,356,219</u> | <u>\$ 2,218,446</u> |

The provision for depreciation expressed as a percentage of the aggregate average depreciable asset balances was 2.53% in 2009 and 2.56% in 2008.

PENNSYLVANIA-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

Note 5: Regulatory Assets

Regulatory assets represent costs that are expected to be fully recovered from customers in future rates. Depending upon Commission approval, certain assets are included in the Company's rate base and others are not.

The components of regulatory assets are as follows:

| | 2009 | 2008 |
|---------------------------------------------------------|-------------------|-------------------|
| Income taxes recoverable through rates | \$ 108,966 | \$ 106,764 |
| Cost of removal | 25,327 | 21,018 |
| Pension and postretirement benefits other than pensions | 18,453 | 12,391 |
| Debt and preferred stock expense | 13,837 | 11,761 |
| Security costs | 6,795 | 8,459 |
| Business service project expense | 2,131 | 3,114 |
| Other | <u>5,962</u> | <u>4,887</u> |
| | <u>\$ 181,471</u> | <u>\$ 168,394</u> |

The Company has recorded a regulatory asset for the additional revenues expected to be realized as the tax effects of temporary differences reverse. These temporary differences are primarily related to the difference between book and tax depreciation on property placed in service before the adoption by the Commission of full normalization for rate making purposes.

The regulatory asset for income taxes recoverable through rates is net of the reduction expected in future revenues as deferred taxes previously provided, attributable to the difference between the state and federal income tax rates under prior law and the current statutory rates, reverse over the average remaining service lives of the related assets.

Pension expense in excess of the amount contributed to the pension plan is deferred. These costs will be recovered in future service rates as increased contributions are made to the pension plan. In addition, the Company obtained Commission authorization in its 2009 rate order to defer the 2009 increase in its pension and postretirement benefits other than pensions (PBOP) expense over the level reflected in its existing rates. The total amount of this deferral was \$6,645 and will be amortized over 24 months beginning in November 2009.

Debt expense is amortized over the lives of the respective issues. Unamortized debt expense is deferred and amortized to the extent that it will be recovered through future service rates. Expenses of preferred stock issues without sinking fund provisions are amortized over 30 years from the date of issue, whereas expenses of issues with sinking fund provisions are charged to operations as shares are retired.

The Company has deferred the cost of increased security measures that were implemented to secure facilities after the terrorist attacks on September 11, 2001. The Commission authorized the Company the recovery of \$15,538 over a 10-year period or \$1,554

PENNSYLVANIA-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

Note 5 (continued)

on an annual basis effective January 29, 2004. In subsequent proceedings, the Company true-up the costs it had submitted in the previous proceeding to \$1,664 on an annual basis.

Business service project expenses consist of re-engineering and start-up activities for consolidated customer and shared administrative service centers that have been established by AWW. On January 25, 2002, the Commission approved \$5,534 of these costs for rate recovery over a 10-year period. In the subsequent proceeding, the Company was allowed to true-up the projected costs it had submitted in the previous proceeding to \$7,844 to be recovered over 8 years.

Note 6: Preferred Stock Without Mandatory Redemption Requirements

In the event of voluntary liquidation, the 4.5% series is redeemable at \$100 per share, provided a majority of the holders consent, or at \$103.50 per share if they do not; all other issues are redeemable at \$100 per share provided the voluntary liquidation is in connection with governmental acquisition of substantially all of the Company's property or common stock. In the event of involuntary liquidation or governmental acquisition, all classes of preferred stocks are redeemable at \$100 per share. All call prices are on 30 days' notice plus accrued dividends.

Note 7: Long-Term Debt

Preferred stock with mandatory redemption requirements on the 9.35% series and the 9.75% series provide for annual sinking fund payments of \$12 and \$10, respectively, at the option of the holder. The requirement on the 8.49% series provides for sinking fund payments to begin in 2012.

Preferred stock with mandatory redemption requirements contain provisions for redemption at various prices on 30 days' notice at the Company's discretion, except for the 9.35% and 9.75% series, which are not callable.

The senior notes payable to affiliate are unsecured and were issued to American Water Capital Corporation ("AWCC"), a subsidiary of AWW, for the principal amount.

In May 2008, the Company issued a long-term note payable of \$81,000 at a rate of 6.25% due in 2018. The proceeds were used to pay down outstanding short-term borrowings from the credit line with AWCC.

Variable rate tax-exempt bonds are remarketed for periods up to 270 days. These bonds may be converted to other short-term variable-rate structures, a fixed-rate structure or subject to redemption. At December 31, 2008, the debt is included in current portion of long-term debt since the Company could not be certain that remarketing would be successful. During 2009, the

PENNSYLVANIA-AMERICAN WATER COMPANY

Notes to Financial Statements

December 31, 2009 and 2008

(Dollars in thousands, except per-share amounts)

Note 7 (continued)

Company successfully remarketed these bonds for \$52,900 with annual interest fixed-rate of 6.0-6.75% and the debt is included in long-term debt. The proceeds of the remarketed bonds were used to pay down outstanding short-term borrowings from the credit line with AWCC.

On April 8, 2009, the Company closed an offering to issue \$80,000 in tax-exempt water facility revenue bonds through the Pennsylvania Economic Development Financing Authority ("PEDFA") at a fixed rate of 6.2% to mature in 2039. The proceeds from the offering were initially kept in Trust, pending the Company's certification that it had incurred qualifying capital expenditures. This issuance has been presented as non-cash on the accompanying Statements of Cash Flows. Subsequent release of these funds by PEDFA are reflected as the release of restricted funds, and are included in investing activities in the accompanying Statement of Cash Flows. As of December 31, 2009, the Company has drawn down \$41,427 of these funds.

The Commonwealth of Pennsylvania offers water facility loans through Pennsylvania Infrastructure Investment Authority ("Pennvest"). These low-interest loans cover the design, engineering, and construction of publicly and privately owned drinking water distribution systems. The water facility loans are available to communities or private firms needing clean drinking water distribution facilities. The interest on this type of loan ranges from 1.00% to 5.00%. The loan disbursements are based upon reimbursable expenditures for a specific approved project. The existing Pennvest loans are secured primarily through a lien on the Company revenues, subordinate to the Company's mortgage indenture. The Company makes monthly payments of principal and interest on these water facility loans. The principal payments, based on notes as of December 31, 2009, are \$2,990 in 2010, \$3,043 in 2011, \$3,088 in 2012, \$2,976 in 2013, and \$3,041 in 2014 and \$21,300 thereafter.

On August 26, 2009, the Company closed an offering to issue an additional \$2,242 in Pennvest loans. The proceeds from the offering will be used to fund certain capital improvement projects.

On December 1, 2009, the Company refunded and reissued \$93,165 of private activity general mortgage bonds scheduled to mature in 2032 and 2033. The bonds 3.60% fixed interest rate expired in December 2009, and the new bonds have a fixed interest rate of 5.50% with a maturity of 2039.

The general mortgage bonds are issuable in series. No bonds senior to the general mortgage bonds may be issued so long as the general mortgage bonds are outstanding. Based on the calculation methodology specified by debt agreements, the amount of bonds authorized is limited, as long-term debt cannot exceed 65% of total capitalization, and as net income of the Company must be equal to or greater than 1.5 times the aggregate annual interest charges on all long-term debt of the Company. At December 31, 2009, long-term debt was 52% of total capitalization and net income was 3.4 times the aggregate annual interest charges on all long-term debt. General mortgage bonds are collateralized by utility plant.

PENNSYLVANIA-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

Note 7 (continued)

The general mortgage bond indentures contain clauses restricting the declaration of common stock dividends and other distributions on capital stock if common stockholder's equity falls below a specified amount. There were no restrictions at December 31, 2009.

Maturities of long-term debt will amount to \$6,390 in 2010, \$6,443 in 2011, \$3,088 in 2012, \$4,176 in 2013 and \$4,241 in 2014 and \$986,561 thereafter.

The indenture for the 6.87% series note has a sinking fund provision that requires an annual retirement of \$3,400 from 2009 through 2011.

Other interest, net includes interest income of approximately \$54 and \$50 at December 31, 2009 and 2008, respectively. The majority of other interest, net represents interest earned on a note receivable from Parkesburg Borough that was paid in full in December 2009.

Note 8: Short-Term Borrowings

The Company maintains a line of credit through AWCC of \$134,000 and \$100,000 at December 31, 2009 and 2008, respectively. The Company may borrow from, or invest in, the line of credit. No compensating balances are required under the agreements.

At December 31, 2009 and 2008, there were \$10,939 and \$90,611 of short-term borrowings outstanding, respectively. The weighted-average annual interest rate on these borrowings at December 31, 2009 and 2008 was 0.75% and 3.64%, respectively.

At December 31, 2009, the Company had \$2,363 outstanding stand-by letters of credit.

The Company received cash capital contributions of \$53,700 and \$33,000 from AWW in 2009 and 2008, respectively. The proceeds from these contributions were used to pay down short-term debt.

AWW, through AWCC, has committed to make additional financing available to the Company, as needed, to pay its obligations as they come due.

PENNSYLVANIA-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

Note 9: General Taxes

Components of general tax expense for the years presented in the statements of income are as follows:

| | <u>2009</u> | <u>2008</u> |
|---------------------------|------------------|------------------|
| Payroll | \$ 3,829 | \$ 3,873 |
| Property | 3,763 | 3,672 |
| Public Utility Commission | 2,820 | 2,642 |
| Capital stock | 1,550 | 1,936 |
| | <u>\$ 11,962</u> | <u>\$ 12,123</u> |

Note 10: Income Taxes

Components of income tax (benefit) expense for the years presented in the statements of income are as follows:

| | <u>2009</u> | <u>2008</u> |
|-------------------------------------------------|------------------|------------------|
| State income taxes: | | |
| Current | \$ (1,833) | \$ 8,389 |
| Deferred | | |
| Current | (264) | 167 |
| Non-current | 11,803 | 894 |
| | <u>9,706</u> | <u>9,450</u> |
| Federal income taxes: | | |
| Current | (46,431) | 3,035 |
| Deferred | | |
| Current | (832) | 527 |
| Non-current | 89,483 | 39,425 |
| Amortization of deferred investment tax credits | (233) | (233) |
| | <u>41,987</u> | <u>42,754</u> |
| Total income taxes | <u>\$ 51,693</u> | <u>\$ 52,204</u> |

In December 2008, the Company as a member of the consolidated group filed a request with the Internal Revenue Service (IRS) to change its tax accounting method for repair and maintenance costs on its utility assets. The IRS partially approved the request in October 2009, with the Company receiving final approval in February 2010, allowing the Company to take a tax deduction for costs that were previously capitalized for tax purposes. As a result, the Company recorded a deferred income tax liability for this temporary difference. In addition, the change in tax accounting method generated a net operating loss which the Company has substantially monetized.

PENNSYLVANIA-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

Note 10 (continued)

The primary components of the net deferred tax liability at December 31, 2009 include basis differences in utility plant, income taxes recoverable through rates, and advances and contributions. No valuation allowances were required on deferred tax assets at December 31, 2009 and 2008, as management believes it is more likely than not that deferred tax assets will be realized.

At December 31, 2008, the Company recorded state net operating loss carryforwards ("NOLs"), which will reduce future taxable income. These NOLs will begin to expire in 2028 if not utilized.

As of December 31, 2009 and 2008, the reserve for uncertain tax positions is \$29,660 and \$0, respectively, excluding accrued interest and penalties. The Company does not expect a material change in this estimate in the next twelve months. The reserve, for uncertain tax positions, could increase or decrease for such things as the expiration of statutes of limitations, audit settlement, or tax examination.

The Company recognizes interest and penalties related to income tax matters in income tax expense; however, none were accrued as of December 31, 2009 and 2008, respectively.

The federal tax returns from 2006 to 2008 remain open. The 2006 statute will expire in 2010. The Company is subject to state taxes. State tax returns from 2004 to 2008 are currently open. The statutes of limitations will begin to expire in 2010.

Note 11: Rate Matters

As necessary, the Company applies to the Commission for changes in the rates charged for service. The rate increase request is based on the level of revenues, operating expenses and capital costs expected to be in effect by the end of the future test year, which is the year which immediately follows the historic test year. The Company can provide no assurances that any rate increase request will be granted by the Commission.

As authorized by the Commission, the Company has instituted a Distribution System Improvement Charge based on specific capital improvements made to the water distribution system. The charge may be adjusted each quarter based on the qualified investment in a prior three-month period. The Company recorded revenues of \$16,065 in 2009 and \$4,027 in 2008 associated with this charge.

On April 24, 2009, the Company filed a rate application with the Commission. Based upon a settlement agreement, the Commission issued its order on November 6, 2009, to increase rates to generate additional annual revenue of \$30,750, or 6.6%, effective November 7, 2009.

PENNSYLVANIA-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

Note 11 (continued)

On April 28, 2008 the Company filed a Coatesville wastewater rate application. Based upon a settlement agreement, the Commission issued a Final Order on November 13, 2008 to generate additional annual revenue of \$1,850 or 76.7% effective November 14, 2008.

Note 12: Employee Benefit Plans

Savings Plan for Employees

The Company maintains 401(k) Savings Plans, sponsored by AWW, allowing employees to save for retirement on a tax-deferred basis. Employees can make contributions that are invested at their direction in one or more funds. The Company makes matching contributions based on a percentage of an employee's contribution, subject to certain limitation. Due to the Company's discontinuing new entrants into the defined benefit pension plan, on January 1, 2006 the Company began providing an additional 5.25% of base pay defined contribution benefit for union employees hired on or after January 1, 2001 and for non-union employees hired on or after January 1, 2006. The Company expensed contributions to the plan totaling \$1,570 for 2009 and \$1,365 for 2008. All of the Company's contributions are invested in one or more funds at the direction of the employee.

Note 13: Postretirement Benefits

Pension Benefits

The Company participates in a Company-funded defined benefit pension plan, sponsored by AWW, covering employees hired before January 1, 2006. Benefits under the plan are based on the employee's years of service and average annual compensation for those 60 consecutive months of employment which yield the highest average. The pension plan has been closed for any employee hired on or after January 1, 2006. Union employees hired on or after January 1, 2001 had their accrued benefit frozen and will be able to receive this benefit as a lump sum upon termination or retirement. Union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006 are provided with a 5.25% of base pay defined contribution plan. Pension cost of the Company is based on an allocation from AWW of the total cost related to the plan. Information regarding accumulated and projected benefit obligations is not prepared at the subsidiary level. The Company was allocated costs of \$13,518 and \$5,841 for 2009 and 2008, respectively.

AWW's funding policy is to contribute at least the minimum amount required under the Employee Retirement Income Security Act of 1974. The Company made contributions to the AWW plan of \$12,922 in 2009 and \$13,055 in 2008. The Company expects to contribute \$14,083 to the AWW plan in 2010.

Postretirement Benefits Other Than Pensions

The Company participates in a Company-funded plan sponsored by AWW that provides certain life insurance benefits for retired employees and certain health care benefits for retired

PENNSYLVANIA-AMERICAN WATER COMPANY

Notes to Financial Statements

December 31, 2009 and 2008

(Dollars in thousands, except per-share amounts)

Note 13 (continued)

employees and their dependents. The retiree welfare plans are closed for union employees hired on or after January 1, 2006, and for non-union employees hired on or after January 1, 2002. Retirees and their dependents under age 65 are covered by a point-of-service managed care plan that requires co-payments or an HMO. Employees who elect to retire prior to attaining age 65 are generally required to make contributions towards their medical coverage until attaining age 65. Retirees and their dependents age 65 and over are covered by a Medicare supplement plan.

Costs of the Company are based on an allocation from AWW of the total cost related to the plan. Information regarding accumulated and projected benefit obligations is not prepared at the subsidiary level. The Company was allocated costs of \$8,799 in 2009 and \$5,643 in 2008.

The Company made contributions to trust funds established for these postretirement benefits of \$8,799 in 2009 and \$5,643 in 2008. The Company's policy is to fund postretirement benefits costs accrued. The Company expects to contribute \$8,405 to the AWW plan in 2010.

Note 14: Stock-Based Compensation

Stock Options and Restricted Stock Units

On February 20, 2009, AWW granted restricted stock units and stock options to certain employees of the Company under the AWW 2007 Omnibus Equity Compensation Plan ("Omnibus Plan"). The restricted stock units vest ratably over the three year performance period beginning January 1, 2009 (the "Performance Period"); however distribution of the shares is contingent upon the achievement of certain market thresholds over the performance period. The stock options vest ratably over a three year service period from January 1, 2009.

On April 22, 2008, AWW granted restricted stock awards, restricted stock units and stock options to certain employees of the Company under the Omnibus Plan. The restricted stock units and the stock options were awarded in two grants with "Grant 1" vesting on January 1, 2010 and "Grant 2" vesting January 1, 2011.

The value of restricted stock units at the date of the grant is amortized through expense over the requisite service period using the straight-line method for restricted stock units with service and/or performance vesting. The grant date fair value of restricted stock awards that have market and service conditions and vest ratably is amortized through expense over the requisite service period using the graded-vesting method. The value of stock options at the date of the grant is amortized through expense over the requisite service period using the straight-line method.

Costs of the Company are based on an allocation from AWW of the total cost for employees of the Company in the plan. The Company recorded compensation expense of \$311 and \$310, included in operation and maintenance expense, during the years ended December 31, 2009 and 2008, respectively. As the Company does not reimburse the cost of the awards to AWW, the offsetting entry to paid-in-capital is a capital contribution from AWW.

PENNSYLVANIA-AMERICAN WATER COMPANY

Notes to Financial Statements

December 31, 2009 and 2008

(Dollars in thousands, except per-share amounts)

Note 14 (continued)

Employee Stock Purchase Plan

AWW's Nonqualified Employee Stock Purchase Plan ("ESPP") was effective as of July 1, 2008. Under the ESPP, the Company's employees can use payroll deductions to acquire AWW common stock at the lesser of 90% of the fair market value as of a) the beginning or b) the end of each three-month purchase period. AWW's ESPP is considered compensatory. Costs of the Company are based on an allocation from AWW of the total cost for employees of the Company in the plan. Compensation costs of \$48 and \$20 were included in operation and maintenance expense for the years ended December 31, 2009 and 2008, respectively. As the Company does not reimburse the cost of the awards to AWW, the offsetting entry to paid-in-capital is a capital contribution from AWW.

Note 15: Related-Party Transactions

American Water Works Service Company, Inc. ("AWWS"), a subsidiary of AWW, provides certain management services to the Company (administration, accounting, data processing, engineering, etc.) and other operating water companies in the AWW system on an at-cost, not-for-profit basis in accordance with a management and service agreement.

Purchases of such services by the Company were accounted for as follows:

| | <u>2009</u> | <u>2008</u> |
|--------------------------------------------------------------------------|------------------|------------------|
| Included in operation and maintenance expense as a charge against income | \$ 35,981 | \$ 40,061 |
| Capitalized primarily in utility plant | <u>\$ 2,854</u> | <u>2,011</u> |
| | <u>\$ 38,835</u> | <u>\$ 42,072</u> |

AWWS leases space in an office building owned by the Company. Rent received under the terms of the lease was \$765 in 2009 and \$738 in 2008. Additionally, the Company received \$93 in 2009 and \$97 in 2008 from AWWS for the rental of furniture and equipment.

The Company maintains a line of credit through AWCC (See Note 8). The Company also participates in AWCC's centralized treasury function, whereby the Company transfers its cash to AWCC and the Company's checks are issued out of AWCC. Under the arrangement, available cash is used to pay down the line of credit, and outstanding credits increase the Company's line-of-credit balance. The Company paid AWCC fees of \$1,587 in 2009 and \$405 in 2008 and recorded interest expense on borrowings of \$705 in 2009 and \$1,905 in 2008. Interest expense on long-term debt with AWCC amounted to \$22,577 and \$20,095 for 2009 and 2008, respectively. Accrued interest included interest due to AWCC of \$3,416 and \$2,288 as of December 31, 2009 and 2008, respectively.

PENNSYLVANIA-AMERICAN WATER COMPANY

Notes to Financial Statements

December 31, 2009 and 2008

(Dollars in thousands, except per-share amounts)

Note 15 (continued)

The Company provides billing and collection services to American Water Resources (“AWR”), a subsidiary of AWW. AWR offers customer protection plans that provide water line, sewer line and in-home protection. The Company recorded revenue of \$516 in 2009 and \$485 in 2008 related to these services.

The Company purchased granular activated carbon from American Carbon Services, a subsidiary of AWW, at five and seven of the Company’s filtration plants during 2009 and 2008, respectively. The total amount paid to American Carbon Services for the removal of the existing filter media, the new carbon media and its installation was \$1,291 in 2009 and \$1,921 in 2008.

The Company pays dividends to AWW on a quarterly basis. The amount of the dividend is based on a percentage of net income adjusted for certain items.

One of AWW's Directors is employed by an electrical utility that supplies electricity and electrical services to the Company. The Company purchased, from various subsidiaries of this electrical utility, approximately \$3,252 and \$1,910 of such services in 2009 and 2008, respectively. This Director has announced his intended retirement from that electrical utility effective March 31, 2010.

Note 16: Fair Values of Financial Instruments

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

Current assets and current liabilities: The carrying amount reported in the balance sheet for current assets and current liabilities approximates their fair value.

Preferred stocks with mandatory redemption requirements and long-term debt: The fair values of the Company's preferred stocks with mandatory redemption requirements and long-term debt are estimated using discounted cash flow analyses based on the Company's current incremental financing rates for similar types of securities.

PENNSYLVANIA-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

Note 16 (continued)

The carrying amounts and fair values of the Company's financial instruments at December 31 are as follows:

| | 2009 | | 2008 | |
|--------------------------------------------------------------------------------------|-----------------|--------------|-----------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Preferred stock with mandatory redemption requirements, including current maturities | \$ 12,451 | \$ 13,826 | \$ 12,451 | \$ 12,362 |
| Long-term debt, including current maturities | \$ 998,448 | \$ 1,078,938 | \$ 923,557 | \$ 850,323 |

Fair Value Measurements

To increase consistency and comparability in fair value measurements, FASB guidance establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels as follows:

- Level 1—quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access as of the reporting date. Financial assets and liabilities utilizing Level 1 inputs include active exchange-traded equity securities, exchange-based derivatives, mutual funds and money market funds.
- Level 2—inputs other than quoted prices included within level 1 that are directly observable for the asset or liability or indirectly observable through corroboration with observable market data. Financial assets and liabilities utilizing Level 2 inputs include fixed income securities, non-exchanged-based derivatives, commingled investment funds not subject to purchase and sale restrictions and fair-value hedges.
- Level 3—unobservable inputs, such as internally-developed pricing models for the asset or liability due to little or no market activity for the asset or liability. Financial assets and liabilities utilizing Level 3 inputs include infrequently-traded non-exchange-based derivatives and commingled investment funds subject to purchase and sale restrictions.

PENNSYLVANIA-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

Note 16 (continued)
Recurring Fair Value Measurements

The following table presents assets and liabilities measured and recorded at fair value on a recurring basis and their level within the fair value hierarchy as of December 31, 2009 and 2008, respectively:

| Recurring Fair Value Measures | At Fair Value as of December 31, 2009 | | | |
|----------------------------------|---------------------------------------|----------------|-------------|------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Restricted funds | \$ 38,573 | \$ - | \$ - | \$ 38,573 |
| Deposits | 52 | - | - | 52 |
| Total assets | <u>38,625</u> | <u>-</u> | <u>-</u> | <u>38,625</u> |
| Liabilities: | | | | |
| Deferred compensation obligation | - | 46 | - | 46 |
| Total liabilities | <u>-</u> | <u>46</u> | <u>-</u> | <u>46</u> |
| Total net assets (liabilities) | <u>\$ 38,625</u> | <u>\$ (46)</u> | <u>\$ -</u> | <u>\$ 38,579</u> |

| Recurring Fair Value Measures | At Fair Value as of December 31, 2008 | | | |
|----------------------------------|---------------------------------------|---------------|-------------|-----------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Deposits | \$ 1,095 | \$ - | \$ - | \$ 1,095 |
| Total assets | <u>1,095</u> | <u>-</u> | <u>-</u> | <u>1,095</u> |
| Liabilities: | | | | |
| Deferred compensation obligation | - | 6 | - | 6 |
| Total liabilities | <u>-</u> | <u>6</u> | <u>-</u> | <u>6</u> |
| Total net assets (liabilities) | <u>\$ 1,095</u> | <u>\$ (6)</u> | <u>\$ -</u> | <u>\$ 1,089</u> |

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

Deposits—Deposits includes escrow funds and certain other deposits held in trust. The Company includes cash deposits in other current assets.

Deferred compensation obligations—The Company's deferred compensation plans allow participants to defer certain cash compensation into notional investment accounts. The Company includes such plans in other long-term liabilities. The value of the Company's deferred

PENNSYLVANIA-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2009 and 2008
(Dollars in thousands, except per-share amounts)

Note 16 (continued)

compensation obligations is based on the market value of the participants' notional investment accounts. The notional investments are comprised primarily of mutual funds, which are based on observable market prices.

Note 17: Operating Leases

The Company has entered into operating leases involving certain facilities and equipment. Rental expenses under operating leases were \$6,038 in 2009 and \$6,040 in 2008. The operating leases for facilities will expire in 2011, 2013 and 2017, and the operating leases for equipment have various expiration dates through 2045.

At December 31, 2009, the minimum annual future rental commitments under operating leases that have initial or remaining non-cancelable lease terms in excess of one year are \$4,223 in 2010, \$3,154 in 2011, \$1,909 in 2012, \$937 in 2013, \$550 in 2014 and \$758 thereafter.

Note 18: Commitments and Contingencies

The Company maintains agreements with other water purveyors for the purchase of water to supplement its water supply. Certain agreements stipulate purchases of minimum quantities of water through various dates. The estimated annual commitment related to the minimum quantities of water purchased is expected to approximate \$1,110 annually in 2010 through 2012, \$1,053 annually in 2013 and 2014, and \$3,859 thereafter. The Company's purchased water expense under these types of agreements amounted to approximately \$2,438 and \$2,602 during the years ended December 31, 2009 and 2008, respectively.

Commitments have been made in connection with certain construction programs. The estimated capital expenditures required under legally binding contracts amounted to \$14,742 at December 31, 2009.

The Company is also routinely involved in condemnation proceedings and legal actions incident to the normal conduct of its business. At December 31, 2009, the Company has accrued approximately \$242 as probable costs, and it is reasonably possible that additional losses could range up to \$10,000 for these matters. For certain matters, the Company is unable to estimate possible losses. The Company believes that damages or settlements, if any, recovered by plaintiffs in such claims or actions, will not have a material adverse effect on the Company's results of operations, financial position or cash flows.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.16

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

16. Supply copies of the Company's balance sheets for each month/quarter for the last two years.

Answer: Please refer to FR XI.1.

Pennsylvania-American Water Company
 Coatesville Wastewater Operations
 Data Requirements of the Pennsylvania Public Utility Commission

FR VII.17

**Pennsylvania-American Water Company
 Coatesville Wastewater Operations**

VII. Rate of Return

17. Provide the bond rating history for the Company and, if applicable, its parent from the major credit rating agencies for the last five years.

Answer: Pennsylvania-American Water Company's long term debt was rated by Standard & Poor's and Moody's Investors Service in 2004 and 2009.

| | Standard & Poor's | Moody's |
|------|-------------------|---------|
| 2004 | AAA | Aaa |
| 2009 | A | A3 |

The credit ratings of American Water Capital Corp. for the last five years are as follows (senior unsecured debt/commercial paper):

| | Standard & Poor's | Moody's |
|------|-------------------|----------|
| 2009 | BBB+/A-2 | Baa2/P-2 |
| 2008 | BBB+/A-2 | Baa2/P-2 |
| 2007 | BBB+/A-2 | Baa2/P-2 |
| 2006 | A-/A-2 | Baa1/P-2 |
| 2005 | A /NR | Baa1/NR |

American Water Works Company, Inc. was also assigned a BBB+ corporate credit rating by Standard & Poor's on June 19, 2008.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.18

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

18. Provide copies of all bond rating reports relating to the Company and, if applicable, its parent for the past two years.

Answer:

Please see the attachment which includes the following:

.....AWK Moodys October 2007 Rating Action
AWK Moodys October 2007 Credit Opinion
AWCC Moodys October 2007 Rating Action
S&P Research Updates 2004 to 2008
PA Moodys February 2010 Credit Opinion
PA Moodys February 5, 2010 Credit Opinion
S&P Ratings Report September 16, 2009



Rating Action: American Water Works Company, Inc (New)

Moody's Downgrades American Water to Baa2; Confirms P-2 Short-Term Rating

New York, October 12, 2007 -- Moody's Investors Service today downgraded to Baa2 from Baa1 the senior unsecured issuer rating of American Water Capital Corp ("Capital"). Moody's also confirmed Capital's P-2 short-term rating. At the same time, Moody's assigned a (P) Baa2 senior unsecured rating to Capital's planned \$1.5 billion note offering and a Baa2 senior unsecured issuer rating to Capital's parent, American Water Works Company, Inc ("American Water"). The rating outlook for both issuers is stable. Today's rating action concludes the review for possible downgrade initiated on August 28, 2007.

Moody's review of Capital's short and long-term ratings was prompted by American Water's planned recapitalization of the company in advance of the divestment, via initial public offering, from its current parent, RWE AG (A1 stable). The initial sale of RWE's interest in American Water is expected to happen in late-2007; however, preceding that transaction, Capital is expected to issue \$1.5 billion of senior unsecured notes in order to substantially repay approximately \$2.0 billion of inter-company debt currently owed to RWE. These notes are expected to be issued in October 2007. It is Moody's understanding that the company will also issue \$500 million of "equity units" concurrent with the IPO that will fund out the balance of inter-company debt owed to RWE.

The one-notch downgrade of Capital's senior unsecured issuer rating, and the assignment of a Baa2 issuer rating to its parent, American Water, reflects the loss of implied support from RWE following the IPO, historically weak consolidated credit metrics, and the increase in financial and operating risk going forward as a publicly traded stand-alone company. Moody's has also taken this opportunity to equalize the new rating for American Water, a holding company, with its finance subsidiary, Capital, due to the existence of a "support agreement" between the two entities that effectively backstops Capital's timely payment of principal and interest, as needed. Nevertheless, an additional concern is that approximately 60% of American Water's consolidated debt will be borrowed at Capital, with the balance at the various regulated operating subsidiaries where the material cash flows are generated. We note that debt at Capital does not benefit from any upstream guarantees from the regulated utility operations nor does the debt obligations of the subsidiaries, including Capital, benefit from any downstream guarantee from American Water.

Moody's considers American Water's position as the largest investor-owned water utility in the U.S. and geographic diversity with regulated operations in 20 states as being positive credit qualities. Moody's views investor-owned water utilities in the U.S. as having greater long-term stability and supportive regulatory treatment than most of their electric utility counterparts which has resulted good levels of historical cash flow from such regulated operations. Although American Water's cash flow derived credit metrics have exhibited weakness for some time and are considered somewhat soft for the Baa2 rating (funds from operations (FFO) to total adjusted debt was approximately 7.5% for the trailing twelve month period ended June 30, 2007), Moody's believes there is capacity for improvement as the company has either filed or is planning to file for rate increases in all of the jurisdictions in which it operates after a long period following RWE's acquisition where the company's ability to increase rates was limited due to stay-out provisions agreed to in some jurisdictions. Timely rate increases and the ability to attract new equity capital will be two key drivers for maintaining the rating going forward as the water utility industry remains capital intensive with infrastructure spending often times at a multiple of depreciation. American Water is facing a sizeable capital spending plan and will need to finance additional rate base with debt and equity at levels appropriate for the rating category to avoid future downward pressure on the rating or outlook given the magnitude of the planned expenditures.

We note that American Water also has a much smaller non-regulated water-related services segment (approximately 12% of fiscal 2006 revenues) that will remain a part of its business model going forward. While this business segment is considered a growth area and is less capital intensive, it is also less profitable. Consequently, the regulated operating subsidiaries will continue to be the primary source of funds to service debt and to pay the expected dividends to its public shareholders.

The stable outlook reflects Moody's expectations that going forward there will be no material change to the currently envisioned capital structure. The refinancing will likely have a negative impact on American Water's financial flexibility going forward as the company terminates its historical reliance on funding from its larger and more financially secure parent and switches to meeting those capital needs from the public debt and equity markets as a standalone entity. Moody's expects the company to maintain adequate liquidity for its operations primarily through Capital's \$700 million commercial paper program which is currently back-stopped by a committed multi-year \$800 million revolving bank facility expiring in September 2012. Although currently lightly drawn, Moody's expects the company may moderately increase its utilization of commercial paper borrowings over the balance of 2007.

Headquartered in Voorhees, New Jersey, American Water Works Company, Inc. is an indirect wholly-owned subsidiary of RWE AG and is the largest investor-owned provider of water, wastewater and related services in North America. It is the parent company of numerous water utilities in the United States and reported revenue in 2006 of \$2.1 billion.

New York
William L. Hess
Managing Director
Corporate Finance Group
Moody's Investors Service
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

New York
James O'Shaughnessy
Analyst
Corporate Finance Group
Moody's Investors Service
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

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Moody's Investors Service

Global Credit Research
Credit Opinion
17 OCT 2007

Credit Opinion: American Water Works Company, Inc.

American Water Works Company, Inc.

New Jersey, United States

Ratings

| | |
|---------------|----------------|
| Category | Moody's Rating |
| Outlook | Stable |
| Issuer Rating | Baa2 |

Contacts

| | |
|------------------------------|--------------|
| Analyst | Phone |
| James O'Shaughnessy/New York | 212.553.1607 |
| William L. Hess/New York | 212.553.3837 |

Key Indicators

| American Water Works Company, Inc. (New) | 2004 | 2005 | 2006 | LTM 6-2007 |
|-------------------------------------------------------------------|-------|-------|-------|------------|
| Funds from Operations / Adjusted Debt [1][2] | 7.0% | 6.7% | 6.9% | 7.9% |
| Retained Cash Flow / Adjusted Debt [2] | 7.0% | 6.7% | 6.9% | 7.9% |
| Common Dividends / Net Income Available for Common | 0.0% | 0.0% | 0.0% | 0.0% |
| Funds from Operations + Adjusted Interest / Adjusted Interest [3] | 2.6x | 2.4x | 2.2x | 2.4x |
| Adjusted Debt / Adjusted Capitalization [2][4] | 67.0% | 68.8% | 59.3% | 53.5% |
| Net Income Available for Common / Common Equity | -2% | -12% | -4% | -3% |

[1] FFO includes add-back of 2/3 annual operating lease expense [2] Debt is adjusted to include preferred stock, 6X rent, and underfunded pension obligation [3] Interest is adjusted to include 1/3 rent and preferred stock dividends [4] Adjusted capitalization reflects the adjustments made to debt

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Company Profile

Headquartered in Voorhees, New Jersey, American Water Works Company, Inc. ("American Water"), is an indirect wholly-owned subsidiary of RWE AG and is the largest investor-owned provider of water, wastewater and related services in North America. It is the parent company of numerous regulated water utility subsidiaries in the United States and reported revenue in 2006 of \$2.1 billion. American Water is multiples larger than other investor owned water utility companies within its peer group in the U. S. Assets supporting this revenue base include its operations in 32 states serving a population of approximately 16.2 million. Although American Water has non-regulated businesses (approximately 12% of revenues) it is primarily viewed, on a consolidated basis, as a regulated water utility company.

American Water is a parent holding company with no direct debt obligations. Its primary financing vehicle is American Water Capital Corp. ("Capital"), a finance subsidiary. American Water also incurs debt at the regulated subsidiary level.

Recent Developments

On October 12, 2007, Moody's downgraded to Baa2 from Baa1 the senior unsecured issuer rating of Capital. Moody's also confirmed Capital's P-2 short-term rating. At the same time, Moody's assigned a (P) Baa2 senior

unsecured rating to Capital's planned \$1.5 billion note offering and a Baa2 senior unsecured issuer rating to Capital's parent, American Water.

The downgrade of Capital's long-term rating was prompted by RWE AG's planned divestiture of the company, via initial public offering. The initial sale of RWE's interest in American Water is expected to happen in late-2007; however, preceding that transaction, Capital is expected to issue \$1.5 billion of senior unsecured notes in order to substantially repay approximately \$2.0 billion of inter-company debt currently owed to RWE. These notes are expected to be issued in October 2007. It is Moody's understanding that the company will also issue \$500 million of "equity units" concurrent with the IPO that will fund out the balance of inter-company debt owed to RWE.

The one-notch downgrade of Capital's senior unsecured issuer rating, and the assignment of a Baa2 issuer rating to its parent, American Water, reflects the loss of implied support from RWE following the IPO, historically weak consolidated credit metrics, and the increase in financial and operating risk going forward as a publicly traded, stand-alone company. Moody's has also taken this opportunity to equalize the new rating for American Water, a holding company, with its finance subsidiary, Capital, due to the existence of a "support agreement" between the two entities that effectively backstops Capital's timely payment of principal and interest, as needed.

Rating Rationale

American Water has a number of positive rating factors contributing to its investment grade rating including geographic diversity of operations and a mostly regulated rate structure which provides stability to cash flows over time (approximately 88% of revenues were derived from regulated operations in 2006). The importance of water to the communities it serves is also an important rating consideration. The ratings also reflect the company's current soft consolidated credit metrics, large capital spending forecast, and risks surrounding the company's transition to a stand-alone publicly traded company.

The key factors influencing American Water's rating and outlook include:

GEOGRAPHIC DIVERSITY AND REGULATED OPERATIONS

With operations in 32 states and areas of Canada, American Water's operating reach is considerable. On the regulated side, American Water operates in 20 states including its largest operations in New Jersey, Pennsylvania, and Illinois, which together accounted for nearly 50% of consolidated revenues in 2006. Although there can be differences in the level of profitability at each subsidiary jurisdiction, the regulated nature of the business should ensure a relatively stable and healthy return over time. Barriers to entry in this business are also very high given the importance of water and the constraints related to collection and distribution of water. The geographic diversity can also provide a balancing effect on the company's cash flows due to seasonal weather effects or timing of rate filings.

SOFT CREDIT METRICS

American Water's cash flow derived credit metrics have exhibited weakness for some time and are considered somewhat soft for the Baa2 rating (funds from operations (FFO) to total adjusted debt was approximately 7.9% for the trailing twelve month period ended June 30, 2007). Moody's believes there is capacity for improvement as the company has either filed or is planning to file for rate increases in many of the jurisdictions in which it operates after a long period following RWE's acquisition where the company's ability to increase rates was limited due to stay-out provisions agreed to in some jurisdictions. Going forward as a public company, we expect American Water will also be under pressure to initiate and continually pay dividends on its common stock.

CAPITAL INTENSIVE INDUSTRY

The regulated water utility business is highly capital intensive. Capital spending rates for American Water have averaged 240% of depreciation from 2004-06 and this level of expenditures often leads to negative free cash flow, which is not uncommon for regulated water and electric utilities. This funding is often financed with debt until "rate-base" is established and factored into allowed returns. This typically requires equity contributions to maintain the targeted balance of debt and equity in the capital structure. Timely rate increases and the ability to attract new equity capital will be two key drivers for maintaining the rating going forward as the water utility industry remains capital intensive with infrastructure spending often a multiple of depreciation. American Water is facing a sizeable capital spending plan and will need to finance additional rate base with debt and equity at levels appropriate for the rating category to avoid future downward pressure on the rating or outlook given the magnitude of the planned expenditures.

SUPPORT AGREEMENT WITH AMERICAN WATER CAPITAL CORP

Capital, a Delaware corporation, is the wholly-owned finance subsidiary of American Water and whose purpose is to streamline the financing function, create cash management efficiency, and lower the cost of capital for American Water's regulated water utility subsidiaries. Capital's senior unsecured Baa2 rating is now equalized with its parent, American Water. We note that American Water has provided credit enhancement through a support agreement between American Water and Capital. American Water will continue to own, during the term of the support

agreement, all of the voting stock of Capital. American Water has also committed to ensure that a positive tangible net worth at Capital will be maintained at all times. In addition, if Capital is unable to make timely payment of interest, principal, or premium on any debt issued and outstanding, American Water has committed to provide immediate and timely funds to Capital.

Moody's effectively views this structure a guarantee and has made no notching differentiation between the two entities. Nevertheless, we note that approximately 60% of American Water's consolidated debt will be borrowed at Capital, with the balance at the various regulated operating subsidiaries where the material cash flows are generated. We note that debt at Capital does not benefit from any explicit upstream guarantees from the regulated utility operations nor does the debt obligations of the subsidiaries, including Capital, benefit from any explicit downstream guarantee from American Water. Also important to note is that American Water's primary source of cash to service debt at Capital comes from the company's regulated utility operations. Although Moody's believes the current ratings capture the cash generating ability of those subsidiary operations, we note that dividends will be limited to the retained, undistributed or current earnings of each jurisdiction.

NON-REGULATED OPERATIONS

We note that American Water also has a much smaller non-regulated water-related services segment (approximately 12% of fiscal 2006 revenues) that will remain a part of its business model going forward. While this business segment is considered a growth area and is less capital intensive, it is also less profitable. We note the segment reported negative EBIT in 2005 and 2006. Consequently, the regulated operating subsidiaries will continue to be the primary source of funds to service debt and to pay the expected dividends to its public shareholders.

Liquidity

In terms of internal liquidity, Moody's generally expects American Water to generate at least \$500 million in FFO per year, with a weighting towards the second half of the year due to seasonality. In addition to internally generated cash flows, Moody's expects that American Water will fund some short-term capital needs with commercial paper borrowings. The \$700 million commercial paper program established at Capital is backstopped by a five-year \$800 million revolving credit agreement that expires in September 2012. There is a relatively balanced maturity schedule for existing debt. Although currently lightly utilized, Moody's expects the company may moderately increase its utilization of commercial paper borrowings over the balance of 2007. Despite the modest negative free cash flow expected over the next four quarters, American Water's liquidity appears to be sufficient to meet the company's needs.

Rating Outlook

The rating outlook is stable. Moody's considers the company's current weak cash flow driven credit metrics but also the room for improvement as the company files for additional rate increases across many of its operating jurisdictions. Although Moody's does not expect a material increase in leverage post-IPO, there are number of other potential cash flow uncertainties to consider, including possible dividend pressure as new publicly traded company.

What Could Change the Rating - Up

The ratings for American Water are not likely to be upgraded in the near-term given the credit metrics and the planned large capital spending program. Levels that would be seen as appropriate for the category include consolidated FFO to adjusted debt in the mid teens with retained cash flow (FFO - dividends) to adjusted debt measuring near 10%.

What Could Change the Rating - Down

There are a number of considerations that Moody's would take into account and likely see as placing negative pressure on American Water or Capital's rating. These considerations include any changes to the existing support agreement between Capital and American Water as well as any significant deterioration in credit metrics due to fundamental business pressure. A prolonged period of financial results leading to FFO to adjusted debt in the low-to-mid single digits for an extended period would place severe pressure on the rating.

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 JOURNALISTS: 212-553-0376
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 JOURNALISTS: 212-553-0376
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Moody's Investors Service

Global Credit Research
Credit Opinion
17 OCT 2007

IWC 3-2 R4

Credit Opinion: American Water Works Company, Inc.

American Water Works Company, Inc.

New Jersey, United States

Ratings:

| Category | Moody's Rating |
|---------------|----------------|
| Outlook | Stable |
| Issuer Rating | Baa2 |

Contacts:

| Analyst | Phone |
|------------------------------|--------------|
| James O'Shaughnessy/New York | 212.553.1807 |
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| Adjusted Debt / Adjusted Capitalization [2][4] | 67.0% | 68.8% | 59.3% | 53.5% |
| Net Income Available for Common / Common Equity | -2% | -12% | -4% | -3% |

[1] FFO includes add-back of 2/3 annual operating lease expense [2] Debt is adjusted to include preferred stock, 6X rent, and underfunded pension obligation [3] Interest is adjusted to include 1/3 rent and preferred stock dividends [4] Adjusted capitalization reflects the adjustments made to debt

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion:

Company Profile

Headquartered in Voorhees, New Jersey, American Water Works Company, Inc. ("American Water"), is an indirect wholly-owned subsidiary of RWE AG and is the largest investor-owned provider of water, wastewater and related services in North America. It is the parent company of numerous regulated water utility subsidiaries in the United States and reported revenue in 2006 of \$2.1 billion. American Water is multiples larger than other investor owned water utility companies within its peer group in the U. S. Assets supporting this revenue base include its operations in 32 states serving a population of approximately 162 million. Although American Water has non-regulated businesses (approximately 12% of revenues) it is primarily viewed, on a consolidated basis, as a regulated water utility company.

American Water is a parent holding company with no direct debt obligations. Its primary financing vehicle is American Water Capital Corp. ("Capitel"), a finance subsidiary. American Water also incurs debt at the regulated subsidiary level.

Recent Developments

On October 12, 2007, Moody's downgraded to Baa2 from Baa1 the senior unsecured issuer rating of Capital. Moody's also confirmed Capital's P-2 short-term rating. At the same time, Moody's assigned a (P) Baa2 senior

unsecured rating to Capital's planned \$1.6 billion note offering and a Baa2 senior unsecured issuer rating to Capital's parent, American Water.

The downgrade of Capital's long-term rating was prompted by RWE AG's planned divestiture of the company, via initial public offering. The initial sale of RWE's interest in American Water is expected to happen in late-2007; however, preceding that transaction, Capital is expected to issue \$1.5 billion of senior unsecured notes in order to substantially repay approximately \$2.0 billion of inter-company debt currently owed to RWE. These notes are expected to be issued in October 2007. It is Moody's understanding that the company will also issue \$500 million of "equity units" concurrent with the IPO that will fund out the balance of inter-company debt owed to RWE.

The one-notch downgrade of Capital's senior unsecured issuer rating, and the assignment of a Baa2 issuer rating to its parent, American Water, reflects the loss of implied support from RWE following the IPO, historically weak consolidated credit metrics, and the increase in financial and operating risk going forward as a publicly traded, stand-alone company. Moody's has also taken this opportunity to equalize the new rating for American Water, a holding company, with its finance subsidiary, Capital, due to the existence of a "support agreement" between the two entities that effectively backstops Capital's timely payment of principal and interest, as needed.

Rating Rationale

American Water has a number of positive rating factors contributing to its investment grade rating including geographic diversity of operations and a mostly regulated rate structure which provides stability to cash flows over time (approximately 88% of revenues were derived from regulated operations in 2006). The importance of water to the communities it serves is also an important rating consideration. The ratings also reflect the company's current soft consolidated credit metrics, large capital spending forecast, and risks surrounding the company's transition to a stand-alone publicly traded company.

The key factors influencing American Water's rating and outlook include:

GEOGRAPHIC DIVERSITY AND REGULATED OPERATIONS

With operations in 32 states and areas of Canada, American Water's operating reach is considerable. On the regulated side, American Water operates in 20 states including its largest operations in New Jersey, Pennsylvania, and Illinois, which together accounted for nearly 50% of consolidated revenues in 2006. Although there can be differences in the level of profitability at each subsidiary jurisdiction, the regulated nature of the business should ensure a relatively stable and healthy return over time. Barriers to entry in this business are also very high given the importance of water and the constraints related to collection and distribution of water. The geographic diversity can also provide a balancing effect on the company's cash flows due to seasonal weather effects or timing of rate filings.

SOFT CREDIT METRICS

American Water's cash flow derived credit metrics have exhibited weakness for some time and are considered somewhat soft for the Baa2 rating (funds from operations (FFO) to total adjusted debt was approximately 7.9% for the trailing twelve month period ended June 30, 2007). Moody's believes there is capacity for improvement as the company has either filed or is planning to file for rate increases in many of the jurisdictions in which it operates after a long period following RWE's acquisition where the company's ability to increase rates was limited due to stay-out provisions agreed to in some jurisdictions. Going forward as a public company, we expect American Water will also be under pressure to initiate and continually pay dividends on its common stock.

CAPITAL INTENSIVE INDUSTRY

The regulated water utility business is highly capital intensive. Capital spending rates for American Water have averaged 240% of depreciation from 2004-06 and this level of expenditures often leads to negative free cash flow, which is not uncommon for regulated water and electric utilities. This funding is often financed with debt until "rate-base" is established and factored into allowed returns. This typically requires equity contributions to maintain the targeted balance of debt and equity in the capital structure. Timely rate increases and the ability to attract new equity capital will be two key drivers for maintaining the rating going forward as the water utility industry remains capital intensive with infrastructure spending often a multiple of depreciation. American Water is facing a sizeable capital spending plan and will need to finance additional rate base with debt and equity at levels appropriate for the rating category to avoid future downward pressure on the rating or outlook given the magnitude of the planned expenditures.

SUPPORT AGREEMENT WITH AMERICAN WATER CAPITAL CORP

Capital, a Delaware corporation, is the wholly-owned finance subsidiary of American Water and whose purpose is to streamline the financing function, create cash management efficiency, and lower the cost of capital for American Water's regulated water utility subsidiaries. Capital's senior unsecured Baa2 rating is now equalized with its parent, American Water. We note that American Water has provided credit enhancement through a support agreement between American Water and Capital. American Water will continue to own, during the term of the support

agreement, all of the voting stock of Capital. American Water has also committed to ensure that a positive tangible net worth at Capital will be maintained at all times. In addition, if Capital is unable to make timely payment of interest, principal, or premium on any debt issued and outstanding, American Water has committed to provide immediate and timely funds to Capital.

Moody's effectively views this structure a guarantee and has made no notching differentiation between the two entities. Nevertheless, we note that approximately 60% of American Water's consolidated debt will be borrowed at Capital, with the balance at the various regulated operating subsidiaries where the material cash flows are generated. We note that debt at Capital does not benefit from any explicit upstream guarantees from the regulated utility operations nor does the debt obligations of the subsidiaries, including Capital, benefit from any explicit downstream guarantees from American Water. Also important to note is that American Water's primary source of cash to service debt at Capital comes from the company's regulated utility operations. Although Moody's believes the current ratings capture the cash generating ability of those subsidiary operations, we note that dividends will be limited to the retained, undistributed or current earnings of each jurisdiction.

NON-REGULATED OPERATIONS

We note that American Water also has a much smaller non-regulated water-related services segment (approximately 12% of fiscal 2006 revenues) that will remain a part of its business model going forward. While this business segment is considered a growth area and is less capital intensive, it is also less profitable. We note the segment reported negative EBIT in 2005 and 2006. Consequently, the regulated operating subsidiaries will continue to be the primary source of funds to service debt and to pay the expected dividends to its public shareholders.

Liquidity

In terms of internal liquidity, Moody's generally expects American Water to generate at least \$500 million in FFO per year, with a weighting towards the second half of the year due to seasonality. In addition to internally generated cash flows, Moody's expects that American Water will fund some short-term capital needs with commercial paper borrowings. The \$700 million commercial paper program established at Capital is backstopped by a five-year \$800 million revolving credit agreement that expires in September 2012. There is a relatively balanced maturity schedule for existing debt. Although currently lightly utilized, Moody's expects the company may moderately increase its utilization of commercial paper borrowings over the balance of 2007. Despite the modest negative free cash flow expected over the next four quarters, American Water's liquidity appears to be sufficient to meet the company's needs.

Rating Outlook

The rating outlook is stable. Moody's considers the company's current weak cash flow driven credit metrics but also the room for improvement as the company files for additional rate increases across many of its operating jurisdictions. Although Moody's does not expect a material increase in leverage post-IPO, there are number of other potential cash flow uncertainties to consider, including possible dividend pressure as new publicly traded company.

What Could Change the Rating - Up

The ratings for American Water are not likely to be upgraded in the near-term given the credit metrics and the planned large capital spending program. Levels that would be seen as appropriate for the category include consolidated FFO to adjusted debt in the mid teens with retained cash flow (FFO - dividends) to adjusted debt measuring near 10%.

What Could Change the Rating - Down

There are a number of considerations that Moody's would take into account and likely see as placing negative pressure on American Water or Capital's rating. These considerations include any changes to the existing support agreement between Capital and American Water as well as any significant deterioration in credit metrics due to fundamental business pressure. A prolonged period of financial results leading to FFO to adjusted debt in the low-to-mid single digits for an extended period would place severe pressure on the rating.

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Moody's Investors Service

Global Credit Research
Rating Action
17 OCT 2006

Rating Action: American Water Capital Corporation

Moody's assigns P-2 short-term rating to American Water Capital

Approximately \$700 million of debt securities affected

New York, October 17, 2006 -- Moody's Investors Service assigned a Prime-2 short term rating to American Water Capital Corp. (Capital) in connection with its new \$700 million commercial paper (CP) program. At the same time, Moody's affirmed Capital's existing Baa1 long-term senior unsecured rating and VMIG-2 short term rating. The outlook remains negative.

The P-2 rating considers Capital's position as a financial conduit of American Water Works Company, Inc. (Water Works), and reflects the understanding that the existing support agreement between the two entities will continue to be maintained. Water Works has committed to ensure that a positive tangible net worth at Capital will be maintained at all times. In addition, if Capital is unable to make timely payment of interest, principal, or premium on any debt issued and outstanding, Water Works has committed to provide immediate and timely funds to Capital.

Capital's commercial paper program is fully backstopped by an \$800 million five-year committed revolving credit facility. Use of proceeds under the program includes general corporate purposes and refinancing of existing credit lines. The backstop facility, which was signed on September 15, 2006, terminates in five years (2011), has same-day borrowing availability and one financial covenant permitting a maximum level of debt to capitalization at Water Works of 70%. The credit agreement contains a material adverse change clause only at the initial extension of credit; an event that occurred at the closing of the facility with the issuance of L/C's.

Moody's long-term rating of Baa1 for Capital's existing senior unsecured obligations reflects the relatively stable nature of the cash flows expected from Water Works' regulated water utility businesses. Also considered in the rating is Water Works' plan to be divested, via initial public offering, from its current owner, RWE AG (A1 stable), of Germany. Moody's anticipates the company's capital structure following the spin-off, expected by mid-2007, will reflect a partial refinancing of Water Works' existing debt that should not result in a material increase in leverage but will require a significant amount of refinancing of inter-company debt with RWE.

At this time, the long-term rating is constrained by the uncertainty surrounding the liquidity and capital structure of American Water Works post IPO. Although RWE has no obligation to guarantee payments on securities issued by Capital or other subsidiaries of Water Works, Moody's has historically considered the financial strength of RWE and its ownership of Water Works in Capital's rating. The elimination of this relationship will likely be viewed negatively with respect to the company's overall credit profile which could possibly result in a reassessment of the long and short term ratings, following the planned change of ownership. Apart from the anticipated IPO transaction, the negative outlook also reflects the continuing uncertainty surrounding prospects for rate recovery and the ability of Water Works to strengthen credit ratios over time. We note as well that Water Works will soon be operating as a stand alone entity following its spin-off from RWE, with all the financial and operating responsibilities attached thereto as a publicly traded company.

Headquartered in Voorhees, New Jersey, American Water Works Company, Inc. is an indirect wholly-owned subsidiary of RWE AG and is the largest investor-owned provider of water, wastewater and related services in North America. It is the parent company of numerous water utilities in the United States and reported revenue in 2005 of \$2.0 billion.

New York
William L. Hess
Senior Vice President
Corporate Finance Group
Moody's Investors Service
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

James O'Shaughnessy
Analyst
Corporate Finance Group

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Moody's Investors Service

Global Credit Research
 Issuer Comment
 12 DEC 2006

Issuer Comment: American Water Capital Corp.

Moody's Comments on American Water's \$500 million Private Placement

American Water Works Company Inc.'s (American Water) planned \$500 million senior unsecured bond offering will have no immediate impact on Moody's rating of the company's financial conduit, American Water Capital Corp. (Baa1, negative outlook). The notes are expected to be placed privately and will have American Water Capital Corp. as the sole obligor. As Moody's understands the transaction, proceeds will be used to refinance existing inter-company advances from RWE AG, its current parent, and will become a more permanent component of its capital structure going forward. Both Moody's and American Water have historically considered this inter-company class of obligations as debt. Consequently, for ratio calculation purposes this debt financing is not viewed as being incremental. However, it will remove a certain level of flexibility on the part of American Water as this obligation becomes a more defined contractual debt obligation with a stated maturity rather than an obligation that could, in effect, be rolled over indefinitely at the discretion of RWE. American Water is targeting the completion of this financing by year-end 2006.

Moody's will continue to monitor the ratings of American Water as its plan to be divested from its current owner, via initial public offering, progresses; along with any developments related to the company's future strategy, business risk profile, and the ultimate level of debt to be employed in its capital structure post IPO. We note that Moody's current negative outlook for senior unsecured obligations of American Water Capital reflects both the relatively weak credit metrics for its rating category as well as the future elimination of support from its financially stronger parent, RWE, post IPO, which is expected to occur sometime in mid-2007.

Headquartered in Voorhees, New Jersey, American Water Works Company, Inc. is an indirect wholly-owned subsidiary of RWE AG and is the largest investor-owned provider of water, wastewater and related services in North America. It is the parent company of numerous water utilities in the United States and reported revenues of approximately \$2.0 billion for the last twelve months ended September 30, 2006.

| Contacts | Phone |
|------------------------------|--------------|
| James O'Shaughnessy/New York | 212-553-1607 |
| James Hempstead/New York | 212-553-4318 |
| Michael Rowan/New York | 212-553-4465 |
| William L. Hess/New York | 212-553-3837 |

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Moody's Investors Service

Global Credit Research
Rating Action
7 JUN 2004

Rating Action: American Water Capital Corporation

**MOODY'S CONFIRMS THE Baa1 SENIOR UNSECURED RATING OF AMERICAN WATER CAPITAL CORP.;
RATING OUTLOOK IS NEGATIVE**

Approximately \$95 Million of Debt Affected

New York, June 07, 2004 – Moody's Investors Service confirmed the Baa1 senior unsecured rating of American Water Capital Corp. (AWCC), with a negative outlook. The company's short-term rating of VMIG 2 for remarketable industrial revenue bonds was not placed under review and remains unchanged. This rating action concludes the review for possible downgrade that was initiated on November 26, 2003.

The rating of AWCC is primarily based upon the support of its parent, American Water Works, Company, Inc. (AWW), which operates regulated water utilities in 18 states. The confirmation of AWCC's rating reflects the relatively stable nature of AWW's water utility business, and financial strength that is expected to be derived from its ownership by RWE AG (A1 senior unsecured, negative outlook). RWE funds substantially all of AWW's short-term capital requirements. The rating confirmation also incorporates Moody's expectation that regulators will approve rate increases that result in improvement of AWW's consolidated cash flow coverages to a level that is more consistent with the rating category.

The negative rating outlook reflects the possibility that American Water Capital's ratings could be downgraded if regulators do not approve rate increases of sufficient magnitude to improve AWW's consolidated cash flow coverages to a level that is more commensurate with the rating category. The negative outlook is also influenced by the negative rating outlook for RWE, whose ratings are a meaningful consideration for the rating of AWCC.

American Water Works' financial results deteriorated in 2002 and 2003, with an increasing level of consolidated debt. However, consolidated funds from operations and cash from operations are anticipated to increase over the next few years. Financial results are expected to improve in 2004 and 2005 due to regulatory rate increases. Some of this expected improvement will result from rate increases that have already been authorized in late 2003 and thus far in 2004. AWW's need to file for rate increases in most states in which it operates reflects the high level of capital spending necessary to upgrade and maintain its water systems in compliance with regulatory standards.

American Water Capital Corp. (AWCC), a Delaware corporation, is a wholly-owned finance subsidiary of American Water Works Company (American Water Works or AWW). The purpose of this finance subsidiary is to streamline the financing function, create cash management efficiency, and lower the cost of capital for AWW's regulated water utility subsidiaries. AWCC is the primary funding vehicle for AWW and its utility subsidiaries. American Water Works has provided credit enhancement through a support agreement between AWW and AWCC. American Water Works will continue to own, during the term of the support agreement, all of the voting stock of AWCC. American Water Works has committed to ensure that a positive tangible net worth at AWCC will be maintained at all times. In addition, if AWCC is unable to make timely payment of interest, principal, or premium on any debt issued and outstanding, American Water Works has committed to provide immediate and timely funds to AWCC.

A merger between RWE AG and American Water Works Company was consummated in January 2003. American Water Works and its regulated water utilities operate as subsidiaries of RWE. American Water Capital has a committed credit facility for borrowing from RWE in amounts up to \$550 million. There is currently \$330 million outstanding under this credit agreement.

The rating of AWCC incorporates the benefit of AWW's ownership by RWE. The consolidated financial metrics of AWW would not support the Baa1 rating of AWCC on a stand-alone basis. The rating incorporates Moody's view that AWW derives significant financial flexibility from the ability to defer (if necessary) its preferred dividend payments to the parent, and its ability to borrow from the RWE family of companies.

American Water Works Company is the parent company of numerous water utilities in the United States. American Water Works Company is an indirect wholly-owned subsidiary of RWE AG. Headquartered in Essen, Germany, RWE AG is a large international energy and utility company with core activities in electricity, gas, water, and wastewater.

New York
Daniel Gates

Managing Director
Corporate Finance Group
Moody's Investors Service
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

New York
Mo Ying W. Seto
Senior Vice President
Corporate Finance Group
Moody's Investors Service
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

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Research Update:

American Water Works, Sub Ratings Remain On CreditWatch; IPO Timing Still Uncertain

Rationale

On Jan. 29, 2008, Standard & Poor's Ratings Services said that its 'A-' corporate credit rating on water and wastewater utility company American Water Works Co. Inc. (AWW) and its funding subsidiary, American Water Capital Corp. (AWCC) will remain on CreditWatch with negative implications. Standard & Poor's placed the ratings on CreditWatch on Nov. 15, 2007, after parent RWE AG (A+/Negative/A-1) postponed AWW's equity offering. The reaffirmation of the CreditWatch listing follows recent statements by RWE's management that the AWW spin-off could still be delayed beyond April and possibly occur in late 2008. We still believe the postponement of the IPO distracts AWW's management and could stall necessary improvements to the company's financial profile, which depends on the successful execution of a number of rate cases across several states. Additional delays to the IPO or AWW's inability to achieve improved financial performance in 2008 is likely to result in a downgrade.

As of Sept. 30, 2007, AWW's pro forma total debt, including capitalized operating leases and tax-effected pension and postretirement obligations, was \$5.7 billion.

The ratings on the Voorhees, N.J.-based AWW reflect our assessment of the company's stand-alone credit quality based on its proposed post-IPO business plan, which includes improvements in the utility's financial profile above current levels. AWW has received all regulatory approvals necessary for its divestiture from RWE AG. The ratings are also based on our expectation of regulatory support to fund the company's sizable capital-spending requirements through rate cases or supportive policies, such as infrastructure surcharges, forward-looking test years, and single tariff pricing.

AWW's excellent business risk profile is characterized by an excellent competitive position with high barriers to entry; a diverse and supportive regulatory environment that provides reasonably allowed ROEs, incentives for infrastructure improvements and support for acquiring small water companies; an above-average service territory that provides some market, cash flow, and regulatory diversification; a stable customer base that is predominantly residential and commercial; and the relatively low operating risk of regulated and nonregulated operations. AWW's aggressive financial profile, uncertainties associated with its planned equity and equity unit offerings, elevated capital-spending requirements for infrastructure replacement, increased compliance costs with water-quality standards, and the company's reliance on acquisitions to provide growth partly offset these strengths.

RWE indirectly owns AWW. Through RWE's regulated subsidiaries, AWW provides water and wastewater services to more than 3.3 million customers in 20 states. AWW's regulated utility subsidiaries represent almost 90% of total revenues, but have provided almost 100% of adjusted EBIT for the past three years. The company's nonregulated subsidiaries consist of water and wastewater

Research Update: American Water Works, Sub Ratings Remain On Credit Watch; IPO Timing Still Uncertain

facility management and maintenance, as well as design and construction consulting services related to water and wastewater plants. We view these nonregulated segments as having modest incremental risk to AWW due to their lack of cash flow contribution and modest expected capital requirements.

AWW's financial metrics are weak for the rating and partly result from agreements with some state regulators not to file rate cases for up to three years. This was a condition of RWE's acquisition of AWW. As evidenced by the filing of 11 rate cases in 2007, we expect AWW to actively pursue additional rate cases as determined by its rising operating costs, capital-spending plans, and pension and other postretirement obligations. We anticipate that current rate case activity may lead to annual revenue increases of up to \$175 million, if granted. Another reason for the weak performance is AWW's significant goodwill impairments over the past three years. The impairments, which have totaled more than \$1 billion, were based on slower-than-expected growth in RWE's North American water segment, privatization of water utilities in North America, and valuation of its nonregulated businesses. Based on indicative market values, an impairment of up to \$300 million could be reported in fourth-quarter 2007.

Adjusted funds from operations (FFO) to total debt is still below 10%, which is weak for the rating. In addition, significant rate relief is necessary for the company to earn its authorized rate of return of about 10%. We expect adjusted FFO, which is subpar at \$475 million for the 12 months ended Sept. 30, 2007, to benefit from continued customer growth and rate increases in several key states. After AWW issued \$1.5 billion of senior notes, which the company used to redeem RWE intercompany preferred stock, adjusted debt to capital increased to 56% as of Sept. 30, 2007, from 48% as of June 30, 2007. The increase in leverage is partly due to the intermediate equity treatment of the preferred stock, compared with the 100% debt treatment of the newly issued debt.

As a condition of the regulatory approvals for the sale, RWE has agreed that AWW's capital structure will consist of at least 45% common equity at the time of the IPO. As of Sept. 30, 2007, common equity consisted of 47% of AWW's total book capitalization. RWE must infuse additional cash equity if leverage increases from current levels.

Short-term rating factors

The 'A-2' short-term ratings on AWW and AWCC reflect sizable borrowing capacity under the company's revolving credit facility and stable cash flows from regulated subsidiaries. However, AWW's cash uses include high levels of capital spending, substantial upcoming debt maturities, and expectations that the company will institute a common stock dividend after it completes the proposed IPO. Capital expenditures are projected at \$4 billion to \$4.5 billion during the next five years for infrastructure replacements, new facility construction, maintenance of water-quality and environmental standards, and system reliability.

With cash from operations for the past 12 months of only \$390 million, AWW's cash flow generation is insufficient to meet its ongoing operating and capital needs, and will require additional access to the capital markets over the intermediate term. Scheduled debt maturities of \$196 million in 2008, \$55

Research Update: American Water Works, Sub Ratings Remain On CreditWatch; IPO Timing Still Uncertain

million in 2009, and \$54 million in 2010 are fairly sizable. AWW is expected to implement a dividend policy with its equity issuance, roughly matching the average dividend yield of other companies in its peer group, which is about 2%. As such, annual dividend payments could exceed \$100 million.

As of Sept. 30, 2007, AWW had \$151 million in unrestricted cash, about \$415 million available under its \$800 million revolving credit facility, which matures on Sept. 15, 2011, and a \$10 million short-term working-capital line of credit. Financial covenants include a maximum debt to capital (with adjustments) of 70% and restrictions on liens, distributions, debt incurred at AWW, and asset sales.

Ratings List

Ratings Remain On CreditWatch Negative

American Water Works Co. Inc.

Corp. credit rating A-/Watch Neg

American Water Capital Corp.

Corp. credit rating A-/Watch Neg
Senior unsecured debt A-/Watch Neg
Preferred stock BBB/Watch Neg

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November 15, 2007

Research Update:

**American Water Works 'A-'
Long-Term Ratings Placed On
Watch Negative After Postponing
IPO**

Primary Credit Analyst:

Kenneth L. Farer, New York (1) 212-438-1679; kenneth_farer@standardandpoors.com

Table Of Contents

Rationale

Ratings List

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Research Update:

American Water Works 'A-' Long-Term Ratings Placed On Watch Negative After Postponing IPO

Rationale

On Nov. 15, 2007, Standard & Poor's Ratings Services placed its long-term ratings on American Water Works Co. Inc. (AWW) and its funding subsidiary American Water Capital Corp. (AWCC) on CreditWatch with negative implications, including its 'A-' corporate credit ratings. The 'A-2' short-term ratings were not placed on CreditWatch.

The CreditWatch placement follows an announcement by AWW's parent, RWE AG (A+/Negative/A-1), that it has postponed AWW's equity offering, which will delay financial improvements and will likely result in a downgrade if the IPO is not completed prior to the end of the first quarter of 2008. Ratings could be affirmed and removed from CreditWatch if the equity offering is completed prior to that time and financial performance improves in line with management's forecast. RWE stated that the timing of the IPO has not yet been determined, because the company expects the current value paid for AWW will not be sufficient to fund RWE's planned dividend payments and share repurchase program.

The 'A-' corporate credit rating on the Voorhees, N.J.-based water and wastewater utility company reflects our assessment of AWW's stand-alone credit quality based on its proposed post-IPO business plan, which includes improvements in the financial profile. The ratings are also based on our expectation of regulatory support to fund the company's sizable capital-spending requirements through rate cases or supportive policies such as infrastructure surcharges, forward-looking test years, and single tariff pricing.

As of June 30, 2007, AWW's pro-forma total debt, including capitalized operating leases and tax-effected pension and postretirement obligations, was about \$5.3 billion.

AWW's excellent business risk profile of '2' (utility business profiles are categorized from '1' (excellent) to '10' (vulnerable)) is characterized by:

- An excellent competitive position with high barriers to entry;
- A supportive regulatory environment;
- An above-average service territory in terms of size and interconnections;
- A stable customer base that is predominantly residential and commercial; and
- The relatively low operating risk of regulated and nonregulated operations.

The partly offsetting factors are AWW's weak financial profile, uncertainties associated with its planned equity and equity unit offerings, elevated capital-spending requirements for infrastructure replacement,

increased compliance costs with water quality standards, and the company's reliance on acquisitions to provide growth.

AWW, indirectly owned by RWE and through its regulated subsidiaries, provides water and wastewater services to more than 3.3 million customers in 20 states. The company's regulated utility subsidiaries represent almost 90% of total revenues, but have provided almost 100% of adjusted EBIT for the past three years. The company's nonregulated subsidiaries consist of the management and maintenance of water and wastewater facilities as well as the design and construction consulting services related to water and wastewater plants. We view these nonregulated segments as having modest incremental risk to AWW due to their lack of cash flow contribution and modest expected capital requirements.

AWW's financial metrics are weak for the rating and are partly attributed to agreements not to file rate cases with some state regulators for up to three years as a condition of RWE's acquisition of the company. All of the regulatory stay-out provisions expired on June 30, 2007, and AWW is expected to pursue rate cases actively in all jurisdictions as determined by its rising operating costs, capital-spending plans, and pension and other postretirement obligations. Another reason for the weak performance is AWW's goodwill impairments of more than \$700 million recorded during the past three years. The impairments were based on slower-than-expected growth in RWE's North American water segment, privatization of water utilities in North America, and valuation of its nonregulated businesses.

Adjusted FFO to total debt was 9%, which is well below the minimum expectation of 12% for the 'A' rating category. In addition, significant rate relief is necessary for the company to earn its authorized rate of return, which is about 10%. We expect adjusted FFO, which was subpar at \$460 million in 2006, to benefit from continued customer growth and rate increases in several key states. Adjusted debt to capital of 53% and FFO interest coverage of 2.6x are appropriate for the rating.

Although AWW's subsidiaries recover underfunded pension and postretirement benefit obligations through regulatory deferrals, AWW's consolidated pension and other postretirement obligations were underfunded by \$459 million as of Dec. 31, 2006, the last reported date.

Short-term credit factors

The 'A-2' short-term ratings on AWW and AWCC reflect sizeable borrowing capacity under the company's revolving credit facility and stable cash flows from regulated subsidiaries. However, AWW's uses of cash include high levels of capital spending, substantial upcoming debt maturities, and expectations that the company will institute a common stock dividend on completion of its proposed IPO. Capital expenditures are projected at \$4 billion to \$4.5 billion during the next five years for infrastructure replacements, construction of new facilities, maintenance of water quality and environmental standards, and system reliability.

For 2007, the company has forecast capital spending of between \$740 million and \$780 million. Despite the current debt and equity issuances, AWW's cash flow generation is insufficient to meet its ongoing operating and capital needs, and will require additional access to the capital markets over the

intermediate term. Before the IPO and refinancing of its debt obligations, AWW's scheduled debt maturities of \$287 million and \$196 million in 2007 and 2008, respectively, are fairly sizable. Proceeds from the company's \$1.5 billion debt issue completed in October 2007 were used to repay a portion of the intercompany debt owed to RWE. AWW is expected to implement a dividend policy with its equity issuance, roughly matching the average dividend yield of other companies in its peer group, which is about 2%. As such, annual dividend payments could exceed \$100 million.

As of June 30, 2007, AWW had \$51 million in cash, about \$740 million available under its \$800 million revolving credit facility, which matures on Sept. 15, 2011, and a \$10 million short-term working capital line of credit, which matures on Dec. 31, 2007, unless extended. Financial covenants include a maximum debt to capital (with adjustments) of 70% and restrictions on liens, distributions, debt incurred at AWW, and asset sales. As a condition to the regulatory approvals for the sale, AWW has agreed that its capital structure must be comprised of at least 45% common equity at the time of the IPO. The change-of-control provision is more restrictive than most revolving credit agreements, as a change of control is defined as one entity owning 25% or more of the post-IPO outstanding common stock or certain majority changes to the membership of the board of directors.

Ratings List

Ratings Placed On CreditWatch

| | To | From |
|------------------------------------------------------|---------------|-------------|
| American Water Works Co. Inc. Corp. credit rating | A-/Watch Neg | A-/Negative |
| American Water Capital Corp. Corp. credit rating | A-/Watch Neg | A-/Negative |
| Senior unsecured debt | A-/Watch Neg | A- |
| Preferred stock | BBB/Watch Neg | BBB |

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September 19, 2007

Research Update:

**American Water Works 'A-' Corp
Rating Is Affirmed, Off Watch,
Outlook Neg; Debt Issues Rated**

Primary Credit Analyst:
Kenneth L Farer, New York (1) 212-438-1679; kenneth_farer@standardandpoors.com

Table Of Contents

Rationale

Outlook

Ratings List

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Research Update:

American Water Works 'A-' Corp Rating Is Affirmed, Off Watch, Outlook Neg; Debt Issues Rated

Rationale

On Sept. 19, 2007, Standard & Poor's Ratings Services affirmed its 'A-' corporate credit rating on American Water Works Co. Inc. (AWW) and its funding subsidiary, American Water Capital Corp. (AWCC). The ratings were removed from CreditWatch with negative implications. The outlook is negative.

The rating action reflects the stand-alone credit quality of AWW, which has received all regulatory approvals necessary for its parent RWE AG (A+/Negative/A-1) to sell the company via an IPO in late 2007. The rating action also reflects our reassessment of AWW's financial risk profile, based on the company's post-IPO business plan and proposed capital structure.

At the same time, Standard & Poor's assigned its 'A-' senior unsecured debt rating to AWCC's proposed \$1.5 billion debt and 'BBB' preferred stock rating to AWCC's \$500 million proposed equity unit offering. The specific amount of five-year, 10-year, and 30-year notes has not yet been determined.

AWW's subsidiary debt of \$2.1 billion is less than 20% of the company's assets, after adjusting for goodwill. Therefore, the senior unsecured debt issued by the holding company does not merit a lower rating due to structural subordination. However, there is little cushion for additional subsidiary obligations before the 20% threshold would be breached.

The equity unit consists of a debtlike component, the payment of quarterly interest, and a forward common stock purchase contract with the number of shares dependent on AWW's stock price at maturity. We treat the equity units as two financings rather than a single "net" equity financing. Although the transaction incorporating the equity issuance could theoretically be applied to repaying the debt, there is no legal or in-substance defeasance, or any other basis to expect that this will be the case, as there are also remarketing provisions available for the debt portion of the security.

AWW's excellent business risk profile of '2' (Utility business profiles are categorized from '1' (excellent) to '10' (vulnerable)) is characterized by:

- An excellent competitive position with high barriers to entry;
- A supportive regulatory environment;
- An above-average service territory in terms of size and interconnections;
- A stable customer base that is predominantly residential and commercial;
- and
- The relatively low operating risk of regulated and nonregulated operations.

These strengths are partly offset by uncertainties associated with AWW's weak financial profile, planned IPO and debt offerings, elevated capital-spending requirements for infrastructure replacement, increased

compliance costs with water quality standards, and the company's reliance on acquisitions to provide growth partly offset its strengths.

AWW is currently indirectly owned by RWE, and through its regulated subsidiaries, provides water and wastewater services to more than 3.3 million customers in 20 states. The company's regulated utility subsidiaries represent almost 90% of total revenues and have provided almost 100% of adjusted EBIT for the past three years. The company's nonregulated subsidiaries include the management and maintenance of water and wastewater facilities, and the design and construction consulting services related to water and wastewater plants. We view these nonregulated segments as having modest incremental risk to AWW due to their limited revenue and cash flow contribution, modest expected capital requirements, and contractual terms, which are largely with a municipal or governmental entity.

AWW's financial metrics are weak for the current rating. The weak financial measures are partly attributed to agreements not to file rate cases with some state regulators for up to three years as a condition of RWE's acquisition of the company. Another reason for the weak performance is AWW's goodwill impairments of more than \$700 million recorded over the past three years. The impairments were based on downward adjustments to the growth expectations in RWE's North America water segment, slower-than-expected privatization of water utilities in North America, and valuation of its nonregulated businesses. All of the stay-out provisions expired on June 30, 2007, and AWW is expected to actively pursue rate cases in all jurisdictions as determined by its rising operating costs, capital-spending plans, and pension and other postretirement obligations. As of June 30, 2007, AWW's pro forma total debt, including capitalized operating leases and tax-effected pension and postretirement obligations, was about \$5.3 billion, with adjusted debt to capital of 53%. For the 12 months ended Dec. 31, 2006, adjusted funds from operations (FFO) was \$460 million and FFO interest coverage was 2.6x, which are appropriate figures for the current rating. However, adjusted FFO to total debt of 9% is well below the minimum expectation of 12% for the 'A' category. In addition, significant rate relief is necessary for the company to earn its authorized rate of return, which is about 10%.

Although AWW's subsidiaries recover underfunded pension and postretirement benefit obligations through regulatory deferrals, AWW's consolidated pension and other postretirement obligations were underfunded by \$459 million as of Dec. 31, 2006, the last reported date.

Short-term credit factors

The 'A-2' short-term rating on AWW and AWCC reflects:

- Adequate liquidity sources;
- Stable cash flows from regulated subsidiaries;
- The expectation of regulatory support to fund the company's sizable capital-spending requirements through rate cases or supportive policies such as infrastructure surcharges, forward-looking test years, and single tariff pricing; and
- Meaningful debt maturities over the next few years.

As of June 30, 2007, AWW had \$51 million in cash, about \$740 million available under its \$800 million revolving credit facility, which matures on

Research Update: American Water Works 'A-' Corp Rating Is Affirmed, Off Watch, Outlook Neg; Debt Issues Rated

Sept. 15, 2011, and a \$10 million short-term working capital line of credit, which matures on Dec. 31, 2007, unless extended. Financial covenants in the revolving credit facility include a maximum debt to capital (with adjustments) of 70% and restrictions on liens, distributions, debt incurred at AWW, and asset sales. The change-of-control provision is more restrictive than most revolving credit agreements, as a change of control is defined as one entity owning 25% or more of the post-IPO outstanding common stock or certain majority changes to the membership of the board of directors.

Over the past three years, cash flow has steadily declined due to the regulatory stay-out provisions implemented after the company's acquisition by RWE. We expect adjusted FFO, which was subpar at \$460 million in 2006, to benefit from continued customer growth and rate increases in several key states. AWW's uses of cash include high levels of capital spending, substantial upcoming debt maturities, and expectations that the company will institute a common stock dividend on completion of its proposed IPO. Capital expenditures are projected at \$4 billion to \$4.5 billion for the next five years for infrastructure replacements, construction of new facilities, maintenance of water quality and environmental standards, and system reliability. For 2007, the company has forecast capital spending of between \$740 million and \$780 million. Despite the current debt and equity issuances, AWW's cash flow generation is insufficient to meet its ongoing operating and capital needs, and will require additional access to the capital markets over the intermediate term. Before the IPO and refinancing of its debt obligations, AWW's scheduled debt maturities of \$287 million and \$196 million in 2007 and 2008, respectively, are fairly sizable. We expect AWW's dividend policy to roughly match the average dividend yield of other companies in its peer group, which is about 2%, and, therefore, annual dividend payments could exceed \$100 million.

Outlook

The outlook on AWW is negative. The negative outlook reflects the company's current weak financial profile. A downgrade could occur if the pending rate cases, particularly in New Jersey and Pennsylvania, do not allow for adequate rate relief to improve the company's financial profile, the company is unable to complete its planned debt and equity offerings and achieve its stated leverage target in the near term, or if debt leverage steadily increases over the intermediate term. Conversely, we could revise the outlook to stable if AWW's financial profile improves through favorable regulatory rate increases at current ROEs, with limited additional debt leverage.

Ratings List

Ratings Affirmed, Off Watch, Outlook Negative

To From

Research Update: American Water Works 'A-' Corp Rating Is Affirmed, Off Watch, Outlook Neg; Debt Issues Rated

American Water Works Co. Inc.

Corp. credit rating A-/Negative/A-2 A-/Watch Neg/A-2

American Water Capital Corp.

Corp. credit rating A-/Negative/A-2 A-/Watch Neg/A-2
Senior unsecured debt A- BBB+/Watch Neg

Ratings Assigned

Preferred Stock

\$500 million equity units BBB

Senior unsecured debt

\$1.5 billion senior unsecured debt A-

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Standard & Poor's RatingsDirect | September 19, 2007

6

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RESEARCH

Research Update:

American Water Works Assigned 'A-' Corporate Credit Rating, On Watch Neg

Publication date: 13-Oct-2006
Primary Credit Analyst: Kenneth L. Farer, New York (1) 212-438-1679;
kenneth_farer@standardandpoors.com

Rationale

On Oct. 13, 2006, Standard & Poor's Ratings Services assigned its 'A-/A-2' corporate credit rating to American Water Works Co. Inc. At the same time, Standard & Poor's affirmed its 'A-' rating on American Water Capital Corp., a wholly owned subsidiary of American Water Works, that serves as the funding vehicle for American Water Works' regulated water utility subsidiaries. Standard & Poor's also assigned its 'A-2' rating to American Water Capital's \$700 million commercial paper program.

The ratings on American Water Works were placed on CreditWatch with negative implications. The ratings on American Water Capital are also on CreditWatch with negative implications, where they were placed on Nov. 7, 2005.

The ratings on the companies will remain on CreditWatch until the completion of the sale of American Water Works by parent RWE AG (A+/Negative/A-1), which is expected in 2007. The CreditWatch listing reflects continued uncertainty surrounding the extensive regulatory process associated with approving the sale, the need for an updated business plan, and completion of significant debt and equity offerings.

The ratings on American Water Works and American Water Capital reflect the stand-alone credit quality of American Water Works. American Water Works' stand-alone business risk profile is '2' (excellent). (Utility business profiles are categorized from '1' (excellent) to '10' (vulnerable)). The strength of the business profile stems from insulation from competition, geographically diverse and largely residential markets, supportive regulatory environment, and the relatively low operating risk of managing groundwater and water treatment facilities. Uncertainty associated with American Water Works' IPO in 2007, increasingly stringent water quality standards, and the company's reliance on acquisitions to provide growth partly offset its strengths.

American Water Works' stand-alone financial risk profile is intermediate and includes management's projected post-IPO debt-to-capital ratio of 45% to 55%. We will reassess the financial risk profile when additional information is available concerning the company's post-IPO business plan and capital structure.

Historical earnings and margins are stable, supported by healthy markets and regulatory recovery of operating and capital costs, although increased operating and capital expenses can lag regulatory recovery. For the past five years, funds from operations (FFO) to debt has been about 10% and FFO interest coverage was in the 1.5x to 2.5x area. Given the business risk profile of '2', American Water Works' cash flow metrics are somewhat weak for the 'A-' rating.

In RWE's investor presentation related to the sale of its water businesses, the company stated that its North American Water segment, which includes some operations outside of American Water Works, plans to spend \$3.6 billion on capital expenditures from 2005 to 2009, compared with about \$500 million per year recently. American Water Works' increased capital spending is needed to upgrade aging water systems, accommodate population and economic growth, and comply with environmental regulations. RWE projects negative free cash flow and external financing to fund the higher capital spending. Over the intermediate term, continued customer growth and regulatory rate increases

could improve credit measures. However, improvements could be hindered if future regulatory rate increases do not keep pace with the company's increased capital spending.

Short-term credit factors

The 'A-2' short-term rating on American Water Works and American Water Capital reflects:

- Adequate consolidated liquidity,
- Stable cash flows from regulated subsidiaries,
- American Water Capital's \$800 million revolving credit facility, which matures on Sept. 15, 2011 (excluding extensions), and
- Manageable debt maturities over the next few years.

American Water Works has maintained adequate cash balances, typically exceeding \$50 million, although future levels could differ after the sale by RWE. Uses of American Water Capital's \$800 million revolving credit facility, which matures on Sept. 15, 2011, are targeted for backup to the company's \$700 million commercial paper program and LOCs, as needed. Financial covenants in the revolving credit facility include a maximum debt to capital (with adjustments) of 70% and restrictions on liens, distributions, debt incurred at American Water Works, and asset sales. The change of control provision is more restrictive than most revolving credit agreements as a change of control is defined as one entity owning 25% or more of the post-IPO outstanding common stock or certain majority changes to the membership of the board of directors.

Ratings List

Ratings Assigned

American Water Works Co. Inc.
Corporate credit rating A-/Watch Neg/A-2

American Water Capital Corp.
Commercial paper rating A-2

Ratings Affirmed

American Water Capital Corp.
Corporate credit rating A-/Watch Neg/--

Complete ratings information is available to subscribers of RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search.

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Publication date: 14-Feb-2006
Reprinted from RatingsDirect

Summary: American Water Capital Corp.

Primary Credit Analyst: Kevin L Beicke, CFA, New York (1) 212-438-7847; kevin_beicke@standardandpoors.com

Credit Rating
A/Watch Neg/NR

Rationale

American Water Capital Corp. (AWCC) is a wholly owned subsidiary of American Water (unrated) and serves as the funding vehicle for American Water's regulated water utility subsidiaries. The ratings on AWCC remain on CreditWatch with negative implications. American Water is a wholly owned subsidiary of parent RWE AG (A+/Negative/A-1).

The ratings on AWCC reflect the stand-alone credit quality of American Water. In November 2005, RWE announced its intention to sell its U.K. and U.S. water businesses and focus on its electricity and gas operations in Europe. The intercompany funding support RWE has given AWCC is expected to remain until all the intercompany debt has been refinanced, which should occur sometime before the sale has been completed. The sale process will start with RWE's U.S. water operations, and then will continue with its U.K. water business, RWE Thames Water PLC (A/Watch Neg/A-1). The process will be lengthy, because it requires the approval of RWE's supervisory board, as well as several regulatory jurisdictions. The goal is to complete both transactions during 2007.

The CreditWatch listing on AWCC is not expected to be resolved until the completion of the sale, because of the greater amount of uncertainty regarding the future plans for the American Water operations versus those of RWE Thames Water. This uncertainty is the result of the extensive regulatory approval process that will be required, due to American Water's large and geographically diverse operations.

American Water's stand-alone credit quality is supported by its '2' (excellent) business risk profile. (Utility business risk profiles are categorized from '1' (excellent) to '10' (vulnerable)). The company's business risk profile benefits from geographic and regulatory diversity, a large customer base that is mostly residential and commercial, and a generally supportive regulatory environment. These strengths are slightly offset by the somewhat increased risk from American Water's nonregulated water and wastewater operations.

American Water's excellent business risk profile is partly countered by the company's intermediate, stand-alone financial risk profile, which is weak for the rating. Debt leverage has improved dramatically since the merger with RWE, dropping to 47.5% from 69.1% at year-end 2002, due to RWE's \$3 billion infusion of preferred stock and common equity in 2003. However, for the 12-months ended Sept. 30, 2005, adjusted funds from operations (FFO) to average total debt was just 13%, which is low, but a significant improvement from 7.5% in fiscal 2003. Adjusted FFO interest coverage and

adjusted EBIT interest coverage have also improved since 2003, to 3.6x and 2.2x, respectively. The company's ROE was a mere 1.4%, but is expected to improve due to the continued filing of rate cases.

Liquidity

AWCC's liquidity position is adequate. American Water has received previous support from RWE in the form of intercompany loans, but this support will lessen going forward. Leading up to the completion of the sale of RWE's U.S. water operations, American Water will most likely need to start sourcing its own funding. However, Standard & Poor's expects RWE's continued, although diminished, support to American Water until the sale has been completed to alleviate any near-term liquidity constraints.

Capital-spending needs for American Water will be partially funded internally, with the balance funded through tax-exempt debt issuances in the capital markets or through intercompany loans from RWE. American Water has \$1,219.9 million of long-term debt maturing in 2006, nearly all of which is in the form of RWE intercompany loans.

As of Sept. 30, 2005, American Water had \$51.6 million in cash and cash equivalents. AWCC also has a \$550 million, 364-day revolving credit agreement with RWE. AWCC had \$239.9 million in availability from these credit lines as of Dec. 31, 2004. Borrowing under the credit agreement is based on LIBOR, and AWCC pays a commitment fee of 6.575 basis points on the entire amount. For 2004, the weighted-average interest rate on the outstanding lines was 1.43%.

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The McGraw-Hill Companies

Publication date: 16-Sep-2005

Primary Credit Analysts: Andrew Watt, CFA, New York (1) 212-438-7868, andrew_watt@standardandpoors.com;

Kevin L Belcke, CFA, New York (1) 212-438-7847, kevin_belcke@standardandpoors.com

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American Water Capital Corp.

| |
|----------------------|
| Major Rating Factors |
| Rationale |
| Outlook |
| Accounting |

Corporate Credit Rating

A/Negative/NR

Business Profile

1 **2** 3 4 5 6 7 8 9 10

Financial risk profile:
Intermediate

Debt maturities:

As of Dec. 31, 2004:

2005: \$45.7 million

2006: \$1,219.9 million

2007: \$244.2 million

2008: \$23.4 million

2009: \$116 million

Thereafter: \$2,350.3 million

Total rated debt:

As of Dec. 31, 2004, American Water, the unrated parent, had \$4,359.8 million of debt, \$1,754.7 million of preferred stock without mandatory redemption requirements, and \$26.3 million of preferred stock with mandatory redemption requirements.

Outstanding Rating(s)

American Water Capital Corp.

Sr unsec'd debt

Local currency

A-

Corporate Credit Rating History

Sept. 21, 2000

July 15, 2003

Dec. 30, 2003

A/A-2

A/A-1

NR

Major Rating Factors

Strengths:

- Strong support from ultimate parent, RWE AG;
- Geographic and regulatory diversity;

- Large customer base that is mostly residential and commercial; and
- Generally supportive regulatory environment.

Weaknesses:

- Nonregulated water and wastewater operations; and
- Intermediate financial risk profile, which is weak for the rating.

Rationale

The ratings on American Water Capital Corp. (AWCC) largely reflect the consolidated credit quality of the company's ultimate parent, German multiutility RWE AG (A+/Negative/A-1). AWCC is a wholly owned subsidiary of American Water and serves as the funding vehicle for American Water's regulated water utility subsidiaries. RWE has a strong support arrangement with the company and has provided an equity infusion to American Water and substantially all the debt funding to AWCC.

American Water's stand-alone credit quality is supported by its '2' (excellent) business profile. (Utility business profiles are categorized from '1' (excellent) to '10' (vulnerable).) The company's business profile benefits from geographic and regulatory diversity, a large customer base that is mostly residential and commercial, and a generally supportive regulatory environment. These strengths are only slightly offset by American Water's nonregulated water and wastewater operations. American Water is also hampered by a weak, but improving, financial risk profile.

American Water is the largest U.S. water utility holding company, with regulated utility operations in 21 states. This geographic diversity mitigates adverse weather effects on the company's cash flows and cushions the company from unfavorable rate decisions in any particular regulatory jurisdiction. The majority of revenues come from residential and commercial customers, which provide a stable customer base with predictable water-usage patterns.

The overall regulatory environment is considered supportive, because the jurisdictions where the regulated utility operations are located allow some combination of the following policies: use of a forward-looking test year, recovery of construction expenses in a relatively timely manner, regular rate increases, and single-tariff pricing. However, while being acquired by RWE, American Water postponed filing for rate increases to prevent what may have been perceived as a foreign parent trying to increase returns. These rate cases were then filed within the last two years and the full effect of these rate case decisions will be realized this year.

These strengths are only slightly offset by American Water's involvement in nonregulated water and wastewater operations. Although they are largely fee-based, contract-management operations that are closely related to the company's core business and not capital intensive, some of these nonregulated operations may pose a greater business risk than the company's regulated utilities due to contract renewal risk and also depending on the structure of each contract.

American Water's excellent business risk profile is partly countered by the company's intermediate, stand-alone financial risk profile, which is weak for the rating. Debt leverage has improved dramatically since the merger with RWE, dropping to 48% from 69.1% at year-end 2002, due to RWE's \$3 billion infusion of preferred stock and common equity in 2003. For year-ended Dec. 31, 2004, adjusted funds from operations

(FFO) to average total debt was just 12.5%, which is low, but a significant improvement from 7.5% in fiscal 2003. Adjusted FFO interest coverage and adjusted EBIT interest coverage have also improved over the past year, to 3.7x and 2.2x, respectively. The company's ROE was a mere 1.2% in 2004, but it is expected to improve this year due to the full realization of rate increases in many of the company's service areas.

RWE's performance improved significantly in 2004. FFO increased despite deconsolidation effects, due to increasing prices and cost cutting. Together with disposals of noncore assets, this reduced net debt by 33% to about €2 billion (\$15 billion), ahead of the company's net debt-reduction target of €7 billion (before currency effects and disposals) by year-end 2005. Credit ratios improved, with net debt interest coverage of almost 6x and slightly above 4x when adjusted for pensions, compared with about 5x and slightly less than 4x, respectively, in 2003. FFO to net pension-adjusted debt improved to 23% from 18% in 2003. Additional debt reduction in 2005 and ongoing operating improvements, moderated by high capital expenditures on water, are expected to improve credit ratios further. However, management does not rule out moderated acquisitions in its existing markets, which could slow short-term improvements and slightly increase the company's exposure to high-growth, but riskier, activities.

Liquidity

AWCC's liquidity position largely reflects that of its ultimate parent. RWE's short-term credit quality is supported by large and predictable cash flows, a benign maturity profile, and other material liquidity sources. These include its €3.6 billion cash and securities portfolio (notionally held to offset on-balance-sheet pension and nuclear liabilities) at year-end 2004, large credit facilities, and an undrawn syndicated loan facility of €4 billion, of which €2 billion is for 364 days and €2 billion for five years. Operating cash flows before dividends and acquisitions are expected to remain robustly positive, despite considerable capital expenditures.

Standard & Poor's expects RWE to continue to support AWCC via intercompany loans, alleviating any liquidity constraints for American Water. Capital-spending needs for American Water will be partially funded internally, with the balance funded through tax-exempt debt issuances in the capital markets or through intercompany loans from RWE. American Water's long-term debt maturities are manageable in the near term, with \$45.7 million maturing in 2005. In 2006, \$1,219.9 million comes due, nearly all of which is in the form of RWE intercompany loans.

As of Dec. 31, 2004, American Water had \$52.8 million in cash and cash equivalents. AWCC also has a \$550 million, 364-day revolving credit agreement with RWE that will be up for renewal on Oct. 28, 2005 and is expected to be renewed. AWCC had \$239.9 million in availability from these credit lines as of Dec. 31, 2004. Borrowing under the credit agreement is based on LIBOR, and AWCC pays a commitment fee of 6.575 basis points on the entire amount. For 2004, the weighted-average interest rate on the outstanding lines was 1.43%.

Outlook

AWCC's negative outlook mirrors that of ultimate parent, RWE. The negative outlook on RWE reflects the moderate financial headroom available at the existing rating level. Credit-dilutive, debt-funded acquisitions or a faster-than-expected competitive pace in the German electricity market could pressure the ratings.

A ratings downgrade of one notch for RWE would result in a one-notch downgrade for AWCC. A downgrade of more than one notch for RWE would likely result in the equalization of the two ratings, reflecting the stand-alone credit profile of AWCC combined with the parent's rating as a ceiling.

Accounting

The financial statements for American Water are prepared according to U.S. GAAP. The company's independent auditor, PricewaterhouseCoopers LLP, expressed a nonqualified opinion for 2004.

In 2004, American Water discovered errors in its 2003 consolidated financial statements related to the inclusion of preferred dividends in comprehensive income and the computation of unrealized holding gains/losses on marketable securities, including the related deferred taxes. Because of these errors, the company restated its consolidated financial statements for year-ended Dec. 31, 2003.

American Water's pension and other postretirement benefit plans are significantly underfunded, by \$277.1 million and \$177.3 million, respectively. The utility's total pension funding ratio, which Standard & Poor's defines as the fair value of the plan assets divided by the plan's projected benefit obligation, is low for the utility sector, at 60.7%. The average funding ratio for the industry is about 90%. The total additional minimum liability for American Water's pension plans increased to \$222 million as of Dec. 31, 2004, from \$44 million at Dec. 31, 2003. This increase is primarily attributable to a decrease in the discount rate to 6% from 6.25%. American Water plans to contribute amounts equal to the minimum required contributions in 2005 to the qualified pension plans and its 2005 other postretirement benefit cost to its Voluntary Employees' Beneficiary Association (VEBA) trusts. Pension expense in excess of the amount contributed to the pension plans is deferred by certain regulated subsidiaries pending future recovery in rates charged for utility services, as contributions are made to the plans.

Standard & Poor's also makes adjustments to account for the company's operating leases. We calculate an off-balance-sheet (OBS) amount for debt, interest expense, and depreciation, and include these amounts in the calculation of adjusted ratios. The amounts included in American Water's adjusted ratios for 2004 were \$47.2 million for OBS debt, \$4.9 million for OBS interest expense, and \$11.1 million for OBS depreciation expense.

| Table 1 American Water Capital Corp.-- Competitors | | | | |
|----------------------------------------------------|----------------|-------------------|--------------------------------|--------------------------------|
| --Average of past three fiscal years-- | | | | |
| | American Water | Aqua America Inc. | California Water Service Group | Connecticut Water Service Inc. |
| Rating | A/Negative/--* | A+/Stable/--¶ | A+/Stable/--§ | A/Stable/-- |
| (mil. \$) | | | | |
| Sales | 1,770.1 | 377.1 | 285.3 | 47.1 |
| Net income from cont. oper. | 115.7 | 72.7 | 21.5 | 9.1 |
| Funds from oper. (FFO) | 395.5 | 142.2 | 49.3 | 15.5 |

| | | | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------|---------|-------|-------|
| Capital expenditures | 491.1 | 165.1 | 76.8 | 13.0 |
| Total debt | 4,267.9 | 828.2 | 281.1 | 73.0 |
| Preferred stock | 1,181.4 | 0.1 | 3.5 | 0.8 |
| Common equity | 2,619.8 | 632.6 | 243.8 | 83.7 |
| Total capital | 8,068.9 | 1,461.8 | 528.4 | 157.6 |
| Ratios | | | | |
| Adj. EBIT interest coverage (x) | 1.9 | 3.4 | 2.6 | 3.5 |
| Adj. FFO interest coverage (x) | 2.9 | 4.0 | 3.5 | 4.6 |
| Adj. FFO/avg. total debt (%) | 9.9 | 18.1 | 17.6 | 21.6 |
| Net cash flow/capex (%) | 63.3 | 61.9 | 40.6 | 68.1 |
| Adj. total debt/capital (%) | 53.2 | 57.0 | 54.1 | 46.6 |
| Return on common equity (%) | 2.2 | 12.1 | 8.7 | 10.7 |
| Common dividend payout (%) | 51.4 | 56.2 | 85.1 | 71.3 |
| *Rating reflects that of American Water Capital Corp.; American Water is the unrated parent. †Rating reflects that of Aqua Pennsylvania Inc.; Aqua America Inc. is the unrated parent. §Rating reflects that of California Water Service Co.; California Water Service Group is the unrated parent. | | | | |

| Table 2 American Water -- Financial Summary | | | | | |
|---------------------------------------------|---------------|---------------|------------------|------------------|---------------|
| --Fiscal year ended Dec. 31-- | | | | | |
| Rating history* | A/Negative/-- | A/Negative/-- | A-/Watch Pos/A-2 | A-/Watch Pos/A-2 | A-/Stable/A-2 |
| | 2004 | 2003 | 2002 | 2001 | 2000 |
| (mil. \$) | | | | | |
| Sales | 1,839.0 | 1,766.1 | 1,715.2 | 1,438.9 | 1,350.6 |
| Net inc. from cont. oper. | 145.1 | 57.6 | 144.4 | 161.5 | 161.1 |
| Funds from oper. (FFO) | 542.2 | 307.4 | 337.0 | 342.7 | 345.5 |
| Capital expenditures | 525.0 | 506.0 | 442.2 | 371.7 | 363.5 |
| Total debt | 4,386.1 | 4,354.2 | 4,063.3 | 3,130.2 | 2,844.8 |
| Preferred stock | 1,754.7 | 1,755.7 | 33.9 | 49.4 | 52.7 |

| | | | | | |
|----------------------------------------------------------------------------------------------|---------|---------|---------|---------|---------|
| Common equity | 3,047.4 | 3,009.4 | 1,801.9 | 1,758.0 | 1,669.7 |
| Total capital | 9,188.2 | 9,119.3 | 5,899.1 | 4,937.6 | 4,567.2 |
| Ratios | | | | | |
| Adj. EBIT Interest coverage (x) | 2.2 | 1.8 | 1.8 | 2.4 | 2.3 |
| Adj. FFO Interest coverage (x) | 3.7 | 2.5 | 2.5 | 2.7 | 2.8 |
| Adj. FFO/avg. total debt (%) | 12.5 | 7.5 | 9.5 | 11.6 | 12.7 |
| Net cash flow/capex (%) | 83.6 | 50.2 | 54.0 | 66.9 | 69.8 |
| Adj. total debt/capital (%) | 48.0 | 48.0 | 69.1 | 63.6 | 62.5 |
| Return on common equity (%) | 1.2 | (0.4) | 7.3 | 8.9 | 8.7 |
| Common dividend payout (%) | 0.0 | 0.0 | 67.9 | 58.0 | 56.0 |
| *Ratings reflect that of American Water Capital Corp.; American Water is the unrated parent. | | | | | |

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The McGraw-Hill Companies

Research:**Research Update: American Water Capital Ratings Are Lowered To 'A-', On Watch Neg Re: Sale By Parent**

Publication date: 07-Nov-2005
Primary Credit Analyst: Kevin L. Beicke, CFA, New York (1) 212-438-7847;
kevin_beicke@standardandpoors.com

Credit Rating: A-/Watch Neg/NR

Rationale

On Nov. 7, 2005, Standard & Poor's Ratings Services lowered its corporate credit rating on American Water Capital Corp. (AWCC) to 'A-' from 'A' and placed the ratings on CreditWatch with negative implications. In addition, AWCC's senior unsecured ratings were lowered to 'BBB+' from 'A-'.

AWCC is a wholly owned subsidiary of American Water and serves as the funding vehicle for American Water's regulated water utility subsidiaries. American Water is a wholly owned subsidiary of parent RWE AG (A+/Negative/A-1).

The rating action follows the announcement made by RWE of its intention to sell its U.K. and U.S. water businesses and reflects the weaker, stand-alone credit quality of AWCC, absent RWE's support. Standard & Poor's will meet with American Water's management to discuss in detail the effect of this announcement, especially in relation to the future strategic direction, financial policy, capital structure, liquidity, and funding of the company. The CreditWatch listing on AWCC is not expected to be resolved until the completion of the sale, due to the greater amount of uncertainty regarding the future plans for the American Water operations versus those of the U.K. water business, RWE Thames Water PLC (A-/Watch Neg/A-1).

RWE's decision is driven by its desire to focus on electricity and gas operations in Europe. The sale process will start with the U.S. water operations. Once this transaction is well underway, it will continue with RWE Thames Water. The process will be lengthy, as it requires the approval of RWE's supervisory board and regulatory approvals. The goal is to complete both transactions during 2007.

American Water's stand-alone credit quality is supported by its '2' (excellent) business profile. (Utility business profiles are categorized from '1' (excellent) to '10' (vulnerable).) The company's business profile benefits from geographic and regulatory diversity, a large customer base that is mostly residential and commercial, and a generally supportive regulatory environment. These strengths are only slightly offset by American Water's nonregulated water and wastewater operations. American Water is also hampered by a weak, but improving, financial risk profile.

American Water's excellent business risk profile is partly countered by the company's intermediate, stand-alone financial risk profile, which is weak for the rating. Debt leverage has improved dramatically since the merger with RWE, dropping to 48% from 69.1% at year-end 2002, due to RWE's \$3 billion infusion of preferred stock and common equity in 2003. For year-ended Dec. 31, 2004, adjusted funds from operations (FFO) to average total debt was just 12.5%, which is low, but a significant improvement from 7.5% in fiscal 2003. Adjusted FFO interest coverage and adjusted EBIT interest coverage have also improved over the past year, to 3.7x and 2.2x, respectively. The company's ROE was a mere 1.2% in 2004, but is expected to improve this year due to the full realization of rate increases in many of the company's service areas.

Liquidity

AWCC's liquidity position is adequate. American Water has received previous support from RWE in the form of intercompany loans, but this support will lessen going forward. Leading up to the completion of the sale of RWE's U.S. water operations, it is expected that American Water will gradually need to start sourcing its own funding. However, Standard & Poor's expects RWE's continued, although diminished, support to American Water before the completion of the sale to

alleviate any near-term liquidity constraints.

Capital-spending needs for American Water will be partially funded internally, with the balance funded through tax-exempt debt issuances in the capital markets or through intercompany loans from RWE. American Water has \$1,219.9 million of long-term debt maturing in 2006, nearly all of which is in the form of RWE intercompany loans.

As of March 31, 2005, American Water had \$41.7 million in cash and cash equivalents. AWCC also has a \$550 million, 364-day revolving credit agreement with RWE. AWCC had \$239.9 million in availability from these credit lines as of Dec. 31, 2004. Borrowing under the credit agreement is based on LIBOR, and AWCC pays a commitment fee of 6.575 basis points on the entire amount. For 2004, the weighted-average interest rate on the outstanding lines was 1.43%.

Ratings List

Ratings Lowered, Placed On Watch Neg

American Water Capital Corp.

| | To | From |
|-------------------------|-----------------|---------------|
| Corp. credit rating | A-/Watch Neg/-- | A/Negative/-- |
| Senior unsecured rating | BBB+/Watch Neg | A- |

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Publication date: 22-Jun-2005

Primary Credit Analyst(s): Andrew Watt, CFA, New York (1) 212-438-7868, andrew_watt@standardandpoors.com;

Kevin L Belcke, CFA, New York (1) 212-438-7847, kevin_belcke@standardandpoors.com

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Summary: American Water Capital Corp.

Credit Rating:
A/Negative/NR

Rationale

The ratings on American Water Capital Corp. (AWCC) largely reflect the consolidated credit quality of its ultimate parent, German multiutility RWE AG. AWCC is a wholly owned subsidiary of American Water and serves as the funding vehicle for American Water's regulated water utility companies. RWE has a strong support arrangement with the company and has provided an equity infusion to American Water and substantially all the debt funding to AWCC.

American Water's stand-alone credit quality is supported by a strong business position, which is characterized by geographic and regulatory diversity, a large customer base that is mostly residential and commercial, and a generally supportive regulatory environment. These strengths are slightly offset by American Water's nonregulated water and wastewater operations, despite the fact that these operations are closely related to the company's core business and are mostly fee based and not capital intensive. American Water is also hampered by a weak, but improving, financial profile.

American Water is the largest U.S. water utility holding company, with regulated utility operations in 21 states. This geographic diversity mitigates adverse weather effects on the company's cash flows and cushions the company from unfavorable rate decisions in any particular regulatory jurisdiction. The majority of revenues come from residential and commercial customers, which provide a stable customer base with predictable water-usage patterns.

The overall regulatory environment is viewed as supportive, because the jurisdictions in which the regulated utility operations are located allow some combination of the following policies: use of a forward-looking test year, recovery of construction expenses in a relatively timely manner, regular rate increases, and single-tariff pricing. However, while being acquired by RWE, American Water postponed filing for rate increases to prevent what may have been perceived as a foreign parent trying to increase returns. These rate cases have since been filed and rate increases have been allowed in several jurisdictions.

These strengths are slightly offset by American Water's involvement in nonregulated water and wastewater operations. Although they are largely fee-based, contract management operations that are closely related to the company's core business and not capital intensive, some of these nonregulated operations may pose a somewhat greater business risk than the company's regulated utilities.

American Water's strong business profile is partly countered by the company's weak, but improving, stand-alone financial profile. Debt leverage has improved dramatically since the merger with RWE, dropping to 47.7% from 69.1% at year-end 2002. For the 12-months ended Oct. 1, 2004, adjusted funds from operations (FFO) to average total debt was just 11%, which is low, but an improvement from 8.2% in fiscal 2003. Adjusted FFO interest coverage and adjusted EBIT interest coverage have improved from previous years, to 3.4x and 2.2x, respectively. The company's ROE was a mere 1.3%, mainly due to RWE's \$3 billion infusion of common equity and preferred stock in 2003 and American Water's postponement of filing for rate increases during a period of industrywide inflation.

RWE's performance improved significantly in 2004. FFO increased despite deconsolidation effects, due to increasing prices and cost cutting. Together with disposals of noncore assets, this reduced net debt by 33% to about €2 billion (\$15 billion), ahead of the company's net debt-reduction target of €7 billion (before currency effects and disposals) by year-end 2005. Credit ratios improved, with net debt interest coverage of almost 6x and slightly above 4x when adjusted for pensions, compared with about 5x and slightly less than 4x, respectively, in 2003. FFO to net pension-adjusted debt improved to 23% from 18% in 2003. Additional debt reduction in 2005 and ongoing operating improvements, moderated by high capital expenditures on water; are expected to improve credit ratios further. However, management does not rule out moderated acquisitions in its existing markets, which could slow short-term improvements and slightly increase the company's exposure to high-growth, but riskier, activities.

Liquidity

AWCC's liquidity position largely reflects that of its ultimate parent. RWE's short-term credit quality is supported by large and predictable cash flows, a benign maturity profile, and other material sources of liquidity. These include its €3.6 billion cash and securities portfolio (notionally held to offset on-balance-sheet pension and nuclear liabilities) at year-end 2004, large credit facilities, and an undrawn syndicated loan facility of €4 billion, of which €2 billion is for 364 days and €2 billion for five years. Operating cash flows before dividends and acquisitions are expected to remain robustly positive, despite considerable capital expenditures.

Standard & Poor's expects RWE to continue to support AWCC in the form of intercompany loans, alleviating any liquidity constraints for American Water. Capital-spending needs for American Water will be partially funded internally, with the balance funded through tax-exempt debt issuances in the capital markets or through intercompany loans from RWE. American Water's long-term debt maturities are manageable in the near term, with \$61.9 million maturing in 2005. In 2006, \$1,219.8 million comes due, nearly all of which is in the form of RWE intercompany loans.

As of Oct. 1, 2004, American Water had \$35.6 million in cash and cash equivalents. AWCC also has a \$550 million, 364-day revolving credit agreement with RWE that will be up for renewal on Oct. 28, 2005. Borrowing under the credit agreement is based on LIBOR, and AWCC pays a

commitment fee of 7.25 basis points on the entire amount. For 2003, the weighted-average interest rate on the outstanding lines was 1.16%.

Outlook

AWCC's negative outlook mirrors that of ultimate parent RWE. The negative outlook on RWE reflects the moderate financial headroom available to the company at the existing rating level. Credit-dilutive, debt-funded acquisitions or a faster-than-expected competitive pace in the German electricity market could pressure the ratings.

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Publication date: 25-Mar-2005

Primary Credit Analyst(s): Andrew Watt, CFA, New York (1) 212-438-7868, andrew_watt@standardandpoors.com;

Kevin L. Beicke, CFA, New York (1) 212-438-7847, kevin_beicke@standardandpoors.com

Reprinted from RatingsDirect

Summary: American Water Capital Corp.

Credit Rating
A/Negative/NR

Rationale

The ratings on American Water Capital Corp. (AWCC) largely reflect the consolidated credit quality of its ultimate parent, German multiutility RWE AG (A+/Negative/A-1). AWCC is a wholly owned subsidiary of American Water (unrated) and serves as the funding vehicle for American Water's regulated water utility companies. RWE has a strong support arrangement with the company and has provided an equity infusion to American Water and substantially all the debt funding to AWCC.

American Water's stand-alone credit quality is supported by a strong business position, which is characterized by geographic and regulatory diversity, a large customer base that is mostly residential and commercial, and a generally supportive regulatory environment. These strengths are slightly offset by American Water's nonregulated water and wastewater operations, despite the fact that these operations are closely related to the company's core business and for the most part, are fee-based and not capital intensive. American Water is also hampered by a weak, but improving, financial profile.

Voorhees, N.J.-based American Water had \$4,298.1 million of debt and \$26.4 million of hybrid-preferred securities as of Oct. 1, 2004.

American Water is the largest U.S. water utility holding company, with regulated utility operations in 21 states. This geographic diversity mitigates adverse weather effects on the company's cash flows and cushions the company from unfavorable rate decisions in any particular regulatory jurisdiction. The majority of revenues come from residential and commercial customers, which provide a stable customer base with predictable water-usage patterns.

The overall regulatory environment is viewed as supportive, because the jurisdictions in which the regulated utility operations are located allow some combination of the following policies: use of a forward-looking test year, recovery of construction expenses in a relatively timely manner, regular rate increases, and single-tariff pricing. However, while being acquired by RWE, American Water postponed filing for rate increases to prevent what may have been perceived as a foreign parent trying to increase returns. These rate cases have since been filed and rate increases have been allowed in several jurisdictions.

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RWE's financial profile is constrained by a high debt balance. Debt peaked after the American Water acquisition, but decreased thereafter due to significantly lower investment and noncore disposals. Gross debt increased moderately to about \$30 billion by year-end 2003, and FFO to net pension-adjusted interest coverage decreased slightly to less than 4x. FFO to debt and to net pension-adjusted debt deteriorated to 18%.

Liquidity

AWCC's liquidity position largely reflects that of its ultimate parent. RWE's short-term credit quality is underpinned by large and fairly predictable cash flows, a benign maturity profile, and material other sources of liquidity. These include its \$4.8 billion cash and securities portfolio (notionally held to offset on-balance-sheet pension and nuclear liabilities) and large credit facilities of which a portion is unused, including a recently renewed undrawn syndicated loan facility of \$4 billion, of which \$2 billion is for 364 days and \$2.5 billion is for five years. Operating cash flows before dividends and acquisitions are expected to be positive for the next few years. Working capital has fluctuated significantly in recent years, mainly due to one-off factors related to disposals, but working-capital needs are generally fairly predictable.

Standard & Poor's expects RWE to continue to support AWCC in the form of intercompany loans, alleviating any liquidity constraints for American Water. Capital-spending needs for American Water will be partially funded internally, with the balance funded through tax-exempt debt issuances in the capital markets or through intercompany loans from RWE. American Water's long-term debt maturities are manageable in the near term, with \$61.9 million maturing in 2005. In 2006, \$1,219.8 million comes due, nearly all of which is in the form of RWE intercompany loans.

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Outlook

AWCC's negative outlook mirrors that of ultimate parent RWE. The negative outlook on RWE reflects the moderate financial headroom available at the existing rating level. Credit-diluting acquisitions, which are not expected, or a faster-than-expected competitive pace in the German electricity market due to the regulator or earlier-than-expected investments would pressure the ratings.

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The McGraw-Hill Companies

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Primary Credit Analyst(s): Andrew Watt, CFA, New York (1) 212-438-7868, andrew_watt@standardandpoors.com

Kevin L. Beicke, CFA, New York (1) 212-438-7847, kevin_beicke@standardandpoors.com

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American Water is the largest U.S. water utility holding company, with regulated utility operations in 21 states. This geographic diversity mitigates adverse weather effects on the company's cash flows and cushions the company from unfavorable rate decisions in any particular regulatory jurisdiction. About 80% of revenues come from residential and commercial customers, which provide a stable customer base with predictable water-usage patterns.

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American Water's strong overall business profile is partly countered by the company's weak, but improving, stand-alone financial profile. Debt leverage has improved dramatically since the merger with RWE, dropping to 47.7% from 69.1% at year-end 2002. For the 12-months ended Oct. 1, 2004, adjusted funds from operations (FFO) to average total debt was just 11%, which is low, but an improvement from 8.2% in fiscal 2003. Adjusted FFO interest coverage and adjusted EBIT interest coverage have improved from previous years, to 3.4x and 2.2x, respectively. The company's ROE was a mere 1.3%, mainly due to RWE's \$3 billion infusion of common equity and preferred stock in 2003 and American Water's postponement of filing for rate increases during a period of industrywide inflation.

RWE's financial profile is constrained by a high debt balance. Net debt peaked at €3 billion after the American Water acquisition, but decreased thereafter due to strict investment discipline and disposals. The net debt target for year-end 2005 has been tightened to €7 billion from €20 billion, excluding key disposals. Gross debt increased moderately to about €30 billion by year-end 2003 and FFO to net pension-adjusted debt deteriorated to 18%. FFO net pension-adjusted interest coverage deteriorated slightly to less than 4x.

Liquidity.

AWCC's liquidity position largely reflects that of its ultimate parent. RWE's robust liquidity position is supported by its large and fairly predictable cash flows, a benign maturity profile, and other material liquidity sources. RWE has a €2.3 billion securities portfolio (notionally held to offset on-balance-sheet pension and nuclear liabilities), large credit facilities of which a portion is unused, and an undrawn syndicated loan facility of €5 billion, of which € billion is for 364 days and €2.5 billion is for five years. Operating cash flows before dividends and acquisitions are expected to be positive for the next few years. Working capital has fluctuated significantly in recent years, mainly due to one-off factors related to disposals, but working-capital needs are generally fairly stable and predictable.

Standard & Poor's expects RWE to continue to support AWCC in the form of intercompany loans, alleviating any liquidity constraints for American Water. Capital-spending needs for American Water will be partially funded internally, with the balance funded through tax-exempt debt issuances in the capital markets or through intercompany loans from RWE. American Water's long-term debt maturities are manageable in the near term, with \$61.9 million maturing in 2005. In 2006, \$1,219.8 million comes due, nearly all of which is in the form of RWE intercompany loans.

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commitment fee of 7.25 basis points on the entire amount. For 2003, the weighted-average interest rate on the outstanding lines was 1.16%.

Outlook

The negative outlook on AWCC reflects the outlook of its ultimate parent RWE. The negative outlook on RWE reflects the continued, limited financial headroom available at the existing rating level. Credit-diluting acquisitions, which are not expected, or a faster-than-expected competitive pace in electricity supply would pressure the ratings.

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The McGraw-Hill Companies

Publication date: 02-Sep-2004
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American Water Capital Corp.

Credit Analysts: Andrew Watt, New York (1) 212-438-7868; Kevin Beicke, New York (1) 212-438-7847

Major Rating Factors
Rationale
Outlook
Business Description
Rating Methodology
Business Profile
Financial Policy: Moderate
Financial Profile

Corporate Credit Rating

A/Negative/NR

Business Profile

1 2 3 4 5 6 7 8 9 10

Financial policy:

Moderate

Debt maturities:

As of Dec. 31, 2003:
2004: \$78.6 million
2005: \$61.9 million
2006: \$1,219.8 million
2007: \$74.1 million
2008: \$23.3 million
Thereafter: \$2,365.1 million

Bank lines/Liquid assets:

The company has a \$550 million, 364-day revolving credit agreement with ultimate parent RWE that is up for renewal on Oct. 28, 2004. As of Dec. 31, 2003, \$126.7 million was available under this agreement.

Total rated debt:

American Water, the unrated parent, had \$4,296.8 million of debt and \$26.6 million of hybrid-preferred securities as of July 2, 2004.

Outstanding Rating(s)

American Water Capital Corp.

Sr unsecd debt

Local currency

A-

Corporate Credit Rating History

| | |
|----------------|--------|
| June 19, 2000 | A- |
| Sept. 21, 2000 | A-/A-2 |
| July 15, 2003 | A/A-1 |
| Dec. 30, 2003 | A/NR |

Major Rating Factors

Strengths:

- Strong support from ultimate parent, RWE AG;
- Geographic and regulatory diversity;
- Large customer base that is mostly residential and commercial; and
- Generally supportive regulatory environment.

Weaknesses:

- Nonregulated water and wastewater operations, which are largely fee-based; and
- Weak, but improving, financial profile for the rating.

Rationale

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American Water's stand-alone credit quality is supported by a strong business position, which is characterized by geographic and regulatory diversity, a large customer base that is mostly residential and commercial, and a generally supportive regulatory environment. These strengths are somewhat offset by American Water's nonregulated water and wastewater operations, despite the fact that these operations are closely related to the company's core business and for the most part are fee based and not capital intensive. American Water is also hampered by a weak, but improving, financial profile.

Voorhees, N.J.-based American Water had \$4,296.8 million of debt and \$26.6 million of hybrid-preferred securities as of July 2, 2004.

American Water is the largest U.S. water utility holding company, with operations in 29 states and three Canadian provinces. This geographic diversity mitigates adverse weather effects on the company's cash flows and cushions the company from unfavorable rate decisions in any particular regulatory jurisdiction. About 80% of revenues come from residential and commercial customers, which provide a stable customer base with predictable water-usage patterns.

The overall regulatory environment is viewed as supportive, because the jurisdictions in which the regulated utility operations are located allow some combination of the following policies: use of a forward-looking test year, recovery of construction expenses in a relatively timely manner, regular rate increases, and single-tariff pricing. However, while in the process of being acquired by RWE, American Water postponed filing for rate increases to prevent what may have been perceived as a foreign parent trying to increase returns.

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greater business risk than the company's core operations.

American Water's strong overall business profile is partly countered by the company's weak, but improving, stand-alone financial profile. Debt leverage has improved dramatically since the merger with RWE, dropping to 47.8% from 69.1% at year-end 2002. For the 12-months ended July 2, 2004, adjusted funds from operations (FFO) to average total debt was just 10.8%, which is low. Adjusted FFO interest coverage and adjusted EBIT interest coverage have improved from previous years, to 3.3x and 2.2x, respectively. The company's ROE was a mere 1%, mainly due to RWE's \$3 billion infusion of common equity and preferred stock in 2003 and American Water's postponement of filing for rate increases during a period of industrywide rising costs.

RWE's financial profile is constrained by a high debt balance. Net debt peaked at €3 billion after the American Water acquisition, but decreased thereafter due to strict investment discipline and disposals. The net debt target for year-end 2005 has been tightened to €7 billion from €0 billion, excluding key disposals. Gross debt increased moderately to about €0 billion by year-end 2003 and FFO to net pension-adjusted debt deteriorated to 18%. FFO net pension-adjusted interest coverage deteriorated slightly to less than 4x.

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Outlook

The negative outlook on AWCC reflects the outlook of its ultimate parent RWE. The negative outlook on RWE reflects the continued, limited financial headroom available at the existing rating level. Credit-diluting acquisitions – which are not expected – or a

faster-than-expected competitive pace in electricity supply would pressure the rating.

Business Description

AWCC is the financing subsidiary of American Water, the largest U.S. water utility holding company with regulated utility operations serving about 2.9 million customers in 21 states. American Water was purchased by RWE in January 2003 for \$4.6 billion. American Water contributes about 40% of RWE's water division revenues and EBITDA.

AWCC's ultimate parent, RWE, is one of Germany's largest corporations. The company has been commercially managed for a long time. Ownership is widespread, with municipalities jointly holding about 35%. RWE is the group's management holding parent, responsible for group strategy and treasury. Fully owned core businesses include:

- A vertically integrated, but unbundled electricity business, consisting of eight separate entities (including Innogy, including the generation units RWE Power and RWE Rheinbraun (also the world's largest lignite producer), and separate trading (RWE Trading), supply (RWE Plus), and transmission units (RWE Net), which are mostly active in Germany. RWE Plus is the country's largest or second-largest supplier, depending on the measures used;
- Innogy, RWE's vertically integrated U.K. energy business. Innogy is the third-largest utility in the U.K.'s electricity and gas markets;
- Thames Water, the U.K.'s largest and the world's third-largest water utility, which also manages the group's non-U.S. international water activities;
- American Water, the largest company in the fragmented U.S. water market;
- RWE DEA, an upstream oil and gas unit; and
- RWE Umwelt, which is the largest company in the fragmented German waste market. This business has recently been reclassified as noncore.

Core operations also include the 80%-owned RWE Gas, the second-largest supplier in Germany, albeit by a considerable distance, which also holds Transgas, the Czech Republic's vertically integrated gas monopoly.

Rating Methodology

In determining the ratings on AWCC, Standard & Poor's considers the stand-alone credit profile of its parent, American Water. As a result of the support agreement between the two entities, the credit quality of AWCC is the same as that of American Water. In turn, the credit quality of American Water reflects the consolidated credit profiles of its operating subsidiaries.

Standard & Poor's then notches up the stand-alone rating of AWCC to reflect the material level of support from RWE and the core nature of American Water's regulated water operations to the RWE water division. However, Standard & Poor's does not equalize the ratings on RWE and AWCC. While the operations of American Water are core to the RWE group, the stand-alone credit profile of American Water is significantly weaker than that of the consolidated credit profile of RWE.

The outlook on AWCC reflects Standard & Poor's presumption that AWCC's credit quality will be dictated by RWE, and ratings movement could be in the same direction. Nevertheless, ratings movement will be evaluated periodically, to ensure that the ratings accurately reflect Standard & Poor's assessment of the level of support from

RWE to American Water.

Business Profile

American Water's above-average business profile is a '2' measured on a 10-point scale ('1' equals low risk and '10' equals high risk), largely reflecting the water utility industry's regulated operating environment and monopolistic structure. The company's business profile is supported by geographic and regulatory diversity, a large customer base that is mostly residential and commercial, and a generally supportive regulatory environment. These strengths are somewhat offset by American Water's nonregulated water and wastewater operations, despite the fact that these operations are closely related to the company's core business and for the most part are fee-based and not capital intensive.

American Water is the largest U.S. water utility holding company, with regulated water utility operations and/or contract management operations in a total of 29 states and three Canadian provinces. American Water's regulated water utility operations are spread throughout 21 states. This geographic diversity mitigates adverse weather effects on the company's cash flows and cushions the company from unfavorable rate decisions in any particular regulatory jurisdiction.

The customer base is largely residential (about 58% of revenues) and commercial (about 21% of revenues), which provides for significant stability in the revenues and predictable water usage patterns. There is also no material customer concentration. The consistency of the customer base has remained relatively stable over time, despite rapid growth the past few years. The large degree of fragmentation present in the water utility industry, combined with the substantial capital needs of many smaller water companies to meet increasingly stringent water quality standards, affords numerous opportunities for consolidation. American Water has been aggressively acquiring private and municipal water systems, leading to an above-average customer growth rate.

American Water's regulatory environment is viewed as supportive, because each of the 21 jurisdictions in which the company's regulated operations are located provides for some combination of the following policies:

- Use of a forward-looking test year, which results in rates reflective of future costs;
- Interim-period recovery of interest and depreciation expense for major construction projects, until new rates reflect the cost of the project;
- Rate recovery for utility-plant returns before a plant goes into service, instead of capitalizing an allowance for funds used during construction;
- Cost recovery for distribution-system infrastructure replacements without filing a full rate proceeding; and
- Single tariff pricing, which is easier to implement, reduces the complexity of rate proceedings, and spreads fixed costs over a larger customer base.

These strengths are slightly offset by American Water's involvement in nonregulated water and wastewater operations. Although these operations are closely related to the company's core business and are mainly fee-based and not capital intensive, some of these nonregulated operations may pose a somewhat greater business risk than the company's core operations. The risk inherent in these ventures is overbidding for a contract and not earning an adequate return, or earning a return over a

disproportionately long period of time. Nevertheless, American Water's capital spending needs for nonregulated operations continue to be modest at less than 4% of total capital spending.

Financial Policy: Moderate

American Water's financial policy is considered moderate, having become less aggressive after the company was acquired by RWE. Before becoming a part of RWE's water division, American Water had used a liberal amount of debt to fund growth throughout the U.S. As a result, by year-end 2002, debt leverage had increased to 69.1% of total capital. This measure then dropped to 48.1% in 2003 after the acquisition of American Water by RWE and RWE's subsequent \$3 billion infusion of common equity and preferred stock. However, American Water's debt balance is still large and somewhat burdensome on the company's cash flow protection measures.

Financial Profile

Profitability and cash flow.

American Water's profitability measures are weak, partly because the company postponed filing for necessary rate increases following its acquisition by RWE. For the 12-months ended July 2, 2004, EBIT margin was just 23% and income from continuing operations was \$144.8 million. Adjusted EBIT interest coverage was 2.2x, and ROE was a mere 1%, mainly due to RWE's \$3 billion infusion of common equity and preferred stock in 2003 and American Water's postponement of filing for rate increases during a period of industrywide rising costs.

American Water has reliable cash flows, although the company's cash flow protection measures remain weak for the rating on a standalone basis due to the company's large debt balance. For the 12-months ended July 2, 2004, adjusted FFO interest coverage was 3.3x and adjusted FFO to average total debt was a paltry 10.8%. Free operating cash flow (cash flow from operations less capital expenditures) was negative \$156.7 million, showing American Water's current inability to fund capital spending needs solely with internally generated funds.

Capital structure and financial flexibility.

Debt leverage decreased significantly in 2003, following the company's acquisition by RWE and RWE's subsequent \$3 billion infusion of common equity and preferred stock. Adjusted total debt to total capital decreased to 48.1% in 2003 from 69.1% at year-end 2002. Although American Water's equity increased as a result of the infusion, the absolute level of debt also increased, placing pressure on the financial profile. Furthermore, debt leverage is should continue to rise, because free operating cash flow remains insufficient to fund capital spending needs.

American Water has adequate financial flexibility, mainly due to the strong parental support from RWE, which Standard & Poor's assumes will provide funding for American Water's short-term debt needs. The level of capital expenditures poses a challenge because a large part of the spending (over 40%) is for transmission and distribution projects, including expansion, implying that such capital expenditures may not be delayed or postponed. Near-term debt maturities are manageable, with a total of \$78.6 million maturing in 2004 and \$61.9 million in 2005. In 2006, \$1,219.8 million comes due, nearly all of which is in the form of RWE intercompany loans.

| Table 1 American Water -- Competitors | | | | |
|----------------------------------------|----------------|------------------------|--------------------------------|---------------------|
| Industry Sector: Regulated T&D - Water | | | | |
| --Average of past three fiscal years-- | | | | |
| | American Water | Aqua Pennsylvania Inc. | Connecticut Water Service Inc. | Middlesex Water Co. |
| Rating | N.R. | A+/Stable/-- | A/Stable/-- | A/Negative/-- |
| (Mil. \$) | | | | |
| Sales | 1,636.7 | 223.2 | 46.1 | 61.9 |
| Net income from cont. oper. | 121.2 | 49.5 | 8.8 | 7.1 |
| Funds from oper. (FFO) | 338.8 | 88.0 | 15.0 | 12.5 |
| Capital expenditures | 440.0 | 100.2 | 13.5 | 16.3 |
| Total debt | 3,849.2 | 497.1 | 71.6 | 106.0 |
| Preferred stock | 613.0 | 0.0 | 0.8 | 4.1 |
| Common equity | 2,186.9 | 431.7 | 78.0 | 76.1 |
| Total capital | 6,649.1 | 928.7 | 150.4 | 186.2 |
| Ratios | | | | |
| Adj. EBIT Interest coverage (x) | 2.0 | 3.6 | 3.5 | 3.0 |
| Adj. FFO Interest coverage (x) | 2.6 | 3.8 | 4.2 | 3.4 |
| Adj. FFO/avg. total debt (%) | 9.6 | 18.6 | 21.3 | 12.1 |
| Net cash flow/capex (%) | 58.4 | 60.7 | 64.9 | 34.7 |
| Adj. total debt/capital (%) | 58.2 | 53.8 | 47.6 | 56.9 |
| Return on common equity (%) | 4.6 | 12.1 | 11.1 | 13.0 |
| Common dividend payout (%) | 61.8 | 54.9 | 71.6 | 94.7 |
| N.R.--Not rated. | | | | |

| Table 2 American Water -- Financial Summary | | | | |
|---------------------------------------------|------|------|------|------|
| Industry Sector: Regulated T&D - Water | | | | |
| --Fiscal year ended Dec. 31-- | | | | |
| Rating history | N.R. | N.R. | N.R. | N.R. |

| | 2003 | 2002 | 2001 | 2000 | 1999 |
|---------------------------------|---------|---------|---------|---------|---------|
| (Mil. \$) | | | | | |
| Sales | 1,756.1 | 1,715.2 | 1,438.9 | 1,350.6 | 1,260.9 |
| Net Inc. from cont. oper. | 57.6 | 144.4 | 161.5 | 161.1 | 138.9 |
| Funds from oper. (FFO) | 336.8 | 337.0 | 342.7 | 345.5 | 323.9 |
| Capital expenditures | 506.0 | 442.2 | 371.7 | 363.5 | 444.9 |
| Total debt | 4,354.2 | 4,063.3 | 3,130.2 | 2,844.8 | 2,671.4 |
| Preferred stock | 1,755.7 | 33.9 | 49.4 | 52.7 | 93.8 |
| Common equity | 3,000.8 | 1,801.9 | 1,758.0 | 1,669.7 | 1,634.8 |
| Total capital | 9,110.7 | 5,899.1 | 4,937.6 | 4,567.2 | 4,400.0 |
| Ratios | | | | | |
| Adj. EBIT interest coverage (x) | 1.8 | 1.8 | 2.4 | 2.3 | 2.3 |
| Adj. FFO interest coverage (x) | 2.6 | 2.4 | 2.7 | 2.8 | 2.8 |
| Adj. FFO/avg. total debt (%) | 8.2 | 9.5 | 11.6 | 12.7 | 13.3 |
| Net cash flow/capex (%) | 56.0 | 54.0 | 66.9 | 69.8 | 54.1 |
| Adj. total debt/capital (%) | 48.1 | 69.1 | 63.6 | 62.5 | 60.9 |
| Return on common equity (%) | (0.4) | 7.3 | 8.9 | 8.7 | 7.8 |
| Common dividend payout (%) | 0.0 | 67.9 | 58.0 | 56.0 | 58.9 |
| N.R.--Not rated. | | | | | |

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Summary: American Water Capital Corp.

Credit Analysts: Andrew Watt, New York (1) 212-438-7868; Kevin Beicke, New York (1) 212-438-7847

Credit Rating:
A/Negative/NR**Rationale**

The ratings on American Water Capital Corp. (AWCC) largely reflect the consolidated credit quality of its ultimate parent, German multiutility RWE AG. AWCC is a wholly owned subsidiary of American Water and serves as the funding vehicle for American Water's regulated water utility companies. RWE has a strong support arrangement with the company and has provided an equity infusion to American Water and substantially all the debt funding to AWCC.

American Water's stand-alone credit quality is supported by a strong business position, which is characterized by geographic and regulatory diversity, a large customer base that is mostly residential and commercial, and a generally supportive regulatory environment. These strengths are somewhat offset by American Water's largely fee-based, nonregulated water and wastewater operations, which are closely related to the company's core business and are not capital intensive, and a weak, but improving, financial profile.

American Water is the largest U.S. water utility holding company, with operations in 29 states and three Canadian provinces. This geographic diversity mitigates adverse weather effects on the company's cash flows and cushions the company from unfavorable rate decisions in any particular regulatory jurisdiction. About 80% of revenues come from residential and commercial customers, which provide a stable customer base with predictable water-usage patterns. Overall, the regulatory environment is viewed as supportive, because many states allow recovery of construction expenses in a relatively timely manner, provide regular rate increases, and allow the implementation of single-tariff pricing, which reduces the complexity of multitariff rate proceedings.

These strengths are slightly offset by American Water's involvement in nonregulated water and wastewater operations. Although they are largely fee-based contract management operations that are closely related to the company's core business and are not capital intensive, some of these nonregulated operations may pose a somewhat greater business risk than the company's core operations.

American Water's strong overall business profile is partly countered by the company's weak, but improving, stand-alone financial profile. Debt leverage has improved dramatically since the merger with RWE, dropping to 48% from just under 70% at year-end 2002. For the 12-months ended April 2, 2004, adjusted funds from operations (FFO) to average total debt was just 9.3%, which is very low. Adjusted FFO interest coverage and adjusted EBIT

Interest coverage were also below the benchmarks for the rating category, at 2.9x and 1.9x, respectively. The company's ROE was a mere 0.5%, mainly due to RWE's \$3 billion equity infusion in 2003 and the lack of rate increases during a period of industrywide rising costs.

RWE's financial profile is constrained by a high debt balance. Net debt peaked at €3 billion after the American Water acquisition, but decreased thereafter due to strict investment discipline and disposals. The net debt target for year-end 2005 has been tightened to €7 billion from €20 billion, excluding key disposals. Gross debt increased moderately to about €30 billion by year-end 2003 and FFO to net pension-adjusted debt deteriorated to 18%. FFO net pension-adjusted interest coverage deteriorated slightly to less than 4x.

Liquidity.

AWCC's liquidity position largely reflects that of its ultimate parent. RWE's adequate liquidity position is supported by its large and fairly predictable cash flows, a benign maturity profile, and other material sources of liquidity. RWE has a €2.3 billion securities portfolio (notionally held to offset on-balance-sheet pension and nuclear liabilities), large credit facilities of which a portion is unused, and an undrawn syndicated loan facility of €5 billion, of which € billion is for 364 days and €2.5 billion is for five years. Operating cash flows before dividends and acquisitions are expected to be positive over the next few years. Working capital has fluctuated significantly in recent years, mainly due to one-off factors related to disposals, but working-capital needs are generally fairly stable and predictable.

Standard & Poor's expects RWE to continue to provide support to AWCC in the form of intercompany loans, alleviating any liquidity constraints for American Water. Capital-spending needs for American Water will be partially funded internally, with the balance funded through tax-exempt debt issuances in the capital markets or through intercompany loans from RWE. AWCC's long-term debt maturities are manageable for the next two years, with \$41.5 million maturing in 2004 and \$59.7 million in 2005. In 2006, the hefty sum of \$1,069.8 million comes due, nearly all of which is in the form of RWE intercompany loans.

AWCC has a \$550 million, 364-day revolving credit agreement with RWE that is up for renewal on Oct. 28, 2004. As of Dec. 31, 2003, \$126.7 million was available under this agreement. Borrowing under the credit agreement is based on LIBOR, and AWCC pays a commitment fee of 7.25 basis points on the entire amount of the commitment. For 2003, the weighted average interest rate on the outstanding lines was 1.16%.

Outlook

The negative outlook on AWCC reflects the outlook of its ultimate parent RWE. The negative outlook on RWE reflects the continued, limited financial headroom available at the existing rating level. Credit-diluting acquisitions – which are not expected – or a faster-than-expected competitive pace in electricity supply would pressure the rating.

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The McGraw-Hill Companies

Summary: American Water Capital Corp.

Credit Analysis: Andrew Watt, New York (1) 212-438-7868; Kevin Belcke, New York (1) 212-438-7847

Credit Rating
A/Negative/NR**Rationale**

The ratings on American Water Capital Corp. (AWCC) reflect the strong support arrangement with parent and sole owner American Water and, in turn, the strong parental support stemming from AWCC's ultimate parent, German multi-utility RWE AG. AWCC acts as the funding vehicle for American Water's regulated water utility companies.

In determining the ratings on AWCC, Standard & Poor's considers American Water's stand-alone credit profile and then notches up the stand-alone rating to reflect the material level of parental support from RWE and the core nature of American Water's regulated water operations to the RWE water division. However, Standard & Poor's does not equalize the ratings on the two companies. While American Water's operations are core to RWE, American Water's stand-alone credit profile is weaker than that of RWE's consolidated credit profile. The outlook is negative, reflecting Standard & Poor's presumption that RWE will dictate AWCC's credit quality, and that movements in ratings could be in the same direction. Nevertheless, ratings movement will be evaluated periodically to ensure that the ratings accurately reflect Standard & Poor's assessment of the level of support RWE provides to American Water.

AWCC's stand-alone credit profile reflects American Water's strong business position, which is characterized by regulatory diversity and operations in generally supportive regulatory environments, a steadily growing customer base that is largely residential and commercial, geographic diversity with operations in more than 20 states, high-quality operations that meet all Safe Drinking Water Act standards, and a strong competitive position. These strengths are tempered mainly by American Water's involvement in the nonregulated, contract-management water business, which is significantly more risky than regulated water operations. Although American Water's nonregulated ventures do not represent a significant portion of revenues and cash flows, if these ventures increase in size and scope, they could influence American Water's business risk profile. Given American Water's relatively weak financial profile, Standard & Poor's estimates that on a stand-alone basis, AWCC would be rated at the upper end of the 'BBB' rating category.

American Water is the largest water utility holding company in the U.S., with 2.8 million customers and operations in 23 states. It is expected to contribute 40% of RWE's water division revenues and EBITDA. About 80% of revenues and 75% of sales come from residential and commercial customers, providing a stable customer base with predictable water-usage patterns. The geographic diversity mitigates the effect of adverse weather on the company's cash flow and cushions the company from unfavorable rate

decisions in any particular jurisdiction. Overall, the regulatory environment is viewed as supportive, because many states allow recovery of construction expenses with minimal delay, provide regular rate increases, and allow the implementation of single-tariff pricing, which reduces the complexity of multitariff rate proceedings.

AWCC's financial profile largely reflects that of RWE, as well as that of American Water. At financial year-end 2002, RWE had about €9.9 billion (\$32.8 billion) in debt and on-balance-sheet pension liabilities of about €3.3 billion, offset by more than €2 billion of cash and securities. EBITDA to net interest coverage was about 11x, while adjusted funds from operations (FFO) interest coverage was about 8x (about 5x when adjusted for pension liabilities). After acquiring American Water in 2003, RWE began to consolidate and remains committed to stabilizing its debt burden by refraining from further large debt-financed acquisitions and selling noncore operations. As of June 30, 2003, net debt stood at €2.3 billion, but it is targeted to be less than €0 billion by year-end 2005. RWE's debt-protection measures are expected to stabilize or improve from 2004 due to continuous improvements in core operating profitability from full-year consolidations of acquisitions, a continued, favorable trend in German electricity prices, and new cost-cutting initiatives.

American Water's financial profile is relatively weak for the rating. Debt leverage has improved dramatically since the merger with RWE was completed, dropping to under 50% from just under 70% at year-end 2002. Adjusted FFO interest coverage is expected to remain under 3x and adjusted FFO to average total debt is expected to remain at slightly more than 10% for the intermediate term. Capital-spending needs will only be partly internally funded, with the balance funded through debt issuances in the capital markets or through intercompany loans with RWE.

Liquidity.

AWCC's liquidity position largely reflects that of its ultimate parent. RWE's adequate liquidity position is bolstered by its large and legally unencumbered securities portfolio and its unused syndicated credit facility of €5.5 billion. Near-term debt maturities are moderate, with about €5 billion (of which €00 million is at Innogy PLC) in 2004. AWCC's maturity schedule is manageable, with \$41 million in 2004 and \$59 million in 2005. Standard & Poor's expects RWE to continue to provide support in the form of equity infusions and intercompany loans, alleviating any liquidity constraints.

Outlook

The negative outlook on AWCC reflects the outlook of its ultimate parent, RWE. The negative outlook on RWE reflects the limited financial headroom at the current rating level. Furthermore, credit-diluting acquisitions, changes in the company's strategy to sell its noncore assets over the intermediate term, the introduction of a regulator in Germany, or greater-than-expected competition would put direct pressure on the ratings.

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Moody's Investors Service

Credit Opinion: Pennsylvania-American Water Company

Global Credit Research - 05 Feb 2010

Hershey, Pennsylvania, United States

Ratings

| Category | Moody's Rating |
|-------------------------------------------------------|----------------|
| Outlook | Stable |
| Issuer Rating | Baa1 |
| Bkd Senior Secured | A2 |
| Ult Parent: American Water Works Company, Inc. | |
| Outlook | Stable |
| Issuer Rating | Baa2 |

Contacts

| Analyst | Phone |
|------------------------------|--------------|
| James O'Shaughnessy/New York | 212.553.1607 |
| William L. Hess/New York | 212.553.3837 |

Key Indicators

Pennsylvania-American Water Company

| | 2006 | 2007 | 2008 | LTM 9-2009 |
|----------------------------------------------------|-------|-------|-------|------------|
| Funds From Operations ("FFO") / Debt | 15.8% | 14.4% | 17.7% | 15.1% |
| FFO - Dividends ("RCF") / Debt | 11.3% | 9.4% | 12.5% | 10.1% |
| RCF / Capex | 0.7x | 0.5x | 0.6x | 0.6x |
| FFO + Interest / Interest | 3.8x | 3.5x | 4.3x | 3.9x |
| Debt / Capitalization | 47.0% | 46.7% | 46.7% | 46.6% |
| Common Dividends / Net Income Available for Common | 68.7% | 78.6% | 72.3% | 74.1% |
| Net Income Available for Common / Common Equity | 15.5% | 14.8% | 16.9% | 16.3% |

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

- Constructive regulatory environment in Pennsylvania

- "Baa" investment grade credit metrics
- Stable service territory and customer base
- Robust capital investment program
- Subsidiary of larger, more leveraged holding company

Corporate Profile

Headquartered in Hershey, Pennsylvania, The Pennsylvania American Water Company (PA-AWC) distributes water to approximately 630 thousand customers and provides wastewater services to approximately 15 thousand customers, within its 36 county service territory, in Pennsylvania.

PA-AWC is the largest operating subsidiary of its parent, American Water Works Company, Inc. (American Water; Baa2 senior unsecured rating/stable outlook). American Water owns several independent regulated water utilities operating in 20 states. With consolidated revenues of \$2.4 billion (89% regulated in nature), through the 12 months ended September 2009, and 15 million customers, American Water is multiples larger than any other U.S.-based investor owned water holding company.

Moody's also maintains a Baa2 senior unsecured rating (stable outlook) on American Water Capital Corp (AWCC), the finance subsidiary of American Water where all parent-level debt financing, including credit lines are issued.

Previously, American Water was a majority owned subsidiary of German based RWE AG, but in November 2009 RWE completed the last in a series of stock divestitures and as a result, it no longer has an ownership interest in American Water. American Water is now a fully publicly traded company on the NYSE under the ticker ("AWK").

Recent Events

On November 7, 2009, PA-AWC implemented a regulatory approved annual rate increase of \$31 million, reflecting increased operating costs and recovery on approximately \$310 million of capital investment made since its last rate filing in 2007.

On August 3, 2009, Moody's upgraded PA-AWC's senior secured bond rating to A2 from A3, which was part of Moody's initiative to upgrade first mortgage bonds and related secured bonds of most investment-grade regulated utilities to two notches above their senior unsecured rating. Traditionally, a one notch rating differential existed, but the wider notching is based on our analysis of the history of regulated utility defaults, which indicates that regulated utilities have defaulted at a lower rate and experienced lower loss given default rates than non-financial, non-utility corporate issuers. In conjunction with the foregoing action, we also assigned a Baa1 issuer rating to PA-AWC.

Rating Rationale

PA-AWC's Baa1 issuer rating and stable outlook reflect its low business risk profile as a regulated utility, reasonable credit metrics for its rating category, and its stable customer base. Importantly, the rating also considers benefits it receives as a subsidiary of the larger, American Water corporate family.

The rating also considers its aggressive capital spending program and reliance on parent provided liquidity and equity contributions, when necessary, to support its rather robust capital program. PA-AWC's dividend policy is a further rating consideration as cash up-streamed to American Water is an important source of funds for debt service and dividend

requirements at the parent level.

PA-AWC's key rating considerations are outlined in our "Global Regulated Water Utilities" rating methodology, which was published December 2009. PA-AWC's methodology mapped unsecured rating is A3, one notch above its actual Baa1 issuer rating. In our opinion, PA-AWC's reliance on parent provided liquidity support coupled with the significant holding company level debt obligations are constraining factors in the rating. The grid, at the bottom of the credit opinion, details the mapping of PA-AWC's profile to the sub-factors outlined in the methodology. Key rating factors are noted below:

REGULATED BY THE PENNSYLVANIA PUBLIC UTILITIES COMMISSION (PUC)

PA-AWC is regulated by the Pennsylvania Public Utility Commission (PUC), which we view as developed and constructive, with water-related rate cases reviewed in a timely manner. As with its last two rate filings, PA-AWC's 2009 water rate case was settled with new rates in effect within seven months following its initial filing, limiting the regulatory lag on PA-AWC's financial metrics. We view the settled outcomes in all three cases, rather than litigated, positively.

PA-AWC's 2009 initial rate increase request of \$58 million, filed on April 24, 2009, resulted in a \$31 million rate increase effective November 7, 2009. The rate increase incorporated a 10.8% equity return, \$1.8 billion rate base, and a 48.9% equity capitalization. Under the settlement, PA-AWC is precluded from filing another general water rate increase prior to April 21, 2011. Given PA-AWC's robust capital program, we expect the company will quickly file an updated rate case at that time, with new rates effective January 2012.

While the \$31 million increase represented approximately 53% of the original filed amount of \$58 million, we still view the outcome as reasonable. First, we note PA-AWC revised their expense projections and rate increase request down to approximately \$55 million subsequent to the initial filing. We calculate approximately \$18 million, or 74%, of the disallowed rate increase under the revised request was due to the commission's adoption of a lower ROE (10.8%), rather than the company's proposed 12% which we believe reflected rather hopeful expectations. We also estimate that \$2 million of the rate increase request was denied due to rate base reductions for customer advances as well as net contributions in aid of construction; in our opinion adoption of the lower ROE and reductions to rate base, for non-investor capital, appear reasonable. Additionally, \$2 million of revenue request disallowance was due to lower projected expenses being accepted by the commission, which we view as manageable given PA-AWC's reported operating expenses of \$275 million for the 12 months ended September 2009. Importantly, PA-AWC's \$310 million of capital projects were fully incorporated into rate base, which we view favorably. Overall, we view the rate case parameters as supportive of the company's investment grade rating.

MODERATE BUSINESS RISK WITH STABLE CUSTOMER BASE

PA-AWC's customers are 90% residential based on customer count, and 65-70% based on revenues. This largely residential base helps mitigate revenue and cash flow variability commonly found with large industrial consumers. PA-AWC's service area is mature and accordingly its capital program is largely maintenance oriented. We note as well that PA-AWC's operations are geographically dispersed throughout the state, serving communities near the cities of Philadelphia and Pittsburgh. Going forward we expect PA-AWC will continue to acquire small municipal water systems in surrounding service areas. These rather small acquisitions, relative to PA-AWC's existing \$1.8 billion rate base, should have little impact on the company's credit profile.

WATER UTILITY BUSINESS MODEL IS HIGHLY CAPITAL INTENSIVE

The water supply business is highly capital intensive, as reliability and quality standards are constantly in the public eye. Given the capital needs, PA-AWC's funding requirements

have exceeded the company's internally generated cash flow. In 2006 - 2008, the company generated operating cash flows of \$149 million, \$140 million, and \$188 million, while capital expenditures were \$154 million, \$168 million, and \$217 million, respectively. Given our expectations of heightened spending in 2010 and beyond, we envision the company will continue to be in a negative free cash flow position over the next several years. The company's short term cash shortfalls should be met via its inter-company credit facility, and its longer term funding needs should be met through a combination of external debt issuances, and equity contributions from its parent, maintaining targeted debt to capitalization targets. During Q3 2008, American Water made a capital contribution of \$33 million to PA-AWC, which helped balance the company's capitalization prior to its 2009 rate filing.

To help partially alleviate the financing pressures associated with construction spending, Pennsylvania's regulatory framework incorporates a Distribution System Improvement Charge (DSIC). The surcharge is adjusted each quarter to incorporate qualifying capital improvements into rate base incurred over the past quarter while the company is between rate cases. The surcharge is designed to recover fixed costs (both depreciation and pre-tax return) of certain system improvement projects from customers, which helps moderate, in some instances, the financial pressures that affect utility companies that are in the midst of a large capital expenditures program. The surcharge does not capture all capital projects; non-DSIC projects are generally fully incorporated into rate base as part of PA-AWC's next rate case. In 2008 and 2007, the DSIC mechanism provided the company with approximately \$19 million and \$15 million of revenues (about 3.7 - 4.6% of gross revenues), respectively.

REASONABLY SOUND CREDIT METRICS

For the 12 month period ended September 30, 2009, PA-AWC's Funds from Operations (FFO) to debt ratio was approximately 15%, and its FFO + interest / interest ratio was 4.0 times, both ratios reflect Moody's Global Standard Adjustment for operating leases, and a one-time adjustment to 2009 reported cash flow for non-recurring deferred tax benefits; these non-recurring benefits arose from the company's voluntary change to the expensing of certain operating & maintenance costs from its past practice of capitalizing them for tax purposes.

Prospectively, PA-AWC's cash flow to debt and cash interest coverage ratios should remain comfortably above the 15% and around 4.5 times, respectively. This level of cash flow relative to debt is on the strong "Baa" to weak "A" rating level, while the interest coverage is comfortably positioned at the mid "Baa" rating level, under our water methodology. Our assumptions underlying the expected metrics includes a return of normal weather patterns in 2010 (2009 was a historically wet summer), and a full year of rate relief under the 2009 rate settlement. Both of these factors should help mitigate pressure on credit metrics from capital-spending related debt issuance in 2010.

However, we expect some weakening in the company's key cash flow to debt metrics to the mid-Baa rating range during 2011, reflecting additional capital spending related debt issuance and a stay-out provision that was a component of the most recent rate settlement. As previously noted, we anticipate PA-AWC will quickly file for rate relief during Q2-2011, as the stay-out provision abates, with new rates in effect by January 2012. We also expect the company to balance its construction expenditures along the way with both debt and equity issuance in a prudent and timely manner.

PA-AWC's rating also considers its average 74% payout ratio and 11% Retained Cash Flow (RCF) to Debt over the 2005-2008 timeframe. The up-streamed cash helps support parent dividends and debt service on \$3.2 billion of AWCC balance sheet debt at September 30, 2009 (this amount represents approximately 61% of American Water's consolidated long-term debt). We note as well that no significant "ring-fencing" provisions exist at the utility level that would restrict upstream cash flows to American Water. As one of American Water's top two strategic subsidiaries, we consider PA-AWC's dividend as relatively fixed in

nature.

Liquidity Profile

PA-AWC's liquidity includes its internally generated cash flow and a \$100 million inter-company line of credit with AWCC. Over the 12 months ended September 30, 2009, PA-AWC generated approximately \$246 million of funds from operations, including the non-recurring deferred tax benefits. Over the past three years (2005-2008), PA-AWC's funds from operations averaged \$159 million, requiring a funding need to meet same period average capital expenditures of \$180 million. Moody's expects PA-AWC will continue to be in a negative free cash flow position over the next four quarters, as dividends to its parent and capital expenditures will exceed internal cash flow sources, which should be met through a mix of equity infusions from its parent and external capital market debt financings through AWCC.

The extent to which American Water maintains good liquidity will be an important rating consideration for PA-AWC. AWCC has full borrowing access to its parent's \$840 million revolving credit agreement, of which \$155 million expires in September 2012 and \$685 million at September 15, 2013. The facility has same-day drawing availability and no ongoing material adverse change clause. The lone financial covenant is maximum debt to capitalization ratio of 70%, for which American Water's debt to cap was 57% as of September 30, 2009.

Rating Outlook

The stable outlook considers the company's overall credit metrics that are appropriate for the rating, but also anticipates the need for additional rate relief as the company upgrades its infrastructure. In addition, the outlook reflects the constructive regulatory environment in Pennsylvania and that American Water will maintain an adequate liquidity profile.

What Could Change the Rating - Up

The ratings for PA-AWC are not likely to be considered for a ratings upgrade in the near term, given our expectation of a slight weakening of the company's current credit metrics as part of a rather large capital spending program. Moody's would consider the company's rating for a potential upgrade if FFO to debt could reach the high teens while RCF to debt achieved around 16%, on a sustainable basis.

What Could Change the Rating - Down

There are a number of factors that could likely place negative pressure on PA-AWC's ratings. These factors include any significant deterioration in credit metrics, changes in the regulatory framework that are deemed to potentially have a negative influence upon the company's operations and failure to secure needed equity from American Water to maintain its current financial position. In terms of credit metrics, should FFO to debt fall to 10% for an extended period, downward rating pressure would increase.

Rating Factors

Pennsylvania-American Water Company

| Global Regulated Water Utilities | Aaa | Aa | A | Baa | Ba | B |
|--------------------------------------|-----|----|---|-----|----|---|
| Factor 1: Regulatory Environment and | | | | | | |

| | | | | | | |
|----------------------------------------------------------------------------------|---|--|---|------|---|--|
| Asset Ownership (40%) | | | | | | |
| a) Stability & Predictability of Regulatory Environment | | | X | | | |
| b) Asset Ownership Model | X | | | | | |
| c) Cost and Investment Recovery (Ability and Timeliness) | X | | | | | |
| d) Revenue Risk | | | X | | | |
| Factor 2: Operational Characteristics & Asset Risk (10%) | | | | | | |
| a) Operational Efficiency | | | | X | | |
| b) Scale of Capital Program and Asset Condition | | | | X | | |
| Factor 3: Stability of Business Model & Financial Structure (10%) | | | | | | |
| a) Ability & Willingness to Pursue Opportunistic Corp. Activity | | | X | | | |
| b) Ability & Willingness to Increase Leverage | | | X | | | |
| c) Proportion of Revenues Outside Core Water and Wastewater | X | | | | | |
| Factor 4: Key Credit Metrics (40%) 3-Yr average | | | | | | |
| a) FFO + Interest / Interest | | | | X | | |
| b) Debt / Capitalization | | | X | | | |
| c) FFO / Debt | | | X | | | |
| d) RCF / Capex | | | | | X | |
| Rating: | | | | | | |
| Indicated Rating from Methodology | | | | A3 | | |
| Actual Rating Assigned | | | | Baa1 | | |



Moody's Investors Service

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OR SALE.

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| |
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|-----------------------------------------|

My Credit Profile

Table of Contents

- [Overview](#)
- [Rating Action](#)
- [Rationale](#)
- [Outlook](#)
- [Related Research](#)
- [Ratings List](#)

Research Update: American Water Capital Corp.'s Unsecured Notes Rated 'BBB+'; Ratings On American Water Works Affirmed

Publication date: 16-Sep-2009

Primary Credit Analyst: Jonathan Blankenheim, CFA, New York (1) 212-438-3119;
jonathan_blankenheim@standardandpoors.com

Secondary Credit Analyst: Kenneth L Farer, New York (1) 212-438-1679;
kenneth_farer@standardandpoors.com

Overview

- U.S. regulated water utility American Water Capital has issued its \$28.5 million series 2009 unsecured bonds due 2039 through the Illinois Finance Authority.
- We are assigning our 'BBB+' unsecured rating to the bonds.
- We are also affirming our 'BBB+' corporate credit rating on American Water Works Co. Inc. and its regulated and nonregulated subsidiaries.
- Ratings benefit from favorable regulatory cost-recovery mechanisms, stable cash flows, absence of competition within existing service territories, and relatively low operating risk.

Rating Action

On Sept. 16, 2009, Standard & Poor's Ratings Services assigned its 'BBB+' unsecured debt rating to American Water Capital Corp.'s (AWCC) \$28.5 million series 2009 water revenue bonds due Sept. 1, 2039. The Illinois Finance Authority issued the bonds for the company. AWCC will use bond proceeds to finance the purchase of equipment and facilities in Illinois-American Water Co.'s (unrated) service territory.

At the same time, we affirmed our 'BBB+' corporate credit rating on American Water Works Co. Inc. (AWW) and its subsidiaries, including AWCC. The outlook is stable.

The affirmation incorporates our expectation of continued adequate rate relief over the intermediate term to address rising costs and increased capital spending plans, and funding of its capital spending in a balanced manner.

Rationale

The ratings on AWW and its funding subsidiary AWCC reflect the consolidated credit quality of AWW. A favorable competitive position, a diverse and

supportive regulatory environment, and a stable, above-average service territory support AWW's 'excellent' business risk profile. AWW's regulatory framework includes reasonably allowed returns on equity and various cost-recovery mechanisms, including incentives for infrastructure improvements. The company's geographic diversity provides it with some market, cash flow, and regulatory diversification. We view AWW's operating risks associated with its nonregulated operations as fairly low. AWW's aggressive financial profile, elevated capital-spending requirements for infrastructure replacement, increased compliance costs with water-quality standards, and the company's reliance on acquisitions to provide growth partly offset these strengths.

AWW provides regulated water and wastewater services to more than 3.3 million customers in 20 states. The company's regulated utility subsidiaries represent almost 90% of total revenues, but have provided almost 100% of adjusted EBIT for the past three years. The company's nonregulated subsidiaries engage in water and wastewater facility management and maintenance, as well as design and construction consulting services related to water and wastewater plants. We view these nonregulated segments as having modest incremental risk for AWW due to their lack of cash flow contribution and modest expected capital requirements.

A state commission regulates each of AWW's regulated subsidiaries, which supports revenue and cash flow stability. The average allowed return on equity (ROE) in AWW's six largest jurisdictions, which account for about 75% of consolidated revenues, is about 10.3%. This is about the average allowed ROE in the water sector. In a number of jurisdictions, which represent about 50% of consolidated revenues, the utility recovers replacement capital spending between rate cases up to a stated percentage. The importance of infrastructure surcharge mechanisms has increased given AWW's capital program of up to \$1 billion per year. Certain states also allow for surcharges related to the cost of power, chemicals, and purchased water. For the next few years, we expect AWW to file additional rate cases and request additional recovery mechanisms to cover rising operating costs, capital expenditures, and pension and other postretirement obligations.

Consolidated financial metrics are improving, and are acceptable for the 'BBB+' rating. RWE AG's agreements to not file rate cases for up to three years following its acquisition of AWW in 2003, as well as significant goodwill impairments, resulted in a deterioration of the financial profile. In 2008, regulatory commissions granted AWW \$200 million of rate increases and the company currently has filed requests for an additional \$280 million. The company asked for the rate increases to cover rising operating costs, capital expenditures, and pension and other postretirement obligations.

For the 12 months ended June 30, 2009, AWW's adjusted funds from operations (FFO) were \$704 million. FFO to debt was 11.6%, which is acceptable for the rating. Total debt to capital also improved to 60% at June 30, 2009, compared with the 63% as at March 31, 2009, with the completion of \$250 million equity issuance in June 2009. The uncertainties associated with the timing of the company's rate cases and the substantially higher capital plans are significant risks that may prevent adequate improvements to the company's financial profile. We expect FFO to benefit from additional rate increases, although a sustained improvement in consolidated FFO to debt may not materialize given the company's financing needs.

Short-term credit factors

The 'A-2' short-term ratings on AWW and AWCC reflect sizable borrowing capacity under the company's revolving credit facility and stable cash flows from regulated subsidiaries. However, AWW's cash uses include high levels of capital spending, substantial upcoming debt maturities, and common stock dividends. Capital expenditures are projected at around \$4 billion during the

next five years for infrastructure replacements, new facility construction, maintenance of water-quality and environmental standards, and system reliability.

For the 12 months ended June 30, 2009, AWW generated \$688 million of cash from operations. AWW's internal cash generation is insufficient to meet its ongoing operating and capital needs, and therefore requires periodic access to the capital markets. Scheduled debt maturities of \$57 million in 2009, \$45 million in 2010, and \$35 million in 2011 should be manageable given the company's good access to the markets. AWW's annual dividends total about \$130 million. AWW issued about \$250 million of equity and plans to issue a total of about \$300 million of tax-exempt debt in 2009. The company will use the proceeds to fund some of its capital expenditure plans, as well as to reduce short-term debt. We expect AWW to continue to fund its capital expenditures through a prudent mix of debt and equity.

As of Aug. 3, 2009, AWW had about \$633 million available under its \$840 million revolving credit facility. A small portion (15%) of the revolving credit facility matures on Sept. 15, 2012, with the balance due Sept. 15, 2013. The company also has access to a \$10 million short-term working-capital line of credit. The company is in compliance with its various financial covenants, which include a maximum debt to capital (with adjustments) of 70% and restrictions on liens, distributions, debt incurred at AWW, and asset sales.

Outlook

The stable outlook on AWCC and AWW reflects our expectation that the company will receive supportive rate increases over the next three years to address rising costs and increased capital spending plans. The current rating can accommodate some acquisitions, assuming management funds the acquisitions in a balanced manner. We could revise the outlook to negative if financial performance stalls or deteriorates, which could result from substantial debt-financing of capital expenditures or acquisitions, such that FFO to debt falls below 9%. The outlook could also go to negative if rate increases or allowed returns are set at levels substantially below the requested figures and rate case filings take significantly longer to be resolved than currently expected. We could revise the outlook to positive if higher-than-expected rate increases or favorable cost recovery mechanisms allow for adjusted FFO to total debt of closer to 12% and adjusted leverage between 50% and 55%.

Related Research

- "Criteria: Key Credit Factors: Business And Financial Risks In the Investor-Owned Utilities Industry" published Nov. 26, 2008.
- "Industry Report Card: U.S. Investor-Owned Water Utilities Successfully Navigate Turbulent Financial Markets" published July 10, 2009.

Ratings List

Ratings Affirmed

| | |
|-------------------------------|-----------------|
| American Water Works Co. Inc. | |
| Corporate credit rating | BBB+/Stable/A-2 |
| American Water Capital Corp. | |
| Corporate credit rating | BBB+/Stable/A-2 |
| Senior unsecured | BBB+ |
| Commercial paper | A-2 |

New Rating

American Water Capital Corp.
\$28.5 mil. water rev bonds ser 2009B due 2039 BBB+

Complete ratings information is available to RatingsDirect subscribers at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; select your preferred country or region, then Ratings in the left navigation bar, followed by Find a Rating.

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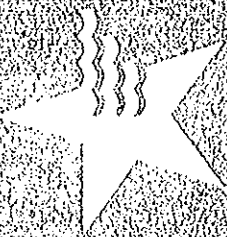
Pennsylvania-American Water Company
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.19

Pennsylvania-American Water Company
VII. Rate of Return

19. Supply copies of all presentations by the Company's and, if applicable, its parent's management and securities analysts during the past 2 years, including presentations of financial projections.

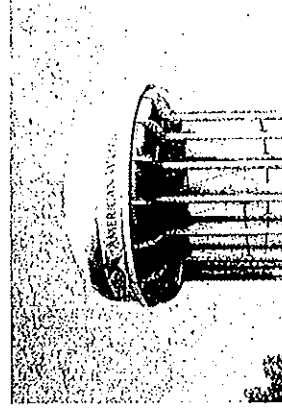
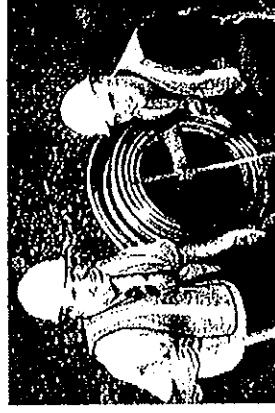
Answer: Please see attached.



AMERICAN WATER

Don Correll
President & Chief Executive Officer
American Water

Brean Murray, Carret & Co. Conference
March 30, 2009





Cautionary statement concerning forward-looking statements

Statements in this release that are "forward-looking statements" are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of factors such as weather conditions, patterns or events, including drought or abnormally high rainfall, changes in general economic, business and financial market conditions, changes in laws, governmental regulations and policies, including environmental, health and water quality and public utility regulations and policies, the decisions of governmental and regulatory bodies, including decisions to raise or lower rates, the timeliness of regulatory commissions' actions concerning rates, migration into or out of our service territories, our ability to obtain permits for expansion projects, changes in customer demand for, and patterns of use of, water, such as may result from conservation efforts, the availability of adequate and cost-effective supplies of chemicals, electricity, fuel, water and other raw materials that are needed for our operations, our ability to successfully acquire and integrate water and wastewater systems that are complementary to our operations and the growth of our business, our ability to manage the expansion of our business, our ability to control operating expenses and to achieve efficiencies in our operations, access to sufficient capital on satisfactory terms, fluctuations in interest rates, restrictive covenants in or changes to the credit ratings on our current or future debt that could increase our financing costs or affect our ability to borrow, make payments on debt or pay dividends, changes in our credit rating, changes in capital requirements, the incurrence of impairment charges, difficulty in obtaining insurance at acceptable rates and on acceptable terms and conditions, ability to retain and attract qualified employees, cost overruns relating to improvements or the expansion of our operations, and civil disturbance or terrorist threats or acts or public apprehension about future disturbances or terrorist threats or acts.

For further information regarding risks and uncertainties associated with American Water's business, please refer to American Water's SEC filings, including the information in item 1A - "Risk Factors" in American Water's Annual Report on Form 10-K for the year ended December 31, 2008."

The Company undertakes no duty to update any forward-looking statement.





Key Investment Highlights

Recognized Market Leader
*with geographic diversity,
national presence and local
relationships*

Strong Visible Growth
*driven by infrastructure
investment, earning
appropriate returns and
consolidation opportunities*

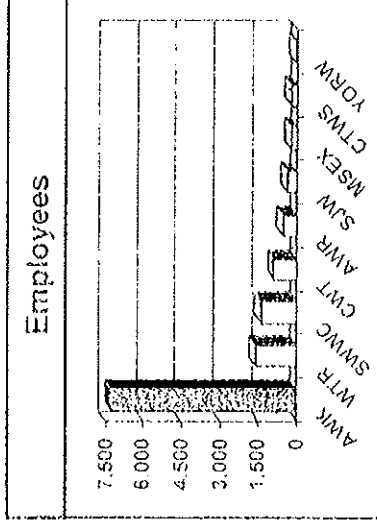
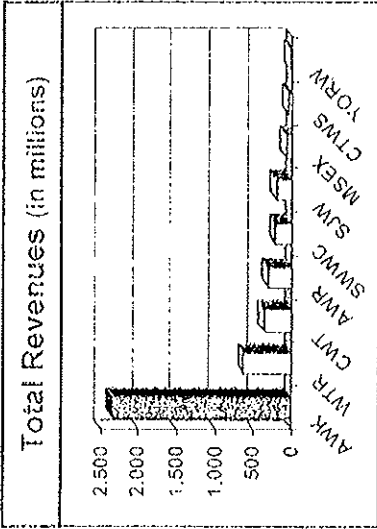
Favorable Risk Profile
*of water utility industry with
supportive regulatory
environment*

Proven Management
*with deep water utility
industry expertise*

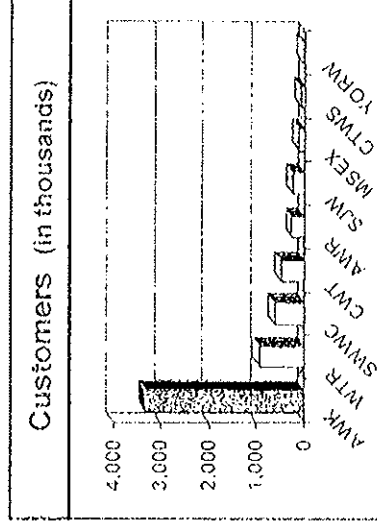
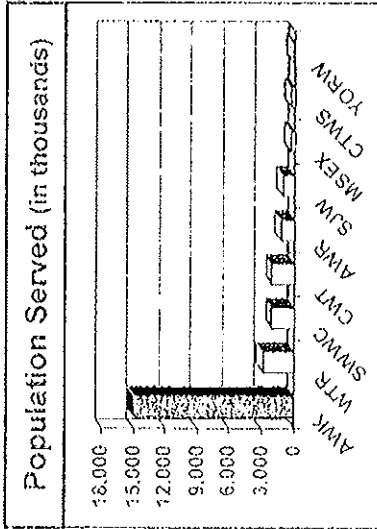
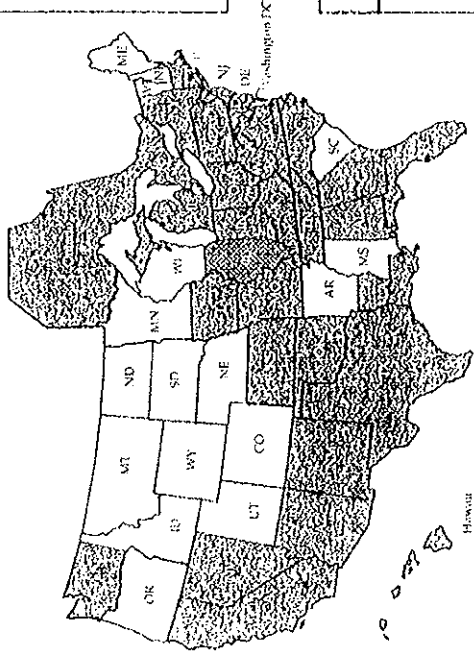
*American Water's an Attractive Total Return Story
with a Compelling Dividend Yield and Growth Outlook.*



The Largest Water Services Provider in North America



American Water's National Presence





Corporate & Industry Milestones

| Year | Event |
|-------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1886 | ■ Founding of American Water as the American Water Works & Guarantee Company |
| 1935 - 1947 | ■ Reorganizes as American Water Works Company, Inc. in response to the Public Utility Holding Act of 1935 |
| 1947 | ■ First listing of common stock on the New York Stock Exchange under the symbol "AWK" |
| 1958 | ■ Acquires operations in Connecticut, Massachusetts and New Hampshire |
| 1962 | ■ Acquires six water systems in suburban Philadelphia; Northeastern Water Company merges with the Company |
| 1964 | ■ Purchases the water utility assets of Southern Gas in West Virginia |
| 1969 | ■ Acquires Paradise Valley Water Company in Arizona |
| 1972 | ■ Passage of Clean Water Act |
| 1973 | ■ Western Pennsylvania Water Company formed through merger of 17 operating subsidiaries |
| 1974 | ■ Passage of Safe Drinking Water Act |
| 1989 | ■ Western Pennsylvania Water Company and Keystone Water Company merge to form Pennsylvania American Water Company, the Company's largest operating subsidiary |
| 1993 | ■ Indiana American Water Company acquires Indiana Cities |
| 1996 | ■ Pennsylvania American Water Company acquires the water service assets of Pennsylvania Gas & Water Company |
| 1999 | ■ Acquires National Enterprises Inc. |
| 2001 | ■ Acquires Azurix North America Corp. RWF signs an agreement to acquire the Company |
| 2002 | ■ Acquires water subsidiaries of Citizens Utilities Company in Arizona, California, Illinois, Indiana, Ohio and Pennsylvania |
| 2003 | ■ RWE completes acquisition of the Company |
| 2005 | ■ RWF announces its intention to divest the Company |
| 2007 | ■ Regulatory State Approval Process Completed |
| 2008 | ■ American Water IPO - April 23, 2008 |

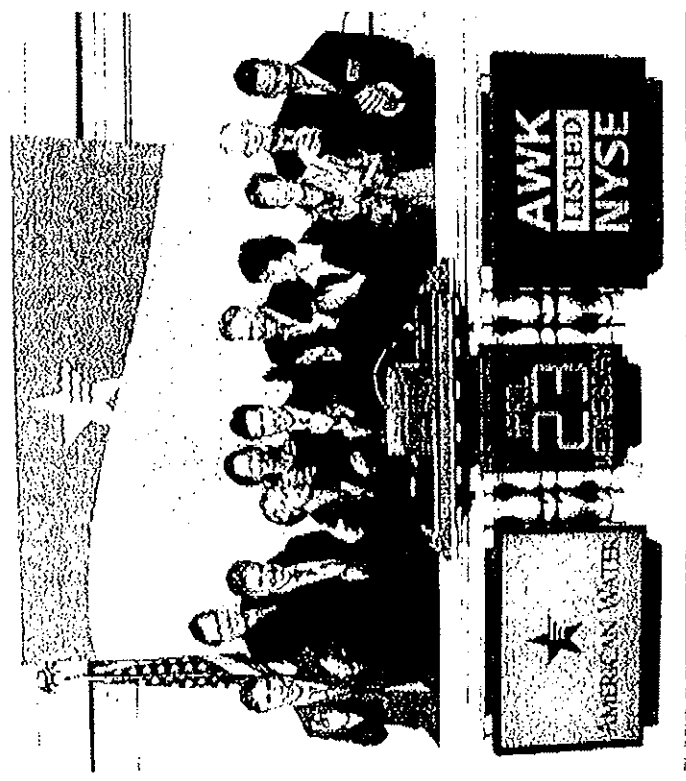
American Water has grown to become the industry leader since its founding 125 years ago





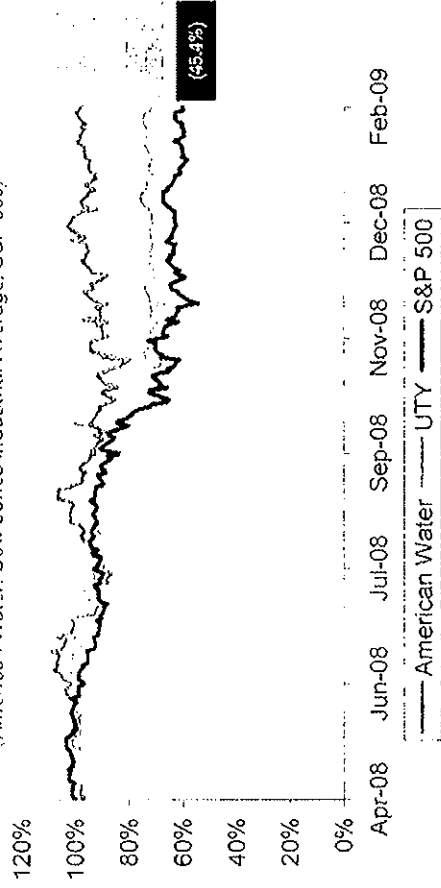
American Water Returns to Public Ownership

April 23, 2008



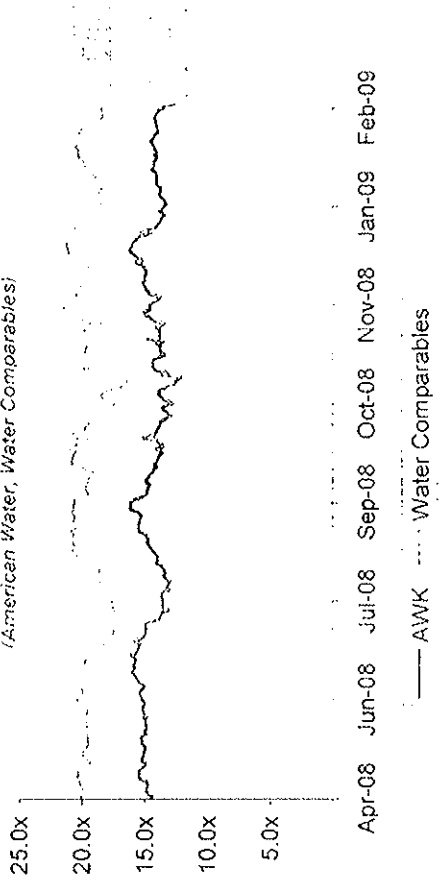
Relative Stock Price Performance since IPO

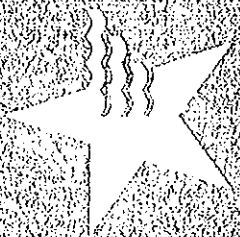
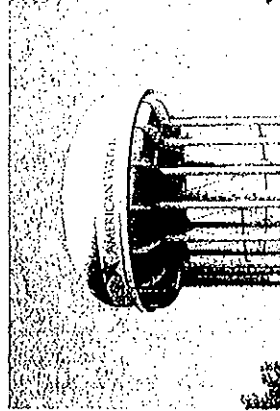
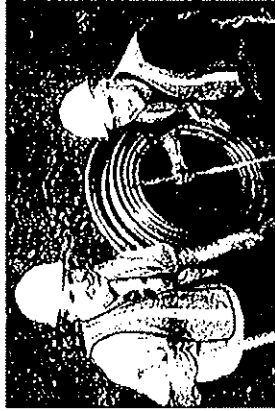
(American Water, Dow Jones Industrial Average, S&P 500)



Forward P/E Ratios since IPO

(American Water, Water Comparables)





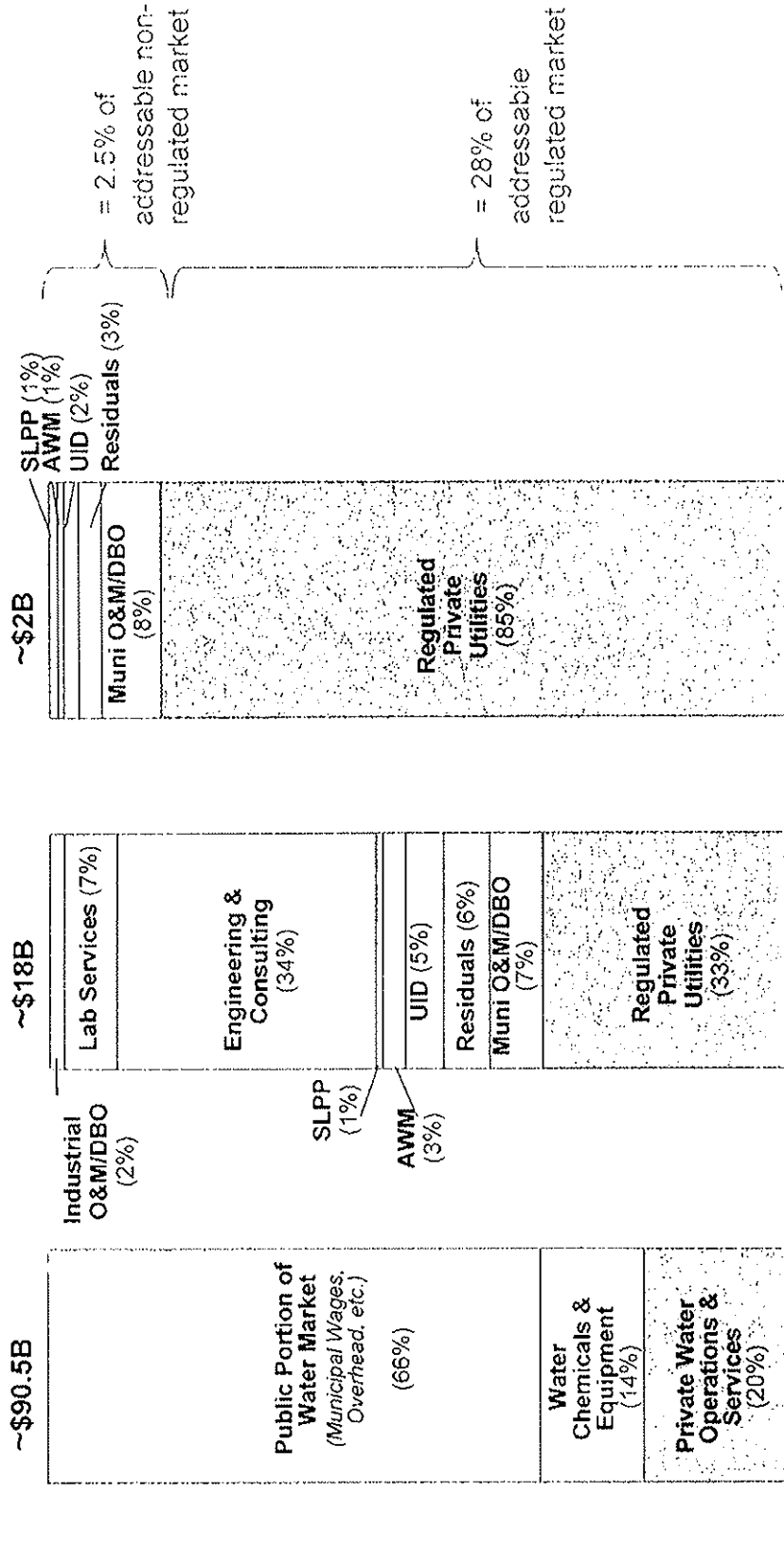
AMERICAN WATER

Water Industry Overview



The U.S. water market is more than \$90 billion - Private water companies capture only 20% of total revenue

Revenue Composition – U.S. Water Market vs. American Water

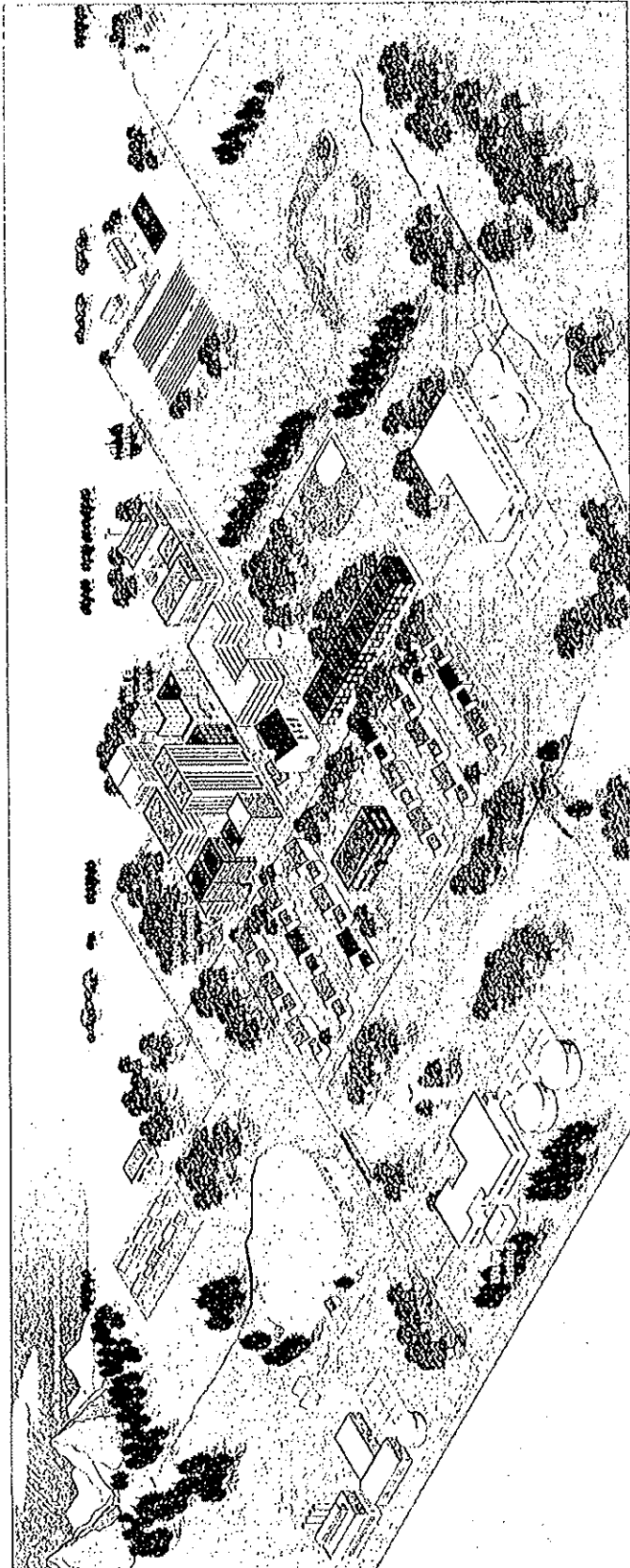


Source: Public Works Financing 2014 Environmental Business Journal and Water Analytics. A.T. Kearney Analysis





American Water's Business – The Integrated Water Cycle



Our goal is to consistently provide customers with safe, high-quality drinking water and reliable water and wastewater services.



Water Industry Has Most Favorable Utility Profile

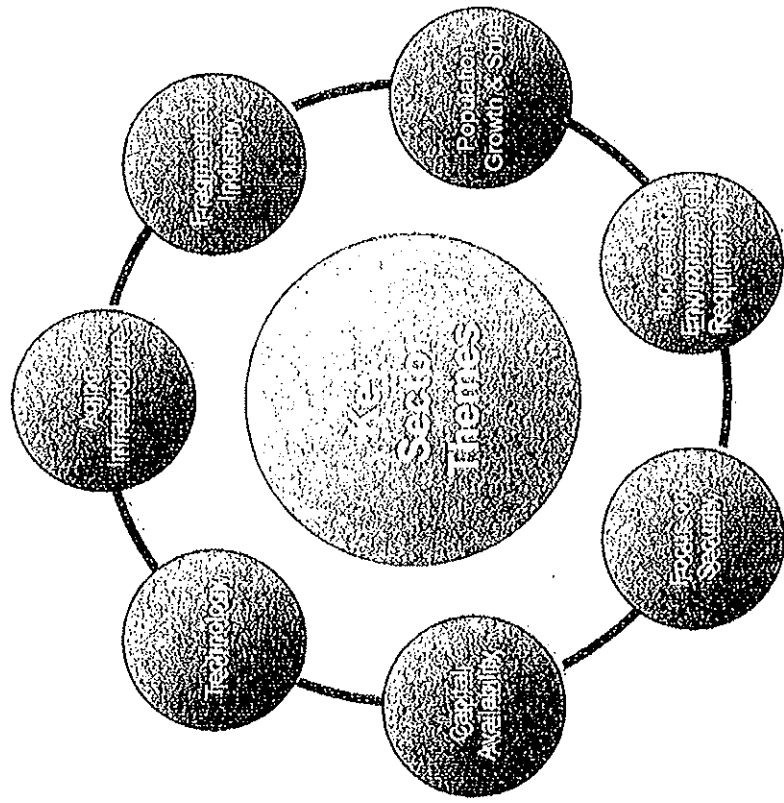
Water Utility Characteristics

Implications

| | |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------|
| ■ The water utility industry has the most favorable utility profile among all utility industries, with the highest customer satisfaction and the lowest financial stress. | ■ The water utility industry has the highest customer satisfaction among all utility industries, with 85% of customers satisfied with their utility. |
| ■ The water utility industry has the lowest financial stress among all utility industries, with 15% of utilities reporting financial stress. | ■ The water utility industry has the lowest financial stress among all utility industries, with 15% of utilities reporting financial stress. |
| ■ The water utility industry has the highest customer satisfaction among all utility industries, with 85% of customers satisfied with their utility. | ■ The water utility industry has the highest customer satisfaction among all utility industries, with 85% of customers satisfied with their utility. |
| ■ The water utility industry has the lowest financial stress among all utility industries, with 15% of utilities reporting financial stress. | ■ The water utility industry has the lowest financial stress among all utility industries, with 15% of utilities reporting financial stress. |
| ■ The water utility industry has the highest customer satisfaction among all utility industries, with 85% of customers satisfied with their utility. | ■ The water utility industry has the highest customer satisfaction among all utility industries, with 85% of customers satisfied with their utility. |
| ■ The water utility industry has the lowest financial stress among all utility industries, with 15% of utilities reporting financial stress. | ■ The water utility industry has the lowest financial stress among all utility industries, with 15% of utilities reporting financial stress. |
| ■ The water utility industry has the highest customer satisfaction among all utility industries, with 85% of customers satisfied with their utility. | ■ The water utility industry has the highest customer satisfaction among all utility industries, with 85% of customers satisfied with their utility. |



Water Industry Poised for Significant Growth



American Water Opportunities

- = Strong visible growth driven by capital investment
- = Investments in low-risk and core regulated asset base for appropriate returns
- = Industry consolidation opportunities

The Bottom Line

Water industry structure favors large players and American Water is best positioned to lead



Organic Growth Driven By Large Capital Needs

Capital investment by water utility industry continues to be driven by aging infrastructure and stringent health & safety regulations

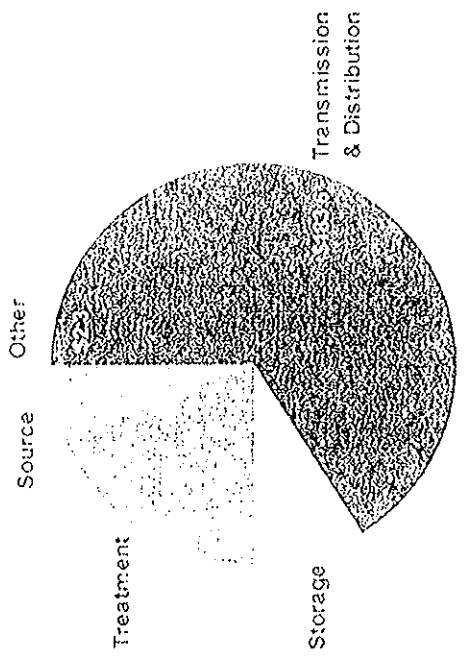
EPA forecasts the total investment to be approximately \$485 – \$896 billion for water and wastewater through 2020 (1)

Nation's infrastructure rated a "D" by The American Council of Engineering Companies

Many municipalities and local owners of water systems are challenged to fund spending requirements

Water shortages and increasing quality standards are stimulating investments in technology

Water Related Capex Needs Through 2022



Total Water: \$ 276.7 Billion (2)(3)

Public health and reliability standards are driving capital investment

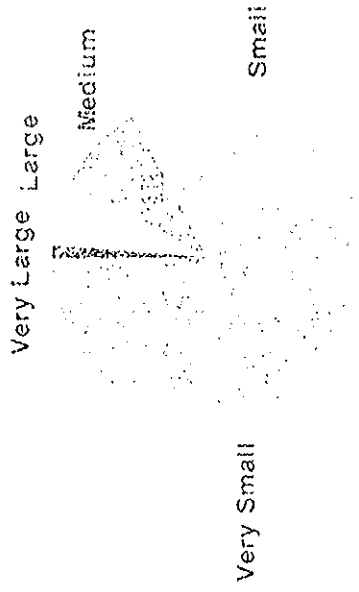
(1) EPA, "National Infrastructure Needs Assessment Report," 2002. (2) American Council of Engineering Companies, "Infrastructure Investment Needs Study," 2002. (3) American Council of Engineering Companies, "Infrastructure Investment Needs Study," 2002.



Consolidation is Essential to Address Industry Challenges

Industry Fragmented Across Small Systems

Number of U.S. Water Systems by Water System Size⁽¹⁾



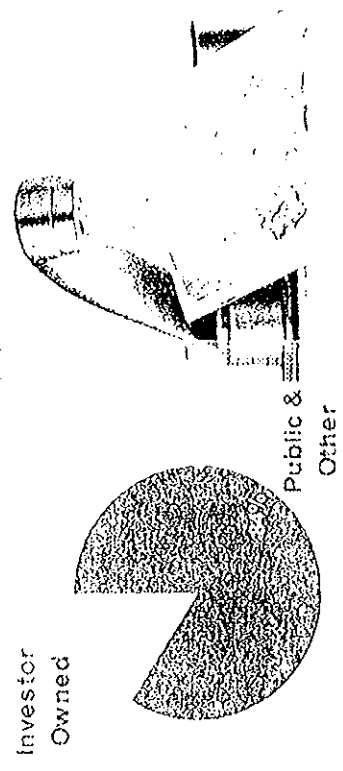
51,998 Water Systems

(1) Source: EPA Drinking and Ground Water Statistics, 2010

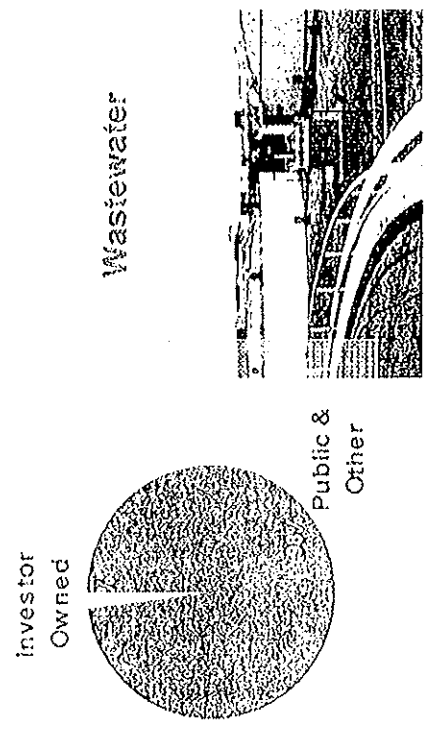
- Maintain quality and reliability
- Meet stringent EPA regulations
- Allocation priorities and limitations of capital for public / local systems

Limited Investor Ownership

Water



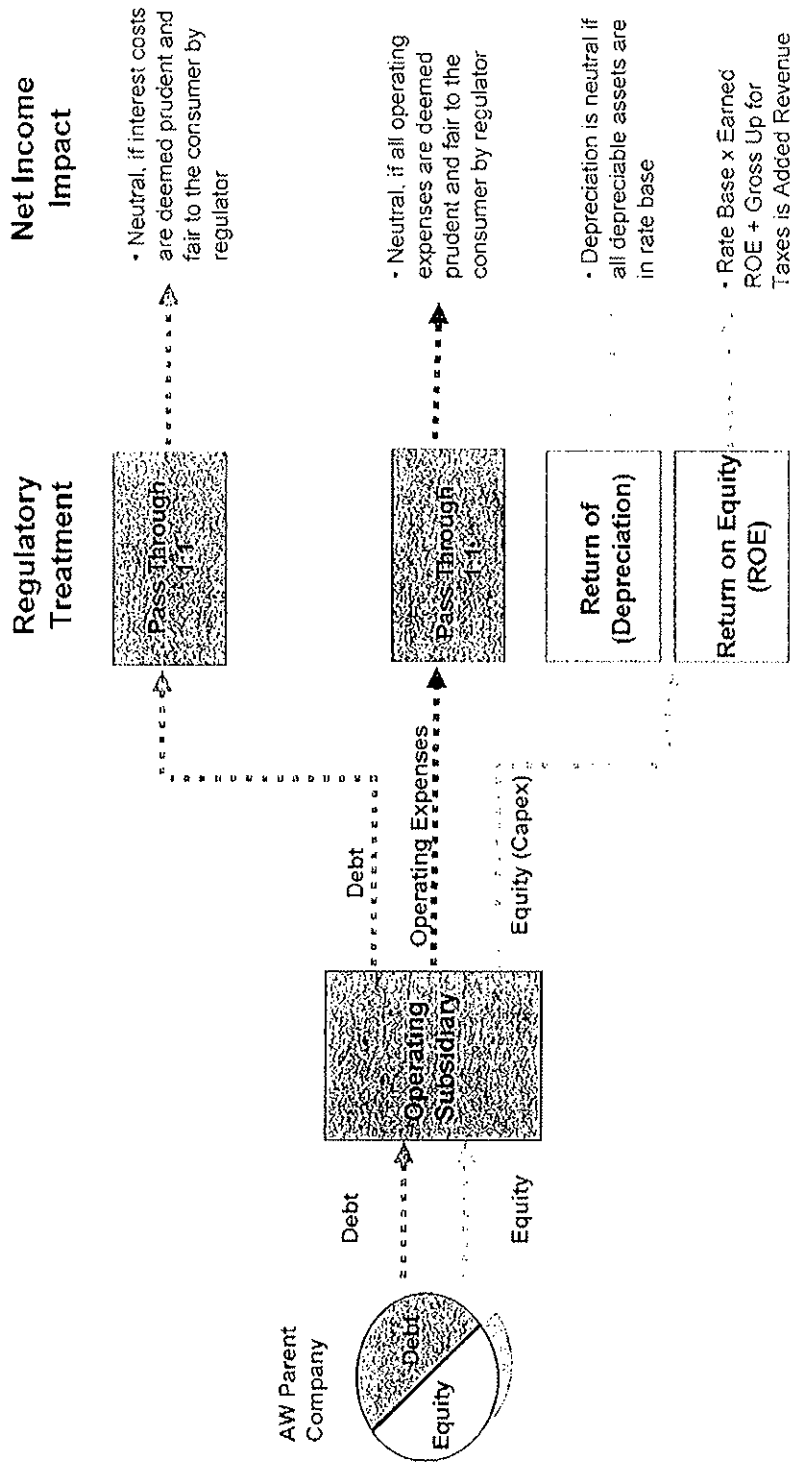
Wastewater



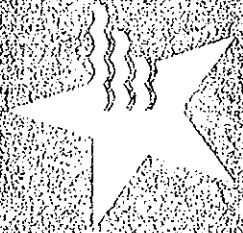
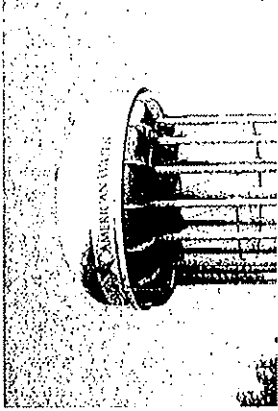
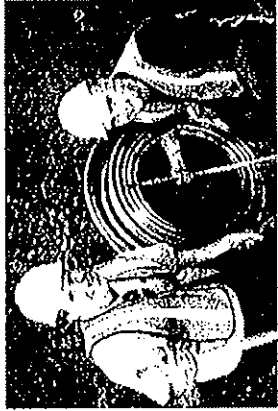
The majority of water systems are owned by public / local entities



The U.S. Rate of Return Regulation



If all assets are included in the company's Rate Base and all operating expenses are deemed prudent and recoverable by the regulator, then the company earns its allowed ROE, assuming no regulatory lag between rate cases.



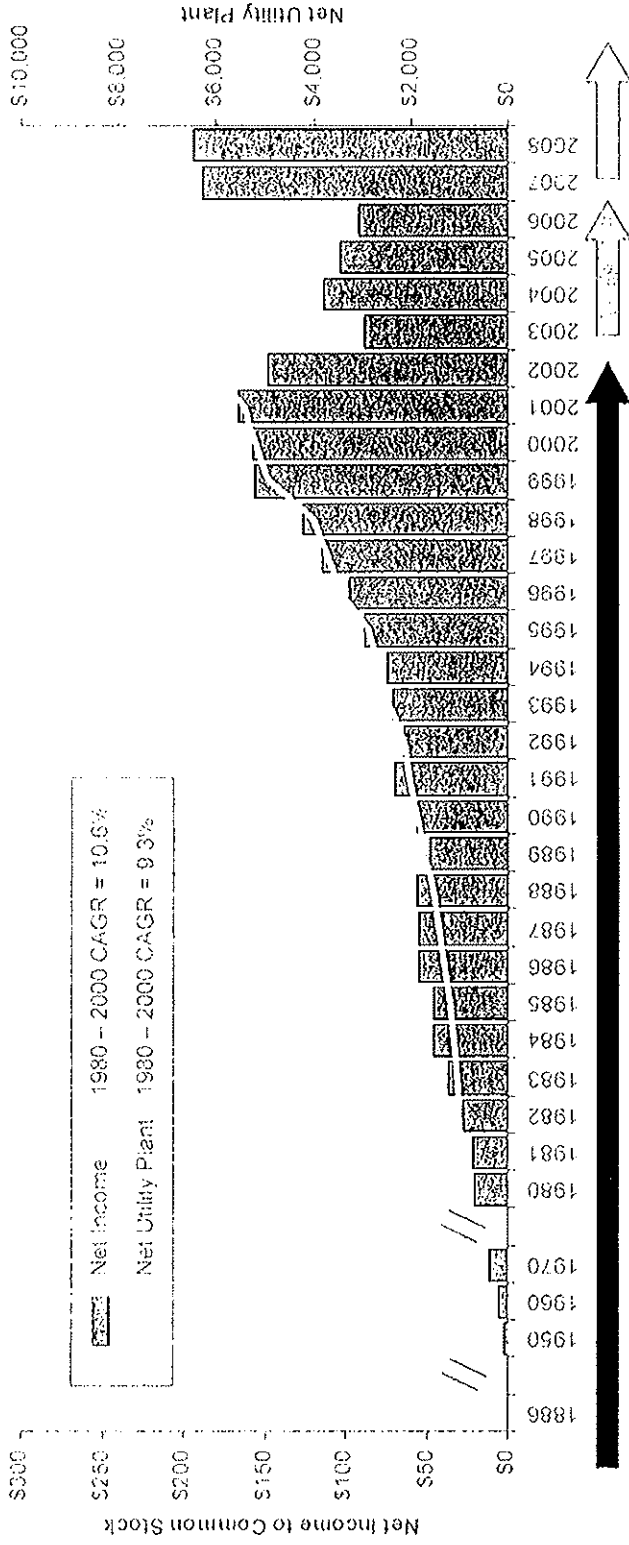
AMERICAN WATER

Company Strategy



The American Water Story

Historical Earnings and Net Utility Plant (\$mm)



1886 to 2002

Earnings Drivers:

- Capital investments
- Manage rate cases
- "Tuck-ins" and acquisitions

Rate case stay outs

Decreased tuck-in and acquisition activity

Capital investments

Manage rate cases

"Regulated-like" opportunities

"Tuck-ins" and acquisitions

Notes:
 Net income to common stock is based on the historical financial statements of American Water Works Company, Inc. (AWW) and its subsidiaries. Net income to common stock is reported on a GAAP basis. Net income to common stock is reported on a GAAP basis. Net income to common stock is reported on a GAAP basis. Net income to common stock is reported on a GAAP basis.



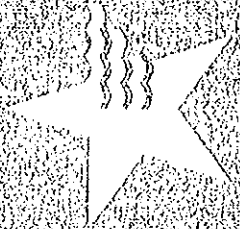
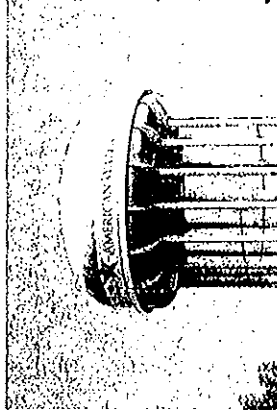
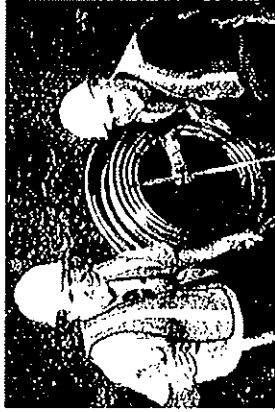
Our Strategic Direction

Realizing Today's Value

- Earn an appropriate rate of return on our investments
- Promote constructive regulatory frameworks
- Attain consistent and predictable financial performance through Regulatory, Weather and Economic Diversity
- Realize operating efficiencies through economies of scale and management of expenses

Investing for Long Term Growth

- Continue allocation of capital for investments in regulated water and wastewater projects
- Continue growth of Regulated Businesses through focused acquisitions
- Continue to pursue "regulated-like" opportunities & complementary lines of business
- Continue focus on operating efficiencies



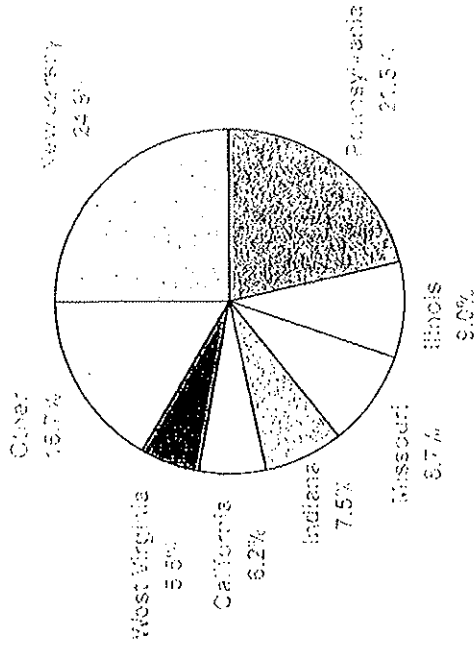
AMERICAN WATER

Company Overview



Our Regulated Businesses

2008 Operating Revenue by State



Sources of Income

Earning an appropriate return on our capital investments

"Tuck-in" acquisitions and bulk water sales

Operating efficiencies

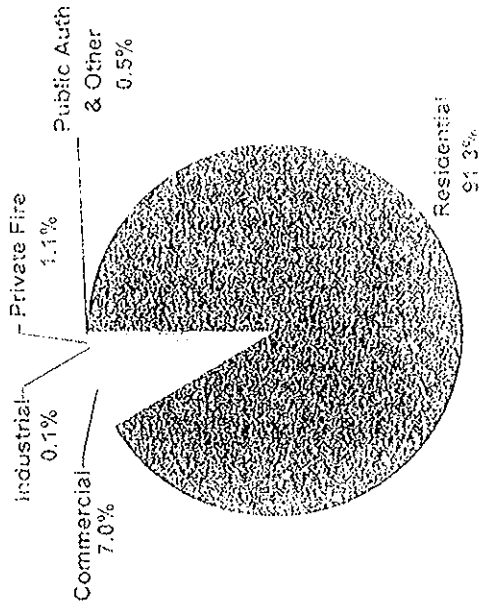
High Degree of Financial Stability

Largely residential customer base promotes consistent operating results

Geographic presence hedges both weather and regulatory risk

Scale enables multiple growth opportunities across service areas

2008 Customers by Class



Total Regulated Customer Connections: 3.3 million



Overview of Capital Expenditures

Capital investment of \$4.0 - \$4.5 bn
between 2009 and 2013

Projected Capital Expenditures

Capital program focused on

Infrastructure replacement

Capacity projects

Source of supply needs

Acquisitions

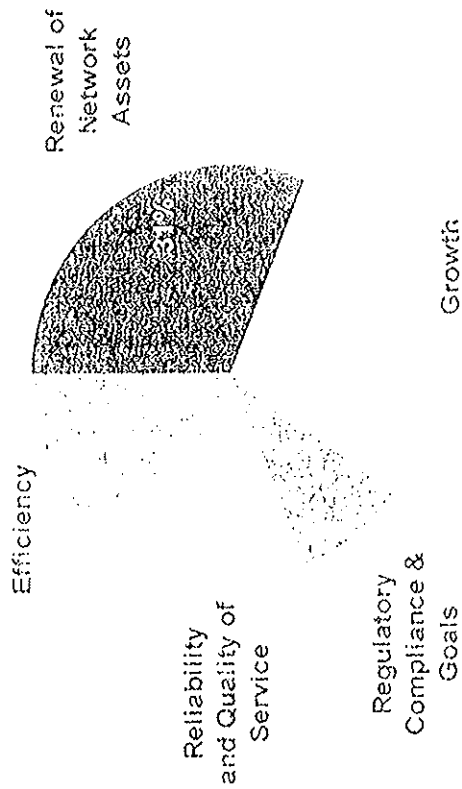
Major projects

Lexington, KY

Monterey, CA

Champaign, IL

Ashtabula, OH

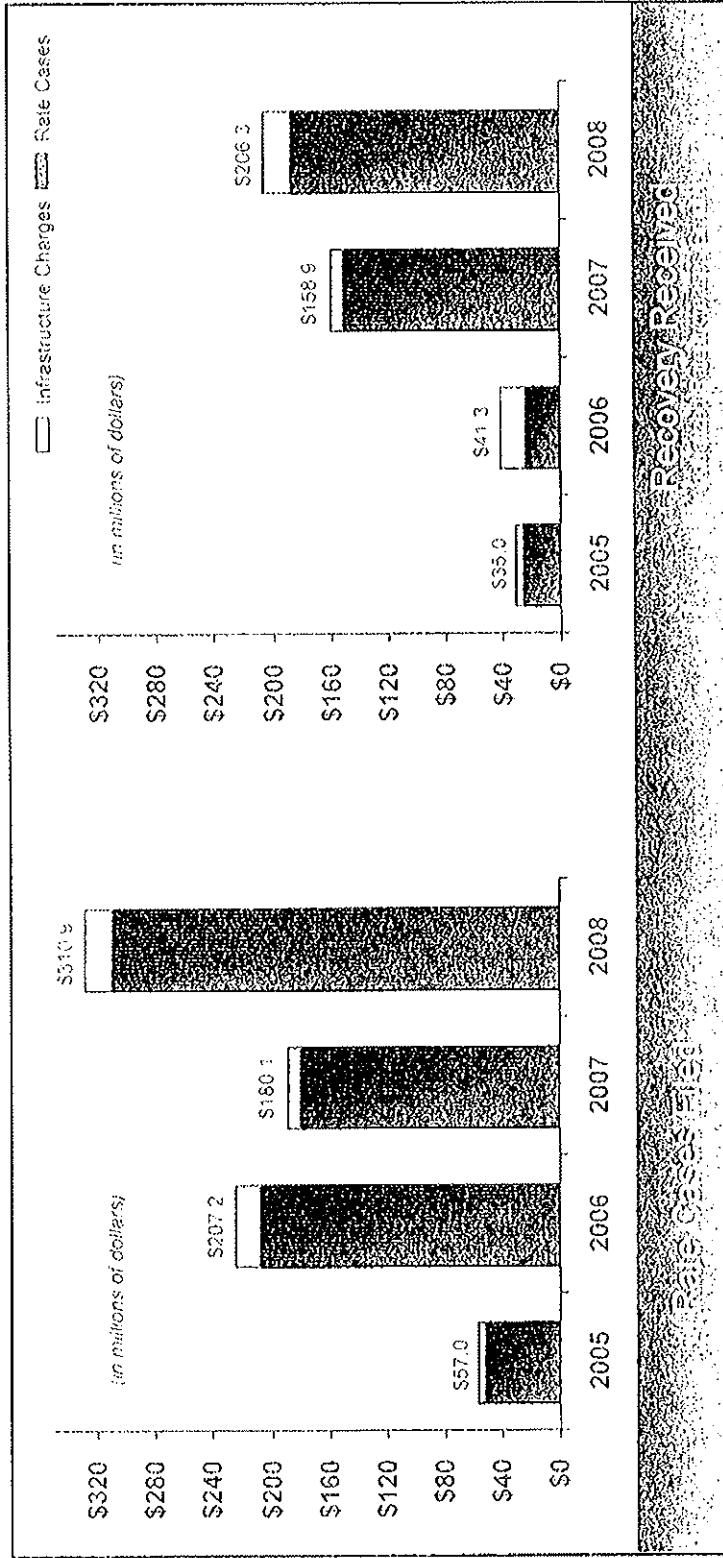


Projected Net Capex of
\$4.0 - \$4.5 billion (2009-2013)

* Net Capex defined as capital expenditures less asset dispositions in real time.



Rate Case Progress – Additional Revenues



As of December 31, 2008, \$104 million in rate cases outstanding
 In 2008, American Water received average ROE of 10.2%



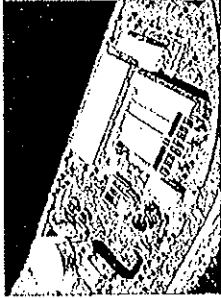
Our Non-Regulated Businesses: A Complement to Core Competencies

Water Reuse



Over 21 projects, 4 states
 Gillette stadium, MA
 Solaire building, NY

Desalination



One operational plant
 Tampa Bay Seawater Desalination Plant, FL
 One pilot plant
 Monterey, CA

Design, Build and Operate



Over 20 projects*
 Lake Pleasant Plant, AZ
 Fillmore, CA
 Carnegie Abbey, RI

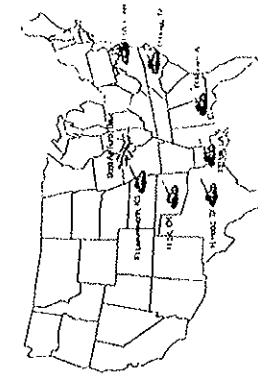
Contract Operations



Over 300 contracts**
 Serving 3m people
 Buffalo, NY
 Seattle, WA
 Warren Township, NJ
 **Includes 266 AWWP projects

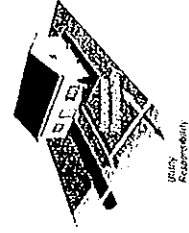
*Includes 15 AWWP projects

Military Bases Privatization



Fort Leavenworth, KS
 Fort Bragg, NC
 Fort Sill, OK
 Fort Rucker, AL
 Scott Air Force Base, IL
 Fort AP Hill, VA
 Fort Hood, TX
 Fort Meade, MD

Homeowner Services



Over 680,000 contracts
 15 states



AWK 2008 Accomplishments: Executing on Our Strategy

Operational and Rate Case Management Achievements

Capital Invested

\$1.01 billion as of December 31, 2008

Significant plant upgrades and expansions completed in Missouri and New Jersey

Rate Cases Granted

\$206.3 million additional annual revenue granted in 2008, including:

New Jersey: \$72.1 million

Missouri: \$34.5 million (general rate case)

Illinois: \$21.6 million (general rate case)

Infrastructure surcharges (Various States, including Missouri and Illinois): \$18.6 million

Averaging greater than 10% return on equity in rate orders received

Rate Cases Filed

\$102.7 million in additional annual revenue in 2008, including:

Arizona, California, Kentucky, New Mexico, Texas and West Virginia



AWK 2008 Accomplishments: Executing on Our Strategy

Business Development and Financial Achievements

"Tuck-ins" Acquired ✓

10 water and wastewater systems (4,938 water and 1,685 wastewater customers)

Contracts Awarded

Two 50 year contracts for the O&M of the water and wastewater systems of Fort Polk and Fort Hood ✓

Approximately \$677 million in revenue

Adequate access to Capital for prudent balance of Debt:Equity

\$850 million Credit facilities

New debt

\$110 million 6.25% Senior Notes due 2018 ✓

\$90 million 6.55% Senior Notes due 2023

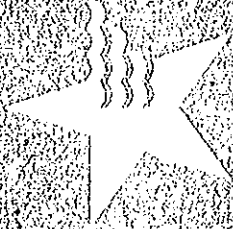
\$75 million 10% Senior Notes due 2038

\$5 million low-interest (1.00%-1.39%) state financing authority loans due 2024-2025

Dividends paid

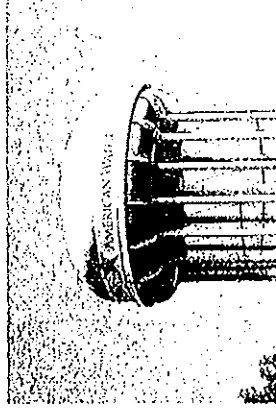
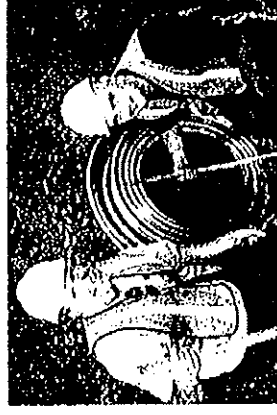
September 2 - \$0.20

December 1 - \$0.20 ✓



AMERICAN WATER

Current Issues and Future Opportunities





In the News – The Economic Stimulus Package

AMERICAN RECOVERY

The New York Times

"Senate Approves Stimulus Plan"

Deal Reached in Congress on \$789 Billion Stimulus Plan

\$789 Billion
Total Stimulus Package

\$21 Billion
Total for Water Infrastructure

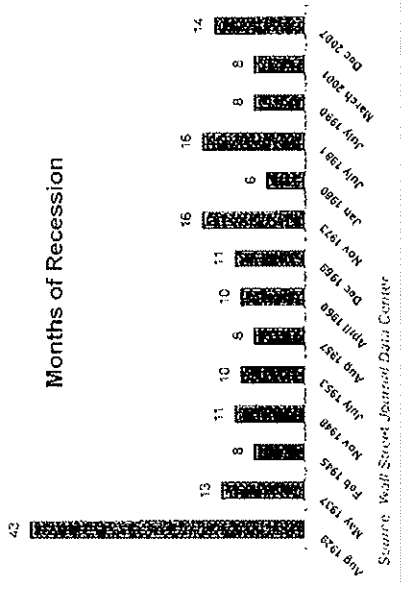
- \$6 Billion for drinking water and wastewater infrastructure improvements
- \$15 billion increase in Private Activity Bond cap

Opportunities for American Water

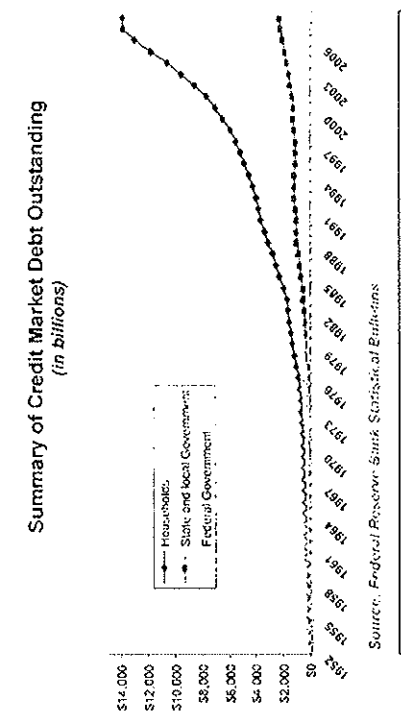
- Increased Business Development Opportunities**
 - Collaborate with municipalities on infrastructure projects
 - Encourage municipalities to upgrade community water systems
- Cash Flow Benefits**
 - Bonus Depreciation Extension
 - AMT Repeal on tax exempt bonds



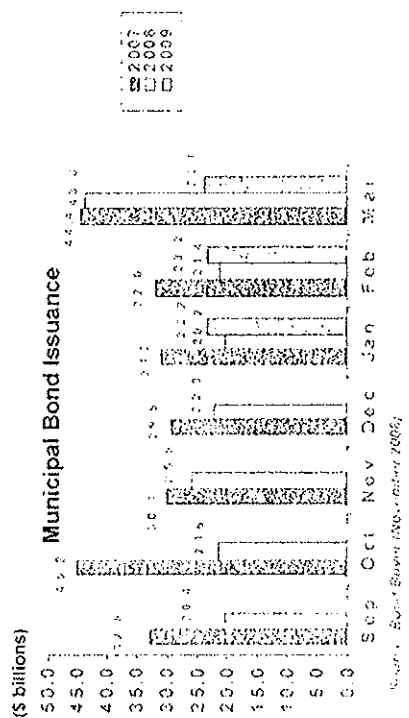
Current US Recession and Capital Markets Volatility could impact ability of Municipalities to finance needed investments



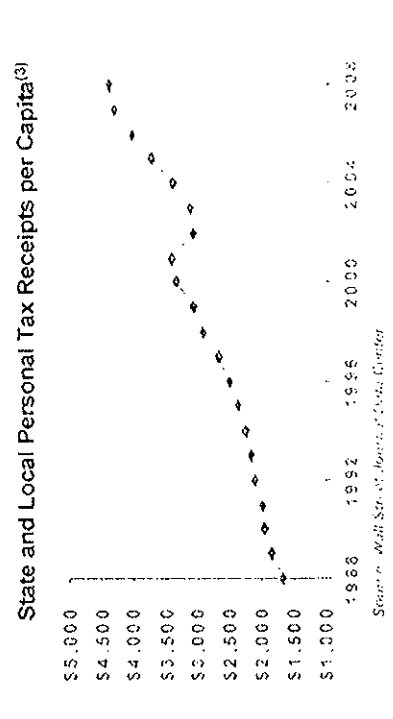
Current recession began December 2007 and has already lasted longer than many previous ones



Debt levels have risen steadily since the early 1950s but with credit markets constrained higher debt levels will be challenged



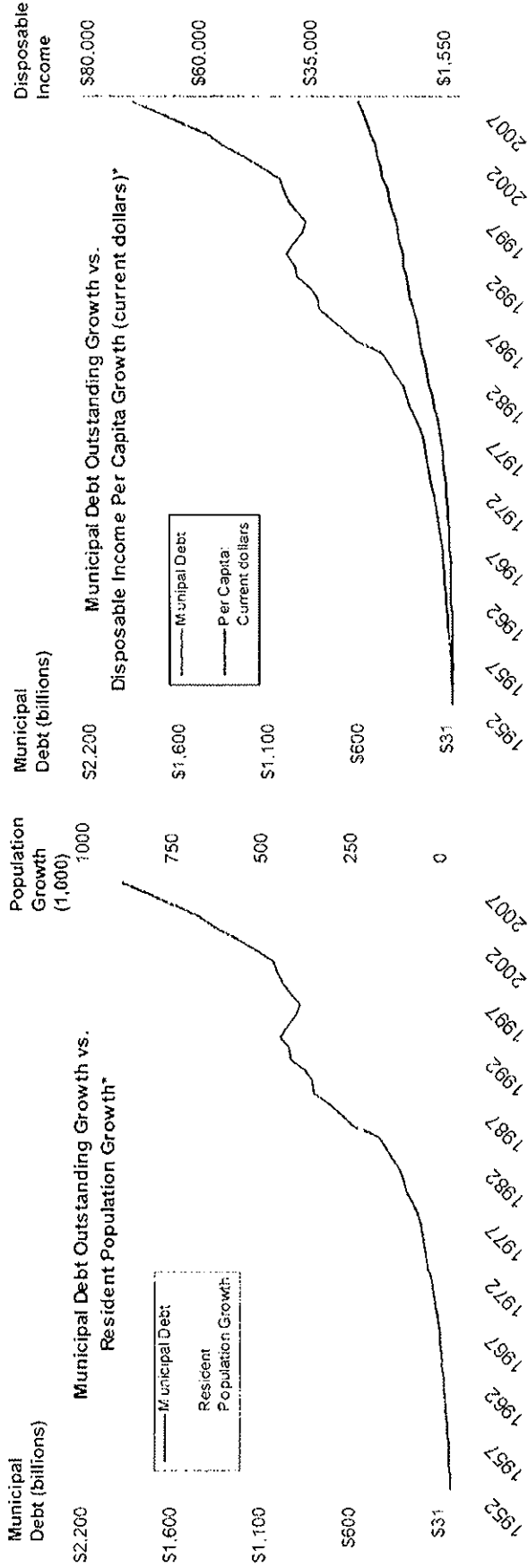
Issuance of municipal bonds has declined significantly since late 2006



Per capita tax receipts have declined significantly since 2000



Municipal Debt Growth Has Far Outpaced both Population Growth and Disposable Income



* All data has been indexed from 1952
 * Source: U.S. Census Bureau



Infrastructure Investment: Aiding Economic Recovery, Creating Shareholder Value

Infrastructure investment is a key driver of economic growth and job creation. It provides the foundation for a strong and resilient economy, and it is essential for the long-term success of our nation.

- Loss of jobs/loss of economic development and growth
- Limited access to operating cash/expensive short-term borrowing
- Access to Credit Denied/Delayed/Costly capital projects delayed
- Lost Values in Pension Funds and 401K retirement accounts
- Foreclosures and Housing Values lost property tax revenue
- Expanded focus on Public Private Partnerships

investment in infrastructure expand economy's productive capacity

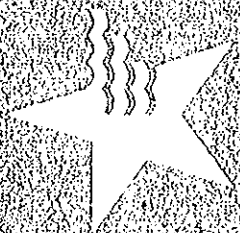
investment in water and sewer infrastructure yields positive returns.

One dollar of water and sewer infrastructure investment increases long-term GDP \$6.35 *

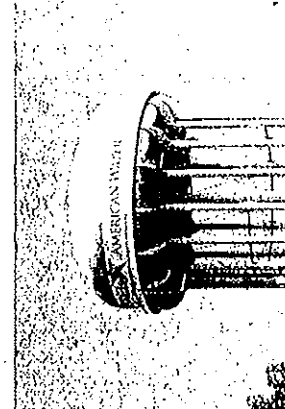
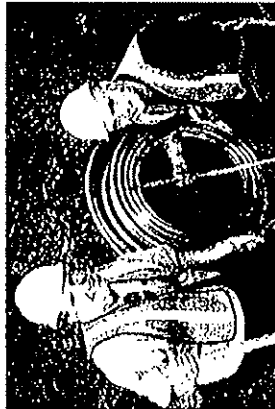
Each additional dollar of water and sewer industry revenue increases revenue in all industries by \$2.62 in that year *

Adding one job in water and sewer creates 3.68 jobs additional jobs in the national economy *

American Water brings the capital, efficiencies and innovations of the private sector to any municipal partnership



AMERICAN WATER



Financial Overview Fourth Quarter and Full Year 2008



Net Income Summary

(Data in thousands, except per share data)

- Net income to common (including impairment charge)
- Impairment charge net of tax
- Net income to common (excluding impairment charge)*
- Common dividends
- Average common shares outstanding, diluted
- Earnings per share
- Earnings per Share (excluding goodwill impairment)*

| | Three Months Ended December 31 | | Twelve Months Ended December 31 | |
|-----------------------------------------------------|-----------------------------------|-------------|------------------------------------|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| Net income to common (including impairment charge) | \$36,407 | (\$234,572) | (\$562,421) | (\$342,826) |
| Impairment charge net of tax | -- | \$261,913 | \$738,475 | \$501,515 |
| Net income to common (excluding impairment charge)* | \$36,407 | \$27,341 | \$176,054 | \$158,689 |
| Common dividends | \$32,063 | -- | \$64,055 | -- |
| Average common shares outstanding, diluted | 160,045 | 160,000 | 159,967 | 160,000 |
| Earnings per share | \$0.23 | (\$1.47) | (\$3.52) | (\$2.14) |
| Earnings per Share (excluding goodwill impairment)* | \$0.23 | \$0.17 | \$1.10 | \$0.99 |

*Table included separately that reconciles the non-GAAP financial measures



Revenue Breakdown – Fourth Quarter and Year-end (\$ in millions)

| | Fourth Quarter 2008 | Year-end 2008 |
|----------------------------------------------|----------------------------|----------------------|
| Revenue Three Months Ended December 31, 2007 | \$553.8 | \$2,214.2 |
| * Rate Increases | \$32.6 | \$132.8 |
| * Reduction in customer consumption | (\$27.3) | (\$52.3) |
| * Growth in Contract Operations Activity | \$2.5 | \$31.1 |
| * Increase in Homeowner Services | \$1.5 | \$7.2 |
| * Other, net | <u>\$5.5</u> | <u>\$3.9</u> |
| Revenue Three Months Ended December 31, 2008 | <u>\$568.6</u> | <u>\$2,336.9</u> |
| Revenue Year Ended December 31, 2007 | | |
| * Rate Increases | | |
| * Reduction in customer consumption | | |
| * Growth in Contract Operations Activity | | |
| * Increase in Homeowner Services | | |
| * Other, net | | |
| Revenue Year Ended December 31, 2008 | | |



Operating Expenses Breakdown – Fourth Quarter and Year-end 2008 (\$ in millions)

| | Fourth Quarter 2008 | Year-end 2008 |
|---------------------------------------------------------|----------------------------|---------------------------------------------------------------------|
| Operating Expenses Three Months Ended December 31, 2007 | \$708.9 | Operating Expenses Year Ended December 31, 2007 \$2,199.1 |
| - Impairment Charge | (\$266.0) | - Impairment Charge \$240.7 |
| - Employee Related Costs | (\$2.3) | - Employee Related Costs \$42.2 |
| - Production Costs | \$2.2 | - Production Costs \$10.5 |
| -Operational Supplies & Services | (\$7.6) | -Operational Supplies & Services (\$10.2) |
| - Maintenance Materials & Services | (\$8.7) | - Maintenance Materials & Services \$8.3 |
| - Customer Billing | (\$1.0) | - Customer Billing \$5.8 |
| - Depreciation & Amortization | \$6.8 | - Depreciation & Amortization \$3.9 |
| - General Taxes | \$5.7 | - General Taxes \$15.9 |
| - Gain on Sale | \$0.5 | - Gain (loss) on Sale \$7.0 |
| - Other | \$1.0 | - Other \$0.6 |
| Operating Expenses Three Months Ended December 31, 2008 | <u>\$439.5</u> | Operating Expenses Year Ended December 31, 2008 <u>\$2,523.8</u> |



2008 Summary – Sources of Capital

Capital expenditures for 2008 - \$1 billion

\$258 million increase over 2007

Internally generated cash

2008 operations - \$552.2 million

\$78.5 million increase over prior year

Financing activities

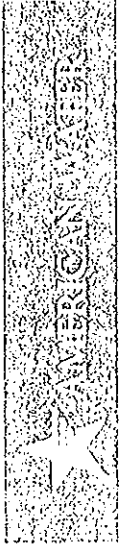
\$850.0 million senior unsecured credit facility accessed

\$437 million drawn down at 12/31/08.

No Commercial Paper outstanding

\$345 million drawn down at 02/23/09

\$178.5 million Commercial Paper outstanding



Key Investment Highlights

Recognized Market Leader

with geographic diversity, national presence and local relationships

Strong Visible Growth

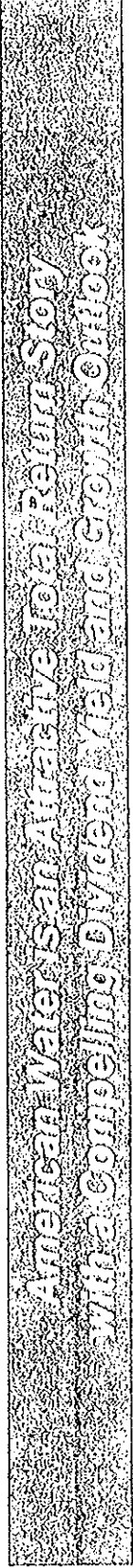
driven by infrastructure investment, earning appropriate returns and consolidation opportunities

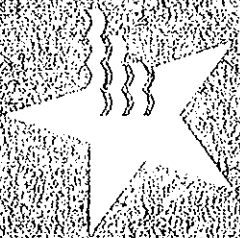
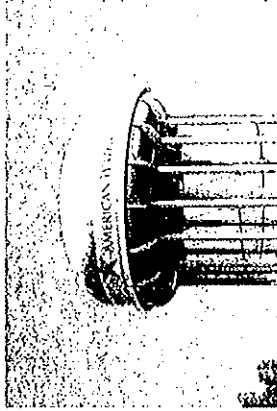
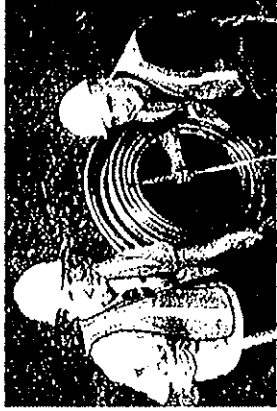
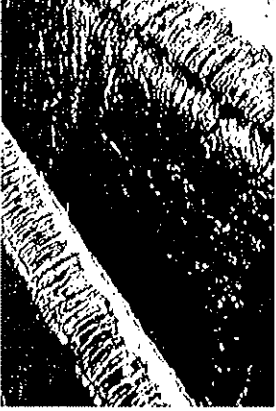
Favorable Risk Profile

of water utility industry with supportive regulatory environment

Proven Management

with deep water utility industry expertise





AMERICAN WATER

Appendix

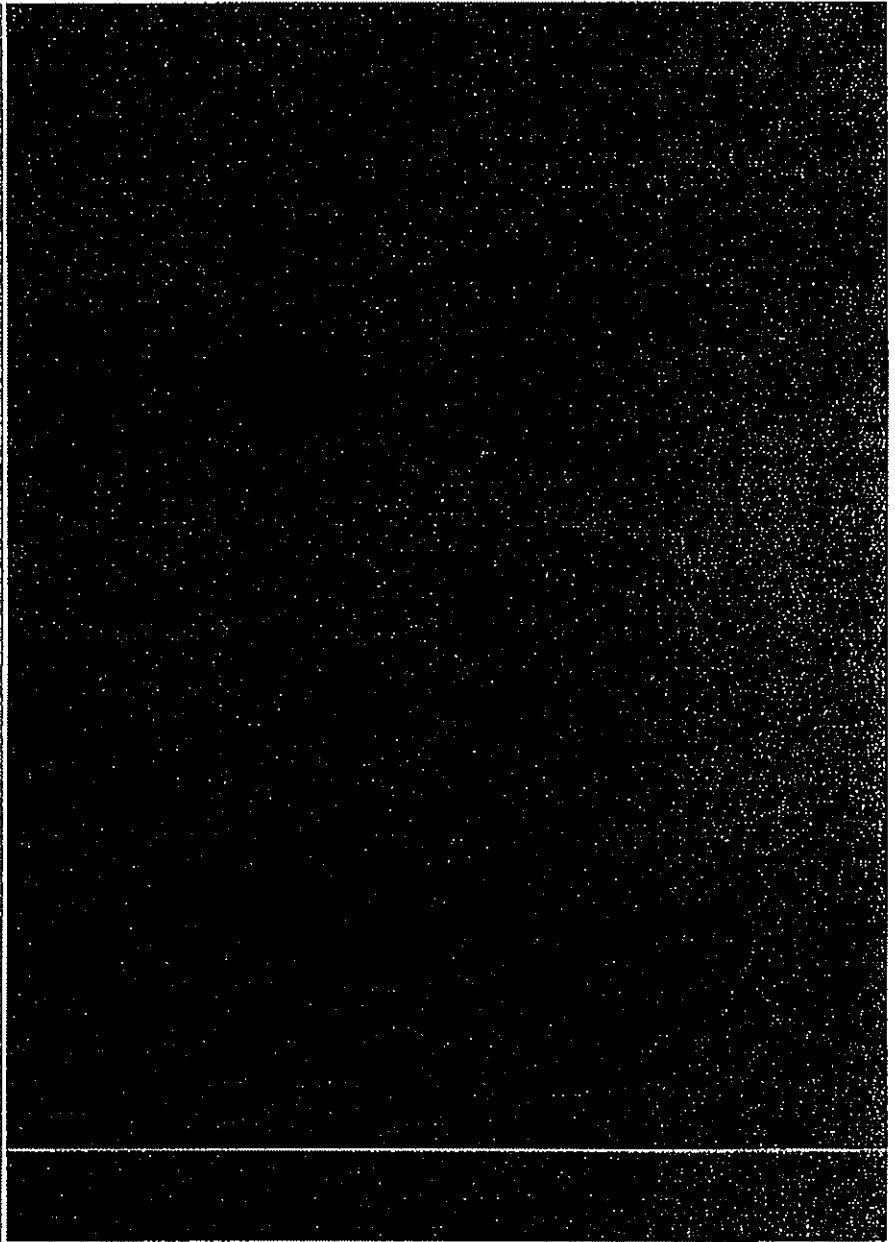
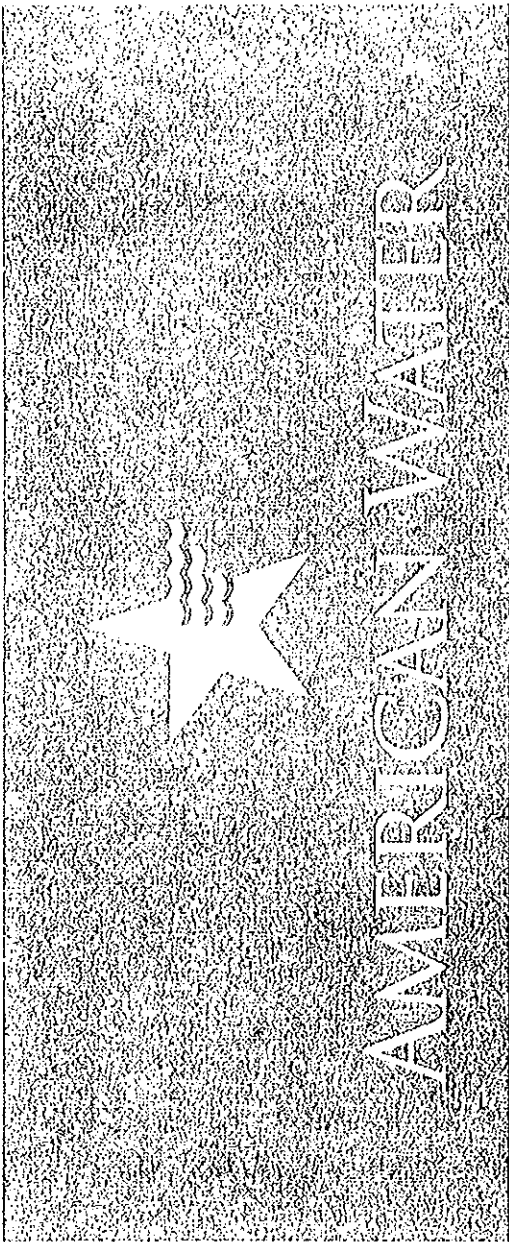
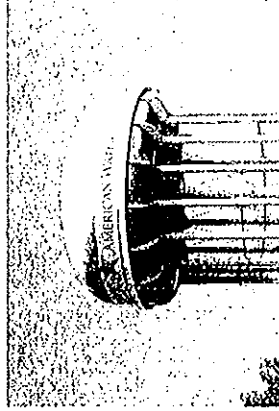
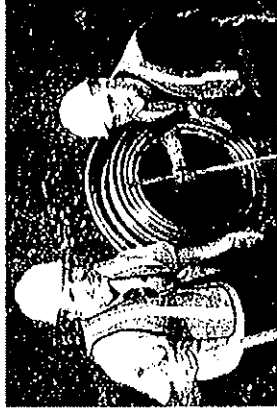


Adjusted EBITDA Reconciliation

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|-------------------------------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| (\$ in Thousands) | | | | | | |
| Net Income (Loss) from Continuing Operations | \$42,140 | \$59,100 | (\$275,130) | (\$155,850) | (\$342,275) | (\$562,421) |
| Adjustments | | | | | | |
| Impairment charges | 3,555 | 78,688 | 385,434 | 221,685 | 509,345 | 750,000 |
| SOX Implementation Costs | 0 | 0 | 0 | 15,400 | 32,002 | 14,464 |
| Divestiture/Sale Expenses | 69,185 | 0 | 0 | 7,359 | 8,113 | 8,666 |
| Other (Condemnation/Regulatory Approvals) | 0 | 0 | 0 | 29,826 | 10,465 | 6,859 |
| Interest and "Interest-like" Items | | | | | | |
| Interest | 280,501 | 315,944 | 345,257 | 365,970 | 283,165 | 285,155 |
| Allowance for Other Funds Used During Construction | (8,326) | (5,476) | (5,810) | (5,980) | (7,759) | (14,497) |
| Allowance for Borrowed Funds Used During Construction | (5,132) | (2,923) | (2,420) | (2,652) | (3,449) | (8,171) |
| Amortization of Debt Expense | 3,872 | 3,377 | 4,367 | 5,062 | 4,867 | 5,895 |
| Preferred Dividends | 487 | 410 | 227 | 215 | 225 | 225 |
| Income Taxes | 60,271 | 66,328 | 50,979 | 46,912 | 86,756 | 111,827 |
| Depreciation and Amortization | 210,588 | 225,260 | 261,364 | 259,181 | 267,335 | 271,261 |
| EBITDA | \$657,141 | \$740,708 | \$764,268 | \$787,128 | \$848,790 | \$869,263 |

Adjusted Net Income Reconciliation

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|-------------------------------------------------------|-----------------|------------------|------------------|-----------------|------------------|------------------|
| (\$ in Thousands) | | | | | | |
| Net Income (Loss) from Continuing Operations | \$42,140 | \$59,100 | (\$275,130) | (\$155,850) | (\$342,275) | (\$562,421) |
| Adjustments | | | | | | |
| Impairment charges | 3,555 | 55,276 | 378,057 | 217,501 | 501,515 | 738,475 |
| SOX Implementation Costs | 0 | 0 | 0 | 9,394 | 19,179 | 8,678 |
| Divestiture/Sale Expenses | 42,203 | 0 | 0 | 4,489 | 4,860 | 5,200 |
| Other (Condemnation/Regulatory Approvals) | 0 | 0 | 0 | 17,334 | 6,269 | 4,116 |
| Adjusted Net Income from Continuing Operations | \$87,898 | \$114,376 | \$102,927 | \$92,868 | \$189,547 | \$194,048 |



Pennsylvania-American Water Company
Northeast Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.20

**Pennsylvania-American Water Company
Northeast Wastewater Operations**

VII. Rate of Return

20. Please provide a listing of all securities issuances for the Company and, if applicable, its parent projected for the next two years. The response shall identify for each projected issuance date, dollar amount, type of security, and effective cost rate.

Answer: Pennsylvania American Water expects to utilize a combination of AWCC, PEDFA, and Pennvest to meet its financing needs during the next two year period.

2009

On April 8, 2009 PAWC secured \$80M tax exempt debt to finance water (\$33M) and Coatesville wastewater (\$47M) projects through the Pennsylvania Economic Development Authority ("PEDFA") at an interest rate of 6.2%.

During 2009 Pennvest financing of approximately \$2.3M closed and was received in 2009. The interest rate for the first 5 years is 1.274%.

\$93.165 million of tax exempt mandatory put bonds were refinanced for 30 years at a fixed rate of 5.50%.

Pennsylvania-American Water had \$53M in 3 variable rate tax-exempt bonds that it was unable to remarket. The Company was required to purchase these bonds in house and remarket them on 5/21/09 at fixed rates from 6.00% to 6.75%.

2010 & 2011

PAWC expects to secure long term debt during 2010 and 2011, based on projected capital investment. The Company is in the process of obtaining approval to close on approximately \$21 million in Pennvest financing during 2010. In addition the Company is in the process of assessing the level of external capital required and the source of available funding. Interest rates would be comparable to that of similarly rated companies and similarly structured debt instruments.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.21

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

21. Please identify any plan by the Company to refinance high cost long-term debt or preferred stock.

Answer: The Pennsylvania-American Water Company has no current plans to refinance the few remaining high cost long-term debt or preferred stock due to make-whole provisions, premiums or mortgage indenture restrictions.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.22

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

22. Please provide copies of all securities analysts' reports relating to the Company and its parent, or both, issued within the past 2 years.

Answer: See attached reports. We have a policy not to distribute analyst research.

Research Report Disclaimer

"The attached reports on American Water Works Company, Inc. represent the opinions of third party companies. American Water neither endorses the material, nor undertakes an obligation to publicly update any subsequent distributions by these or other research companies."

The Company has attached four of the most recent security analyst reports for each of 2008 and 2009 relating to American Water Works. Due to the voluminous nature of providing all of the reports herein, the remaining analyst reports will be made available on request.

COMPANY UPDATE

American Water Works Company, Inc.

(AWK/NYSE)

August 6, 2009

Michael Gaugler, 212-702-6539

gauglerm@bmur.com

Christopher Noon, 212-702-6623

noonc@bmur.com

**BREAN MURRAY
CARRET & CO.**

Reports 2Q09 Results; Maintaining Buy Rating, \$28 Target Price

Investment Summary

**Buy
Target Price: \$28**

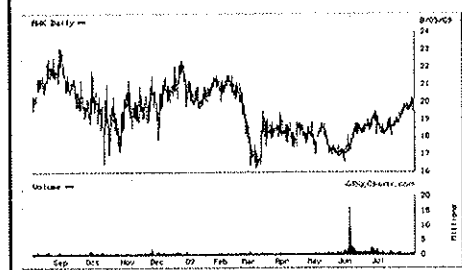
American Water Works reported 2Q09 results that were slightly ahead of expectations. Revenue in the quarter of \$612.7 million (a 4% YoY increase) came in ahead of our \$610 million estimate and EPS of \$0.32 was nicely above our estimate of \$0.29. These impressive results come in the face of exceptionally wet weather in the Northeast during the quarter (most notably May and June), and also reflects the company's ability to manage its cost structure. In the regulated business, revenue increased by \$28.7 million, and total general rate cases now total \$17.7 million for the first half of the year. As of July 31, 2009, AWK was awaiting final orders for general rate cases totaling \$258.1 million in additional revenue. The company's non-regulated business decreased by 4.1% YoY due to lower revenue in the Contract Operations Group and Applied Water Management Group, which was partially offset by an increase in revenues in the Homeowner Services Group. Looking forward, we believe American Water Works is well positioned to benefit from additional rate increases, tuck-in acquisitions, and planned capital expenditures. We are maintaining our Buy rating and \$28 target price, based on a P/E multiple of 20x our 2010 EPS estimate of \$1.41.

Discussion

- Solid 2Q09 results.** American Water Works' 2Q09 results were ahead of estimates on both the top and bottom line. Revenue of \$612.7 million increased 4% from the same quarter last year and beat our \$610 million estimate. Contributing to the increase was the Regulated Business, which saw its revenue increase by \$28.7 million. These results are especially impressive given the wet weather in the Northeast (most notably Pennsylvania and New Jersey). Total volume sold actually decreased 5.5% in the quarter from the same period last year, which resulted in a \$24 million reduction in revenue (\$0.08 per share). The company's non-regulated business saw its revenue decrease 4.1% from the same quarter last year. Overall, we are impressed with the results given the miserable weather conditions AWK was faced with across approximately 50% of its service territory.
- Rate case update.** AWK received additional rate increases in the quarter of \$12.5 million, which brings the YTD total to \$17.7 million. The company also filed rate applications in the quarter in Indiana, Iowa, Ohio, Pennsylvania, Maryland and Illinois, requesting an additional \$182.6 million. As of July 31, 2009, the company was awaiting final orders for rate cases in 10 states, totaling \$258.1 million in additional revenue.
- Adjusting estimates.** Based on the results reported for 2Q09, we are adjusting our forward estimates as follows: our 2009 EPS estimate is now \$1.34 up from \$1.30, and our 2010 EPS estimate is now \$1.41, down from \$1.43. We consider the changes insignificant from a valuation perspective. We will make further adjustments if needed after the conference call scheduled for 9 AM ET today.

| | |
|---------------------------|-----------------|
| Price | \$20.00 |
| 52-Week High/Low | \$23.12 - 16.22 |
| Shares Outstanding (mm) | 174.56 |
| Market Cap. (mm) | \$3,491.24 |
| Average Daily Volume (mm) | 0.80 |

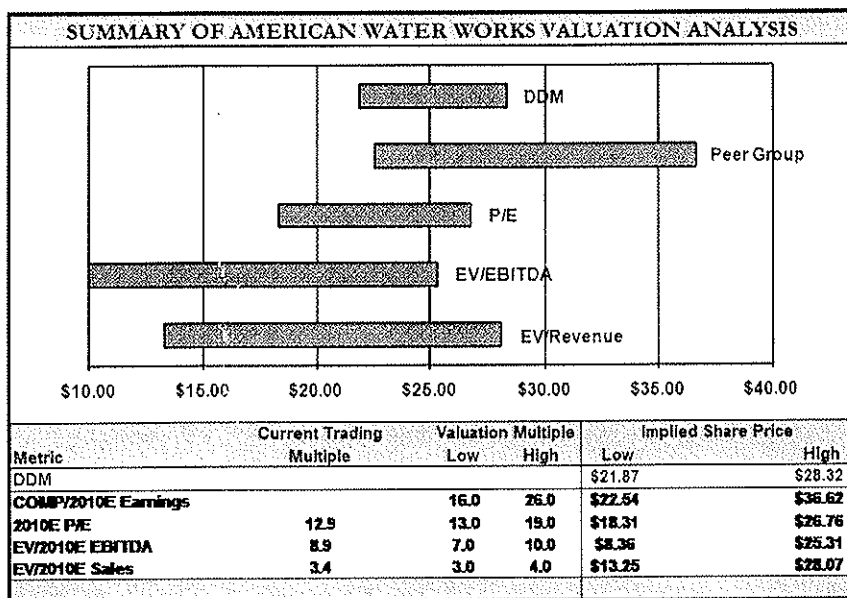
| EPS | FY08A | FY09E | FY10E |
|--------------|---------------|---------------|---------------|
| Mar | \$0.08 | \$0.19A | \$0.18 |
| Jun | \$0.30 | \$0.32A | \$0.39 |
| Prior | - | \$0.29 | - |
| Sep | \$0.55 | \$0.53 | \$0.54 |
| Prior | - | - | \$0.55 |
| Dec | \$0.23 | \$0.30 | \$0.31 |
| Prior | - | \$0.29 | - |
| FY | \$1.16 | \$1.34 | \$1.41 |
| Prior | - | \$1.30 | \$1.43 |
| Consensus | - | \$1.32 | \$1.45 |
| P/E | 17.3x | 14.9x | 14.2x |
| FY Rev. (mm) | \$2,336.99 | \$2,512.76 | \$2,690.34 |



Source: BigCharts.com

Valuation. Based on the results of our summary valuation, we are maintaining our Buy rating and \$28 target price. Judging the shares by 3 criteria – dividend yield, projected long-term growth and valuation relative to the U.S. water utility peer group – we believe the shares of American Water Works rank as among the most attractive from current share price levels. We continue to expect the valuation gap between AWK and the water utility peer group to close (on a P/E basis) based on 1) continued successful recovery of costs through rate relief across the service territories, 2) continued unwinding of the RWE ownership position, and 3) its structured capital expense programs to improve water delivery and quality. Our \$28 target price is based on a P/E multiple of 20x our 2010 EPS estimate of \$1.41, and we recommend investors continue to accumulate shares or add to positions at current levels.

Risks. Weather, acquisition integration, regulatory environment, additional equity offerings, potential goodwill impairments and changes in interest rates.



Source: Company reports, Brean Murray, Carret & Co. estimates

Water Utility Segment Comparisons

| Peer Group Analysis | 08/05/09 | Mkt. Cap | EPS | EPS | EPS | EPS | P/E | P/E | P/E | P/E | Est LT EPS | | |
|----------------------|----------|----------|--------|---------|--------|--------|--------|--------|-------|-------|------------|-------|--------|
| Company Name | Ticker | Price | Rating | (MM) | CY07 | CY08 | CY09E | CY10E | CY07 | CY08E | CY09E | CY10E | Growth |
| AMERICAN WATER WORKS | AWK | \$19.99 | BUY | \$3,489 | NA | \$1.16 | \$1.32 | \$1.45 | NA | 17.2x | 15.1x | 13.8x | 10.0% |
| AQUA AMERICA | WTR | \$18.12 | BUY | \$2,458 | \$0.72 | \$0.73 | \$0.84 | \$0.92 | 25.2x | 24.8x | 21.6x | 19.7x | 9.0% |
| CALIFORNIA WATER | CWT | \$37.99 | BUY | \$788 | \$1.50 | \$1.90 | \$2.09 | \$2.17 | 25.3x | 20.0x | 18.2x | 17.5x | 8.0% |
| AMER STATES WATER | AWR | \$36.84 | HOLD | \$675 | \$1.56 | \$1.56 | \$1.65 | \$1.87 | 23.6x | 23.6x | 22.3x | 19.7x | 4.0% |
| SJW | SJW | \$21.99 | HOLD | \$406 | \$1.04 | \$1.16 | \$0.85 | \$1.12 | 21.1x | 19.0x | 25.9x | 19.6x | NA |
| Group Average | | | | | | | | | 23.8x | 20.9x | 20.6x | 18.1x | 7.8% |

Source: Baseline

| Peer Group Analysis | 08/05/09 | Mkt. Cap | Current | Target | Target | Price | Price | Target | Upside | Yield | | |
|----------------------|----------|----------|---------|---------|----------|----------|----------|---------|---------|---------|-----------|------|
| Company Name | Ticker | Price | Rating | (MM) | Multiple | Multiple | Multiple | Range | Range | Price | Potential | |
| | | | | | CY10 | (Low) | (High) | (Low) | (High) | | | |
| AMERICAN WATER WORKS | AWK | \$19.99 | BUY | \$3,489 | 13.8x | 14.3x | 19.5x | \$20.66 | \$28.28 | \$25.00 | 40% | 4.2% |
| AQUA AMERICA | WTR | \$18.12 | BUY | \$2,458 | 19.7x | 19.0x | 26.0x | \$17.48 | \$23.92 | \$26.00 | 43% | 3.0% |
| CALIFORNIA WATER | CWT | \$37.99 | BUY | \$788 | 17.5x | 16.0x | 21.0x | \$34.72 | \$45.57 | \$44.00 | 16% | 3.1% |
| AMER STATES WATER | AWR | \$36.84 | HOLD | \$675 | 19.7x | 16.0x | 21.0x | \$29.92 | \$39.27 | NA | NA | 2.7% |
| SJW | SJW | \$21.99 | HOLD | \$406 | 19.6x | 16.0x | 22.0x | \$17.92 | \$24.64 | NA | NA | 3.0% |

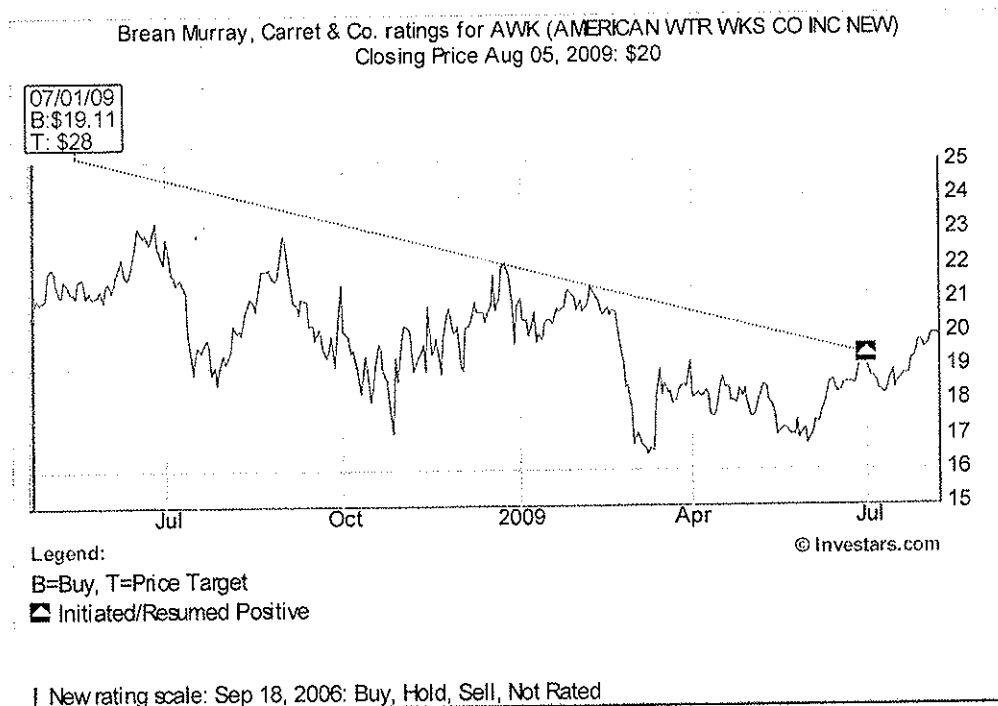
Sources: Baseline, Brean Murray, Carret & Co.

| American Water Works Company, Inc., 2009E | | | | | | | | | | |
|----------------------------------------------------------|--------|----------------|--------|----------------|--------|----------------|--------|----------------|---------|----------------|
| (\$M, except per share data) | | | | | | | | | | |
| Fiscal year ends December 31 | | | | | | | | | | |
| | 1Q09 | Rate or Margin | 2Q09 | Rate or Margin | 3Q09E | Rate or Margin | 4Q09E | Rate or Margin | 2009E | Rate or Margin |
| Operating Revenues | 550.2 | | 612.7 | | 700.9 | | 649.0 | | 2,512.8 | |
| Operation and maintenance | 314.4 | 57% | 330.6 | 54% | 350.4 | 50% | 363.4 | 56% | 1,358.9 | 54% |
| Depreciation and amortization | 68.8 | 13% | 73.2 | 12% | 73.6 | 11% | 74.0 | 11% | 288.6 | 12% |
| General taxes | 52.5 | 10% | 51.7 | 8% | 51.2 | 7% | 51.9 | 8% | 207.3 | 8% |
| Loss (gain) on sales of assets | (0.2) | 0% | - | 0% | - | 0% | - | 0% | (0.2) | 0% |
| Impairment charges | 450.0 | 82% | - | 0% | - | 0% | - | 0% | 450.0 | 10% |
| Total operating expenses, net | 435.5 | 79% | 455.5 | 74% | 475.2 | 68% | 489.3 | 75% | 1,855.5 | 74% |
| Operating income | 114.7 | 21% | 157.2 | 26% | 225.7 | 32% | 159.7 | 26% | 657.2 | 26% |
| Interest, net | (72.0) | -13.1% | (73.7) | -12.0% | (75.7) | -10.8% | (76.6) | -11.6% | (298.0) | -11.9% |
| Amortization of debt expense | (1.5) | -0.3% | (1.5) | -0.2% | (1.4) | -0.2% | (1.5) | -0.2% | (5.9) | -0.2% |
| Other, net | 6.3 | 1.1% | 4.2 | 0.7% | 4.6 | 0.7% | 4.9 | 0.8% | 20.1 | 0.8% |
| Total other income (deductions) | (67.2) | -12.2% | (71.1) | -11.6% | (72.5) | -10.3% | (73.1) | -11.2% | (283.9) | -11.2% |
| Earnings from cont. ops before income taxes | 47.5 | 8.6% | 86.1 | 14.1% | 153.2 | 21.9% | 86.5 | 13.3% | 373.3 | 14.9% |
| Income taxes | 17.6 | 3.1% | 34.1 | 5.6% | 60.7 | 8.7% | 34.3 | 5.3% | 146.6 | 5.8% |
| Earnings from cont. ops | 29.9 | 5.4% | 52.0 | 8.5% | 92.5 | 13.2% | 52.3 | 8.1% | 226.7 | 9.0% |
| Income / (Loss) from discontinued operations, net of tax | - | 0.0% | - | 0.0% | - | 0.0% | - | 0.0% | - | 0.0% |
| Net income | 29.9 | 5.4% | 52.0 | 8.5% | 92.5 | 13.2% | 52.3 | 8.1% | 226.7 | 9.0% |
| Earnings per share: | | | | | | | | | | |
| From continuing operations | \$0.19 | | \$0.32 | | \$0.53 | | \$0.30 | | \$1.34 | |
| Average common shares outstanding | 160 | | 163 | | 174 | | 174 | | 168 | |
| American Water Works Company, Inc., 2010E | | | | | | | | | | |
| (\$M, except per share data) | | | | | | | | | | |
| Fiscal year ends December 31 | | | | | | | | | | |
| | 1Q10E | Rate or Margin | 2Q10E | Rate or Margin | 3Q10E | Rate or Margin | 4Q10E | Rate or Margin | 2010E | Rate or Margin |
| Operating Revenues | 569.5 | | 672.5 | | 751.52 | | 696.76 | | 2,690.3 | |
| Operation and maintenance | 317.8 | 56% | 341.7 | 51% | 381.6 | 51% | 397.2 | 57% | 1,437.6 | 53% |
| Depreciation and amortization | 75.2 | 13% | 77.3 | 12% | 78.9 | 11% | 80.1 | 12% | 311.6 | 12% |
| General taxes | 51.3 | 9% | 60.5 | 9% | 52.6 | 7% | 55.7 | 8% | 220.1 | 8% |
| Loss (gain) on sales of assets | (0.2) | 0% | - | 0% | (0.6) | 0% | (6.3) | -1% | (7.2) | 0% |
| Impairment charges | - | 0% | - | 0% | - | 0% | - | 0% | - | 0% |
| Total operating expenses, net | 444.0 | 78% | 479.5 | 71% | 511.8 | 68% | 526.8 | 76% | 1,862.1 | 73% |
| Operating income | 125.5 | 22% | 193.0 | 29% | 239.7 | 32% | 170.0 | 24% | 728.3 | 27% |
| Interest, net | (76.3) | -13.4% | (77.3) | -11.6% | (78.2) | -10.4% | (79.4) | -11.4% | (311.2) | -11.6% |
| Amortization of debt expense | (1.4) | -0.2% | (1.4) | -0.2% | (1.4) | -0.2% | (1.4) | -0.2% | (5.6) | -0.2% |
| Other, net | 4.8 | 0.8% | 4.6 | 0.7% | 4.8 | 0.6% | 4.6 | 0.7% | 19.1 | 0.7% |
| Total other income (deductions) | (72.9) | -12.8% | (74.0) | -11.0% | (74.8) | -10.0% | (76.1) | -10.9% | (297.7) | -11.1% |
| Earnings from cont. ops before income taxes | 52.6 | 9.2% | 119.0 | 17.7% | 165.0 | 22.0% | 93.9 | 13.6% | 436.5 | 16.0% |
| Income taxes | 21.0 | 4.0% | 47.6 | 7.0% | 66.0 | 8.8% | 37.6 | 5.4% | 172.2 | 6.4% |
| Earnings from cont. ops | 31.5 | 5.5% | 71.4 | 10.6% | 99.0 | 13.2% | 56.4 | 8.1% | 258.3 | 9.6% |
| Income / (Loss) from discontinued operations, net of tax | - | 0.0% | - | 0.0% | - | 0.0% | - | 0.0% | - | 0.0% |
| Net income | 31.5 | 5.5% | 71.4 | 10.6% | 99.0 | 13.2% | 56.4 | 8.1% | 258.3 | 9.6% |
| Earnings per share: | | | | | | | | | | |
| From continuing operations | \$0.18 | | \$0.39 | | \$0.54 | | \$0.31 | | \$1.41 | |
| Average common shares outstanding | 179 | | 184 | | 184 | | 184 | | 183 | |

Source: Company Reports, Brean Murray, Carret & Co. estimates

Important Disclosures

Ratings and Target Price History



All prices are as of the market close on 8/5/2009.

Brean Murray, Carret & Co., LLC has managed or co-managed a public offering or placement of securities of American Water Works Company, Inc. within the past 12 months.

American Water Works Company, Inc. is, or within the last 12 months has been, a client of Brean Murray, Carret & Co., LLC, and investment banking and/or advisory services are being, or have been provided.

Brean Murray, Carret & Co., LLC expects to receive compensation or intends to seek compensation for investment banking and/or advisory services from American Water Works Company, Inc. within the next 3 months.

In the normal course of its business, Brean Murray, Carret & Co., LLC does and intends to seek compensation for investment banking and/or non-investment banking services from the companies in its coverage universe. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decisions. Non-U.S. research analysts that may have contributed to this report are not registered/qualified as research analysts with the FINRA.

The research analyst(s) or research associate(s) principally responsible for the preparation of this research report has received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues. The compensation is determined exclusively by research management and senior management (not including investment banking).

Brean Murray, Carret & Co. Stock Rating System

Buy - Expected to appreciate by at least 10% within the next 12 months.

Hold - Fully valued, not expected to appreciate or decline materially within the next 12 months.

Sell - Expected to decline by at least 10% within the next 12 months.

| | # of Securities | % of Total Securities | # of IB-Related Securities in Past 12 mos. | % of Total Securities |
|--------------|-----------------|-----------------------|-----------------------------------------------|-----------------------|
| BUY | 98 | 58.68% | 10 | 10.2% |
| HOLD | 59 | 35.33% | 1 | 1.69% |
| SELL | 8 | 4.79% | 0 | 0% |
| NOT RATED | 2 | 1.2% | 0 | 0% |
| TOTAL | 167 | | | |

Note : Stock price volatility may cause temporary non-alignment of some ratings with some target prices.

Valuation Methodology and Risks

American Water Works (AWK): Our \$28 target price is based on the shares achieving a P/E multiple of 20x our 2010 EPS estimate of \$1.41. Risks to the achievement of our target price include weather, acquisition integration, regulatory environment, additional equity offerings, potential goodwill impairments and changes in interest rates.

Analyst Certification

We, Michael Gaugler and Christopher Noon, hereby certify that the views expressed in this research report accurately reflect our personal views about any and all of the subject securities or issuers referred to in this document. The analyst and associate analyst further certify that they have not received and will not be receiving direct or indirect compensation in exchange for expressing the recommendation contained in this publication.

Disclaimers

Some companies that Brean Murray, Carret & Co., LLC follows are emerging growth companies whose securities typically involve a higher degree of risk and more volatility than the securities of more established companies. The securities discussed in Brean Murray, Carret & Co., LLC research reports may not be suitable for some investors. Investors must make their own determination as to the appropriateness of an investment in any securities referred to herein, based on their specific investment objectives, financial status and risk tolerance. This report may discuss numerous securities, some of which may not be qualified for sale in certain states and to certain categories of investors. Readers are advised that this analysis report is issued solely for informational purposes and is not to be construed as an offer to sell or the solicitation of an offer to buy. The information contained herein is based on sources which we believe to be reliable but is not guaranteed by us as being accurate and does not purport to be a complete statement or summary of the available data on the company, industry or security discussed in the report. Designated trademarks and brands are the property of their respective owners. Past performance is no guarantee of future results. Any opinions expressed herein are statements of our judgment as of the date of publication and are subject to change without notice. Entities including but not limited to the Firm, its officers, directors, employees, customers, affiliates may have a position, long or short, in the securities referred to herein, and/or other related securities, and from time to time may increase or decrease such position or take a contra position. The Firm (or persons related thereto) may make a market in the securities mentioned herein, and may from time to time perform investment banking or other services for, or solicit investment banking or other business from, and may have other relationships with any company mentioned in this report. Brean Murray, Carret & Co., LLC is a member of SIPC, FINRA, licensed with various state securities regulatory authorities, and a registered U.S. Broker-Dealer. No part of this report may be reproduced in any form without the express permission of Brean Murray, Carret & Co., LLC. Additional information is available upon request.



Debra G. Coy 215-287-8828
 dcoy@jimsonline.com
 Heike M. Doerr 215-665-4448
 hdoerr@jimsonline.com
 Christopher J. Purtill 215-665-6601
 cpurtill@jimsonline.com

American Water Works

AWK - BUY

August 7, 2009

Water

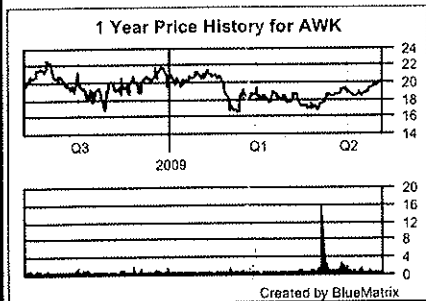
**American Water Works
(AWK) - BUY**

Price: **\$19.80**
 Fair Value Estimate: \$26.00
 52-Week Range: \$23.12-\$16.22
 Market Cap (MM): \$3,457
 Shr.O/S-Diluted (mm): 174.6
 Average Daily Volume: 1,121,324
 Dividend: \$0.80
 Yield: 4.0%

| FYE: Dec | 2008A | 2009E | 2010E |
|------------|--------|--------|--------|
| EPS: | \$1.12 | \$1.36 | \$1.50 |
| Prior EPS: | | \$1.33 | NC |
| P/E Ratio: | 17.7x | 14.6x | 13.2x |

| Quarterly EPS: | | | |
|----------------|--------|---------|----|
| Q1 | \$0.04 | \$0.19A | -- |
| Q2 | \$0.30 | \$0.32A | -- |
| Q3 | \$0.55 | \$0.58 | -- |
| Q4 | \$0.23 | \$0.26 | -- |

EPS: Excludes impairment charges; quarters may not sum to annual due to rounding



**Equity Research
Note**

Another Good Quarter and More in the Pipeline; Maintain BUY

INVESTMENT CONCLUSION:

Yes, it's still a "boring" water utility with a long-term view, but we like it. American Water is simply getting the job done, as it promised when it came back to the public markets last year. It followed up a strong first quarter with solid results in the second quarter, and we expect strong growth to continue through 2009. Management filed several significant cases in key jurisdictions during the quarter, and awards received in the last twelve months more than offset a declining usage pattern. Industrial usage dropped 17% in the quarter and residential usage dropped 5%, the latter mainly due to wet northeast weather. Investor caution around the RWE overhang was somewhat ameliorated after the June offering, but the overhang remains. Overall the company is growing as planned: spending \$400 million in the first half of the year, awaiting authorizations on \$258 million in requested filings, and progressing on acquisitions. We've revised our 2009 estimate to \$1.36 from \$1.33 and maintain our 2010 estimate of \$1.50, though we see opportunity for further upside next year. We maintain our BUY and 12-month fair value of \$26.

KEY POINTS:

- **Second Quarter Results:** American Water reported 2Q earnings of \$0.32/share, a penny ahead of our estimate and consensus, and up 14% year over year. Despite a 5.5% decline in volumetric send-out, revenue grew 4% over the same period last year due to \$46.5 million in new rates. The efficiency ratio improved 210 basis points to 54%, and operating margin improved to 25.7% from 24.2% last year. Lower than expected interest expense also helped on the bottom line. Operating cash flow for the first six months was \$228.7 million, suggesting that our full-year expectation of \$500-600 million is on target.
- **Capital & Growth:** American sold 14.5 million shares in June and completed several debt issuances in the second quarter amounting to \$275 million (\$360 million so far in 2009). These funds, along with the internally generated cash flow are being put to work. American is on schedule to spend \$800 million in 2009. The company is growing via projects in NJ and Texas. The company is also returning capital to shareholders via the recent 5% dividend increase (to \$0.21/quarter) – its first increase since rejoining the public equity markets.
- **Rate Activity:** Rate awards received in the second quarter were modest at \$12.5 million, mainly a \$10 million award in Kentucky. American filed significant cases in the quarter, however, and now has over \$258 million in pending requests, up from \$104 million at the start of the year.
- **Valuation Attractive:** While it has recovered in recent weeks, the stock continues to trade at a steep discount to peers at a P/E of around 15x and 13x our 2009 and 2010 estimates and a 8.3x on a 2010 EV/EBITDA multiple. Our 12-18 month outlook remains positive, as rates flow in and organic growth gradually recovers along with the economy. We maintain our BUY rating and \$26 fair value.

Research Analyst Certifications and Important Disclosures are on pages 5 - 6 of this report

VALUATION SUMMARY:

Since the equity offering in early June, AWK shares have steadily increased from around \$17 to over \$20 (10.1% increase in the last three months). Year to date, the stock is down 4.2% compared to the average decline of 11% among the larger investor-owned water utilities (excluding SouthWest Water's rebound).

On a P/E basis, American trades at about 15x and 13x our 2009 & 2010 estimates respectively, compared to the current peer group average of 23x and 20x. On an EV/EBITDA basis, the company trades at 8.3x our current 2010 EBITDA estimate vs. the group average of 9.7x. On a price/book basis, the stock is currently trading at about 1.1x on "adjusted shareholder equity" (including the estimated portion of goodwill that is captured in rate base), a large discount to the group average of 1.8x book value. Our fair value of \$26 implies a 2009 P/E of 19x and 2010 P/E of 17x. This compares to the assumed group P/E multiples of 23x and 20x 2009 and 2010 estimates, respectively. Our fair value assumes a 2010 EV/EBITDA multiple of 9.3x, compared to the peer group average of 9.5x. American's higher debt load compared to the group accounts for the higher current EV/EBITDA multiple relative to peers. The estimated 2009 ROE on adjusted equity (including a portion of goodwill) is now over 7% -- a steadily improving metric which still offers plenty of room for upside relative to the company's average allowed ROE in the 10-10.5% range.

| Current Data Points | |
|----------------------------------------------------------------------------------|---------|
| Price | \$20.00 |
| Shares outstanding | 174.5 |
| Market cap (\$ mil) | 3,490.2 |
| Net debt/total capital | 57.7% |
| Net debt | 5,363.2 |
| Shareholders equity | 3,928.2 |
| Adjusted shareholders equity* | 3,203.2 |
| Est. 2009 ROE, excl goodwill | 5.8% |
| Est. 2009 ROE on adjusted equity | 7.2% |
| Book value/share | \$22.51 |
| Price/Book | 0.9x |
| Goodwill | 1,250.1 |
| Adjusted book value/share | \$18.36 |
| Price/book, adjusted | 1.1x |
| 2009 Dividend | \$0.82 |
| Dividend Payout Ratio** | 60% |
| Yield | 4.1% |
| *Adjusted equity includes est. portion of goodwill captured in rate base for ROE | |
| **Payout ratio based on 2009E EPS excl. impairment chg | |

Source: Company data, Janney Estimates

| American Water Works (AWK) | | | |
|----------------------------------------------------------|---------|---------|---------|
| | 2008 | 2009E | 2010E |
| Sales (\$ bil) | 2,336.9 | 2,512.0 | 2,750.0 |
| Revenue growth | 5.5% | 7.5% | 9.5% |
| Price/Sales | 1.5x | 1.4x | 1.3x |
| EBITDA (\$ mil) | 831.2 | 962.4 | 1,069.8 |
| EBITDA Growth | 5.1% | 15.8% | |
| Price/EBITDA | 4.2x | 3.6x | 3.3x |
| EV/EBITDA | 10.7x | 9.2x | 8.3x |
| Reported net income | (562.4) | (213.8) | 267.6 |
| Impairment & one-time costs | 741.6 | 443.0 | - |
| Net income ex impairment* | 179.2 | 229.2 | 267.6 |
| EPS ex one-time items | \$1.12 | \$1.36 | \$1.50 |
| EPS Growth | -5.2% | 21.7% | 10.3% |
| P/E | 17.9x | 14.7x | 13.3x |
| *Net income ex impairment and one-time costs, net of tax | | | |

Source: Company data, Janney Estimates

Cash flow and capex. American is using internally generated cash flow as well as new equity and debt to fund its capital investment program. The \$400 million in capex spent in the first half was partially funded with some of the \$228.7 million in operating cash flow generated so far in the year. We still anticipate that the company can generate \$500-600 million in operating cash flow in 2009 compared to plans for \$800 million in capex and approximately \$138 million in dividend payments. The shortfall will be funded with equity capital raised in June and ongoing debt issuances, a typical financing plan for water utilities.

RECENT RATE ACTIVITY: American secured \$12.5 million in new annualized revenue through general rate cases in the second quarter, primarily from a \$10 million Kentucky case effective June 1st. Paired with the West Virginia case received in the first quarter, the company has now been granted \$17.7 million in 2009 in general rate case awards. An additional \$21 million in surcharges was finalized so far in 2009.

American was busy in the second quarter filing new cases in key states, specifically in PA, IN, IL, IA and most recently in OH and AZ as noted in the exhibit below. In Iowa, the company has implemented \$6.8 million in interim rates subject to refund pending final case approval. The most recent significant cases request 12%-12.25% allowed ROEs. We believe the higher requests reflect the higher equity risk we are now seeing in the financial markets, and allowed ROEs may be trending upward slightly from the 10.0-10.2% average we've typically seen in the last couple of years. As a reminder, we typically expect to see awards averaging about 60% of requests.

| | State | File Date | Water/ Sewer | Region | % Increase | \$ Increase (M) | Docket # | Req. ROE | Status Summary |
|----------------------|-------|-----------|---------------|---------------------------------------|---------------------------------------------|---------------------------------------|------------------|----------|----------------------------------------------------------------------------------|
| American Water Works | NJ | | | DSIC Mechanism | N/A | N/A | WO08050358 | N/A | Delayed at July 29th meeting. |
| | CA | 1/23/09 | Water | Sacramento, LA, & Larkfield Districts | 51.3% & 10.25%; 41.3% & 4.1%; 23.4% & 4.07% | \$26.1M, \$6.6M, combined 2010 & 2011 | A0901013 | 10.20% | Public hearings held in early June. Two cities recently approved as intervenors. |
| | AZ | 5/1/08 | Water & Sewer | 10 Districts | 26.4%-169% | \$20M | W-01303A-08-0227 | 11.75% | Waiting on report from ALJ. |
| | PA | 4/24/09 | Water | Consolidated | 13% | \$58M | R-2009-2097323 | 12.00% | Discovery phase |
| | IN | 4/30/09 | Water | Muncie | 39% | \$46.9M | 43680 | 12.00% | Discovery phase |
| | IA | 4/30/09 | Water | Quad City / Clinton | 31% average | \$9.4M | RPU-09-TBD | 12.20% | Discovery phase |
| | OH | 5/7/09 | Water & Sewer | Multiple | 71%-78% | \$8.8M | 09-391-WS-AIR | 12.20% | Discovery phase |
| | IL | 5/29/09 | Water | Metro-East | 28% average | \$58.6M | 09-TBD | 12.25% | Discovery phase |
| | AZ | 7/2/09 | Water & Sewer | Multiple | N/A | \$20.6 | TBD | 12.25% | Discovery phase |

American has filed for a Distribution System Improvement Charge (DSIC) in New Jersey. This mechanism is utilized in several states and allows the company to immediately begin recovering the cost of (and earn a return on) qualifying plant (usually pipe), instead of waiting for the next general rate filing. American requested a 7.5% cap on DSIC increases between rate cases, the level it currently receives in PA. At the end of July, the NJ Board of Public Utilities (BPU) delayed approval of the surcharge. At the same time the BPU requested a management audit of New Jersey American, a common industry practice, to review practices & procedures. Regulatory audits are a part of business as usual, and this audit appears to be unrelated to the DSIC filing and more a function of the time lapsed since the last audit in 1997.

EARNINGS OUTLOOK:

We have raised our 2009 estimate to \$1.36 from \$1.33, accounting for a lower interest expense and the earnings beat in 2Q relative to our forecast. We are currently forecasting approximately 7.5% revenue growth for the year, versus 8% previously in light of the wet summer and hamstrung industrial demand. We expect continued improvements in the operating expense ratio, which improved to 54% from 56.1% in the same period last year, ahead of our forecast. We expect to see improvements of 200 bps per quarter in coming quarters, with the expense ratio for the year dropping to 53% of revenues from 56% in 2008.

Most of the outstanding debt in the second quarter was commercial paper and revolving credit borrowings that carried low interest rates of 25-100 basis points. With longer term debt issued to pay down the short term loans, the interest expense

should pick up in the second half based on rates for the longer term debt of 6-6.5%. Our interest expense assumptions had been too high in the second quarter and we have brought them down to \$80 million from \$85 million in the third quarter, with a similar \$5 reduction in the fourth quarter.

We have maintained our 2010 estimate of \$1.50, which includes 9% revenue growth, assuming normalized weather after two unusually wet summers and a more modest improvement in the operating expense ratio of only 50 basis points. However, if American can continue its pace of rate cases without significant additional operating expense growth, we believe it could generate better leverage from its existing asset base.

The non-regulated segment has been quiet as all eyes seem focused on getting the regulated utility back up to speed, but we may see a resumption of growth in the military base business and municipal contracts business in the next one to two years. Given economic conditions and municipal budgets, we have been hearing more discussion of privatization and outsourcing in recent months. While transactions take time to develop, we continue to believe this part of American Water's business has significant growth potential over the next several years. For the first six months of 2009, revenues in the segment were down slightly year over year, to \$122 million from \$128 million, but EBIT contribution improved to \$10.1 million from \$9.3 million last year on better operating margins.

SECOND QUARTER REVIEW:

Revenue. American posted revenue growth of 4% in the second quarter to \$613 million. This growth came despite a 5.5% volumetric usage decline, including a 16% decline in the industrial customer class, which makes up about 5% of total revenues. These usage declines are sequentially worse than the first quarter, a result of wet weather in the Northeast. More than offsetting the total 5.3 billion gallon shortfall in sendout (\$24 million decline versus last year) was \$46.5 million in rate awards. The remaining incremental revenue came from surcharges and acquisitions offset by a decrease in contract operations. The unregulated business revenue fell 4%, or \$2.8 million, to \$64 million, due to a decline in the contract operations business partially offset by the Homeowner Services Group.

Operating Costs. Year over year, total operating & maintenance (O&M) expenses in the quarter were flat due in part to the decreased send-out, leading to an improved efficiency ratio of 54% from 56%. Production costs were up, led by a 31% increase in chemical costs, a year over year trend that should persist despite somewhat lower chemical costs since the beginning of the year. Employee costs were up slightly, driven by increased pension costs. Notably the "other" cost line item jumped \$6.8 million, about half of which is related to a one-time charge for disallowed rate case expenses in California along with overall higher rate case costs associated with the increased number of filings. We now anticipate a 7% increase in employee costs in 2009, driven mainly by pension expense.

Pension expense. We had expected American's pension expense to grow in 2009, and this was evident in the 30% year over year increase in the second quarter. The jump in expenses is a result of increased amortization of actuarial losses on plan assets associated with stock declines. Management is working with regulators in certain states that currently do not allow for recovery of these costs in the regulatory process but the increased costs remain a drag on margins this year.

Depreciation & Amortization. Depreciation as a percentage of revenue increased to 12% from 11.4% and in absolute terms increased 8.8%. We expect depreciation to increase 8.5% in 2009 as a result of robust capital spending but remain stable as a percentage of revenue.

Growth. American's acquisition of four township water systems outside of Trenton, for \$80 million is still pending. With the timing of closing still unclear, we have assumed a modest penny enhancement to 2009 EPS, although this could easily slip into 2010. Specifically on Trenton, citizens have asked to put the acquisition approval to a referendum which has stretched out the approval process. The company is also growing in New Jersey in Pine Hill (pipeline extension), Warren Township (3 treatment plants), and the ongoing Trenton suburbs acquisition. In Texas, the company is working on a 50,000 GPD desalination pilot program, highlighting the variety of opportunities American has to capitalize on.

Dividend. American's Board of Directors increased the quarterly cash dividend by 5% to \$0.21 from \$0.20; payable September 1st. This is the company's fifth dividend payment and first increase since the IPO. We expect the company to maintain a 50%-70% payout ratio and pay \$0.82 in total dividend in 2009.

Company Description

American Water is the largest investor-owned water and wastewater utility in the U.S., serving approximately 15.6 million people in 32 states across the U.S. & Ontario, Canada. Its primary business as a regulated utility operation accounts for 90% of revenue, supplemented by small, but growing, non-regulated businesses.

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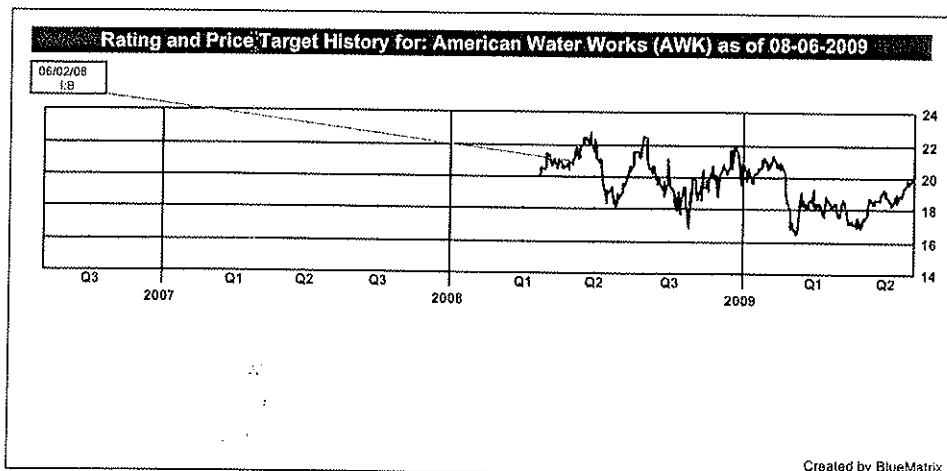
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Price Charts



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|-------------|-------|---------|-----------------------|---------|
| | | | Count | Percent |
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| NEUTRAL [N] | 125 | 47 | 5 | 4 |
| SELL [S] | 5 | 2 | 0 | 0.00 |

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American Water Works

2Q09 Beat Excluding a Negative Weather Impact
Should Lift AWK Shares - ALERT

Neutral

AWK, AWK US

Price: \$20.00

05 August 2009

• **Headline 2Q09 beat, especially after normalizing for weather, but reduced volumes may continue to worry investors.** American Water Works reported solid 2Q09 results of \$0.32 per share, about in line with expectations. The company noted, however, that the 5.5% decline in overall sales volumes vs. 2Q08 resulted in an \$0.08 hit to EPS, in part driven by wet weather in the Northeast. While it is unclear what portion of the \$0.08 impact is in fact related to weather vs. fundamental weakness in sales volumes due to a weak economy, it is clear that AWK would have beat expectations absent the unusually wet weather in the current quarter, and we expect investors to disregard the weather impact, as weather is mean-reverting. We also caution that investors will likely remain concerned about the underlying weakness in sales trends, but expect solid 2Q09 results to outweigh these concerns. Accordingly, we expect modest outperformance in AWK shares in trading tomorrow, and would look for additional color on water sales trends on the company's conference call.

• **Solid 2Q09 results driven by rate relief and cost cuts.** After market close today, American Water Works reported 2Q09 earnings of \$0.32 per share, slightly ahead of our estimate of \$0.30 and about in line with Bloomberg consensus estimate of \$0.31 per share. This compares to \$0.28 in the year-ago quarter. We note that \$0.02 of the year-over-year increase appears to be related to the absence of divestiture and SOX compliance costs, which were not factored into our forecast. AWK continued to benefit from the resolution of additional rate cases in its regulated utilities, and regulatory actions drove a \$0.17 EPS uplift vs. 2Q08, \$0.03 better than our forecast. This was partly offset by usage declines, primarily due to wet weather in the Northeast, which resulted in an \$0.08 hit to EPS. Higher operating expenses reduced EPS by about \$0.06, better than our expectation for a \$0.09 hit in the quarter. It appears to us that American Water Works is using cost management as a way to counterbalance reduced sales volumes, although we note that the company noted in its 1Q09 call that it is unlikely to continue to hold the line on expenses at the same pace for the balance of the year.

• **Conference call details.** Management will host a conference call with investors at 9:00 a.m. EDT tomorrow morning (8/6/09). The dial-in number is: 877-941-6011; pass code: 4120496.

Electric Utilities

Andrew Smith^{AC}

(1-713) 216-7681

andrew.i.smith@jpmorgan.com

Stefka Gerova

(1-212) 622-0549

stefka.g.gerova@jpmorgan.com

Raquel Antonious

(1-212) 622-0144

raquel.s.antonious@jpmorgan.com

J.P. Morgan Securities Inc.

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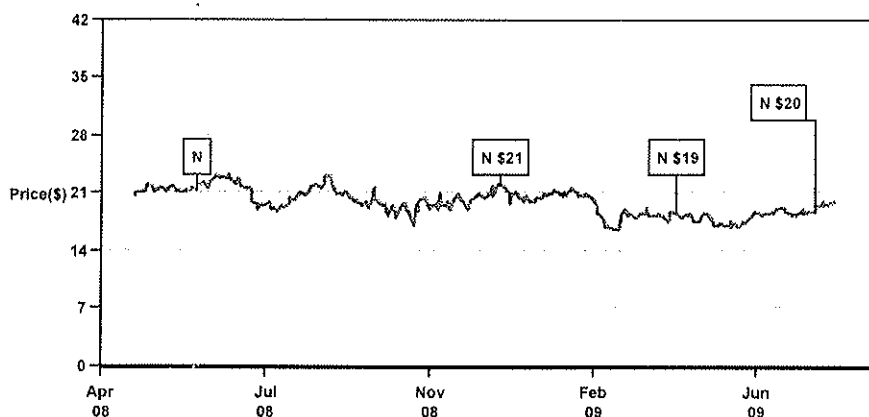
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American Water Works (AWK) Price Chart



| Date | Rating | Share Price (\$) | Price Target (\$) |
|-----------|--------|------------------|-------------------|
| 04-Jun-08 | N | 21.32 | - |
| 23-Dec-08 | N | 22.06 | 21.00 |
| 20-Apr-09 | N | 18.79 | 19.00 |
| 22-Jul-09 | N | 18.83 | 20.00 |

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Jun 04, 2008. This chart shows J.P. Morgan’s continuing coverage of this stock; the current analyst may or may not have covered it over the entire period. J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

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American Water Works, Inc.

(AWK-NYSE)

Rating/Risk: **Outperform/High**

Price: \$20

Target Price: \$26

Second quarter 2009 earnings above expectations as rate relief offsets weather/recession-induced volume declines; Reiterate Outperform rating.

***Investment Conclusion:** American Water Works offers investors the rare combination of above average growth and a discount valuation, and coupled with a robust dividend yield, AWK shares offer a compelling risk-adjusted total return opportunity. American Water's earnings growth will be driven by its ongoing program of rate filings, as management seeks to bring the company's return on equity back into line with industry averages after a period of scarce rate case activity. As this "turnaround" story plays out, American Water Works' earnings are likely to expand at a pace exceeding industry averages before ultimately settling into a more stable pattern of consistent growth. Despite the company's growth prospects, however, many investors remain concerned about a perceived "overhang" issue, as majority shareholder RWE AG has signaled its intention to further reduce its stake in the company. In our view, such concerns are a major factor in AWK shares' discount valuation relative to peers. We believe that this issue will run its course as RWE further reduces its stake, and that this valuation discrepancy represents an opportunity for long-term oriented investors.*

Key Points:

- American Water Works earned \$0.32/share in the second quarter ended 6/30/2009, above our estimate of \$0.30/share and in-line with consensus expectations.
- Higher rates offset volume declines, as the company posted 4% revenue growth despite a 6% drop in gallons shipped due to economic and weather headwinds.
- The top-line will likely continue to benefit from rate relief in the quarters ahead, with the company currently awaiting determinations on \$258 million in rate cases.
- While the recession is having a negative impact on volume sales, this is a "regulatory lag" issue, as consumption declines are "trued up" at the next rate proceeding.
- RWE's "overhang" on AWK shares is likely to dissipate significantly over the next 6-12 months, setting the stage for potentially meaningful P/E multiple expansion.
- Overall, we continue to believe AWK shares offer a compelling risk-adjusted total return opportunity for long-term investors, and we reiterate our Outperform rating.

Fundamental & Valuation Data

| | 2008A | | 2009E | | 2010E | | | |
|------------|-----------|-----------|-----------|-----------|---------|-----------|-----------|-----------|
| | | Current | Prior | Consensus | Current | Prior | Consensus | |
| Mar. | \$0.11 | \$0.19 | \$0.19 | - | A | \$0.21 | \$0.20 | - |
| Jun. | \$0.28 | \$0.32 | \$0.29 | - | A | \$0.33 | \$0.34 | - |
| Sep. | \$0.55 | \$0.52 | \$0.56 | - | E | \$0.59 | \$0.60 | - |
| Dec. | \$0.23 | \$0.32 | \$0.31 | - | E | \$0.37 | \$0.36 | - |
| Year | \$1.17 | \$1.35 | \$1.35 | \$1.32 | E | \$1.50 | \$1.50 | \$1.45 |
| Revenue | \$2,336.9 | \$2,527.8 | \$2,548.9 | \$2,514.0 | | \$2,715.2 | \$2,717.5 | \$2,689.0 |
| EBITDA | \$834.4 | \$953.8 | \$938.5 | | | \$1,051.5 | \$1,046.5 | |
| P/E | 17.1x | 14.8x | | 15.2x | | 13.3x | | |
| EV/Revenue | 3.7x | 3.4x | | | | 3.2x | | |
| EV/EBITDA | 10.3x | 9.0x | | | | 8.2x | | |

*EPS estimates are non-GAAP

August 6, 2009

Industrials

Market Data

| | |
|--------------------------|-------------|
| Current Price: | \$20.00 |
| 52 Week Range: | \$23 - \$16 |
| 12 Month Target: | \$26 |
| Market Value (MM): | \$3,491 |
| Shares Outstanding (MM): | 174.6 |
| Institutional Holdings: | 33.5% |
| Avg Daily Volume (Th): | 814 |
| Dividend: | \$0.84 |
| Dividend Yield: | 4.2% |

Capitalization

| | |
|-------------------------|-------|
| Book Value / Share | \$23 |
| Cash / Share | \$0 |
| Long-Term Debt / Cap'l: | 56.0% |

Fundamental Summary

| | |
|-----------------------|----|
| 3-Yr. Hist. Rev CAGR: | - |
| 2-Yr. Fwd. EPS CAGR: | 9% |
| ROE 2008A: | 6% |

Source: Baseline & B&S

Description

Serving a population of over 15 million and operating in 32 states, American Water Works is the largest water utility services company in the U.S. Founded in Pennsylvania in 1886, the company is headquartered in Voorhees, NJ.

Ryan M. Connors
610.832.5217
rconnors@boenninginc.com

Michael G. Roomberg
610.862.5337
mroomberg@boenninginc.com

Key Points in Detail:

- **2Q09 earnings exceed our estimate as higher rates offset lower volumes.** American Water Works earned \$0.32/share in the quarter ended 6/30/2009, above our estimate of \$0.30/share and in-line with consensus expectations. Overall, it was a very solid quarterly performance in a difficult environment, as the company faced dual headwinds in the form of significant usage declines for industrial customers and wet weather conditions in its core Mid-Atlantic service territory. In particular, American Water Works' ability to continue delivering on its robust rate relief program, as well as its focus on disciplined cost control, enabled the company to deliver strong profitability in the quarter despite considerable challenges on the demand front.
- **Weather, economic headwinds cause gallons shipped to decline.** Rainy conditions blunt demand by reducing the amount of purchased water required for golf course and residential irrigation, and with 29 of 30 days in June exhibiting measurable rain in American Water's key service area, weather was a substantial headwind in the second quarter. Coupled with a 17% drop in volume shipped to industrial customers (who represent roughly 5% of total revenue), this drove a 5.5% decrease in gallons shipped – translating into a year-over-year revenue decline of \$24 million. Despite this considerable headwind, however, ongoing rate relief contributed an incremental \$47 million to the top-line – enabling revenue to *increase* 4% and underscoring a critical aspect of our positive investment thesis for American Water Works.
- **Rate case docket remains active, sets stage for further top-line gains.** Looking ahead, rate relief will remain a source of robust growth, with the company awaiting final determinations on nearly \$260 million in rate filings. Even discounting this gross figure by 30% to reflect the likelihood that final settlement amounts fall short of initial requests, this translates to roughly 12% of trailing four quarter regulated revenue – a sizable amount and a significant growth opportunity. Recently filed rate cases include requests for \$59 million in new rates in Illinois, \$58 million in Pennsylvania, and \$47 million in Indiana, among others. As American Water continues to work its way out of its current “under-earning” status, we believe that further rate relief will drive significant top- and bottom-line growth for an extended period of time.
- **With RWE stake now under 50%, end in sight for “overhang.”** Dating back to the April 2008 IPO, an oft-cited rationale for *not* investing in AWK shares is that major shareholder RWE's stated intention to liquidate much of its position will put a persistent “ask” over the stock, precluding it from moving higher or from sustaining any meaningful gains. Not only has this rationale been dead wrong (AWK shares have trounced the broad market indices and performed in-line with overhang-free peers since the IPO), but it becomes even less relevant with each subsequent share sale by RWE. Following the June offering, RWE now owns less than 50% of the company, and in our view further share sales will lead investors to recognize that this issue is in its twilight – enabling potentially meaningful P/E multiple expansion.
- **AWK shares offers attractive risk-adjusted total return opp'ty.** With valuations for many water utilities already at a significant premium to the broad market, investing in this area is largely predicated on an expectation of consistent earnings growth and the additive effect of dividends on total return rather than on P/E expansion (i.e. growing the “E” – not the “P”). In our view, the artificial RWE overhang issue makes American Water the exception by providing the opportunity for meaningful multiple expansion as this perceived overhang dissipates. Indeed, our \$26 target price (30% above current levels) reflects a forward multiple of just 17x – arguably *conservative* in relation to peers such as AWR (21x) and WTR (20x).

American Water posted solid second quarter EPS despite headwinds from both the economy and wet weather conditions.

Revenue increased 4% from a year ago, as \$47 million in rate relief offset a \$24 million decline due to lower volumes.

Not only has the RWE “overhang” argument been dead wrong, but it becomes less relevant with each RWE sale.

This perceived overhang makes AWK a rarity among water utilities: A compelling “multiple expansion” based story.

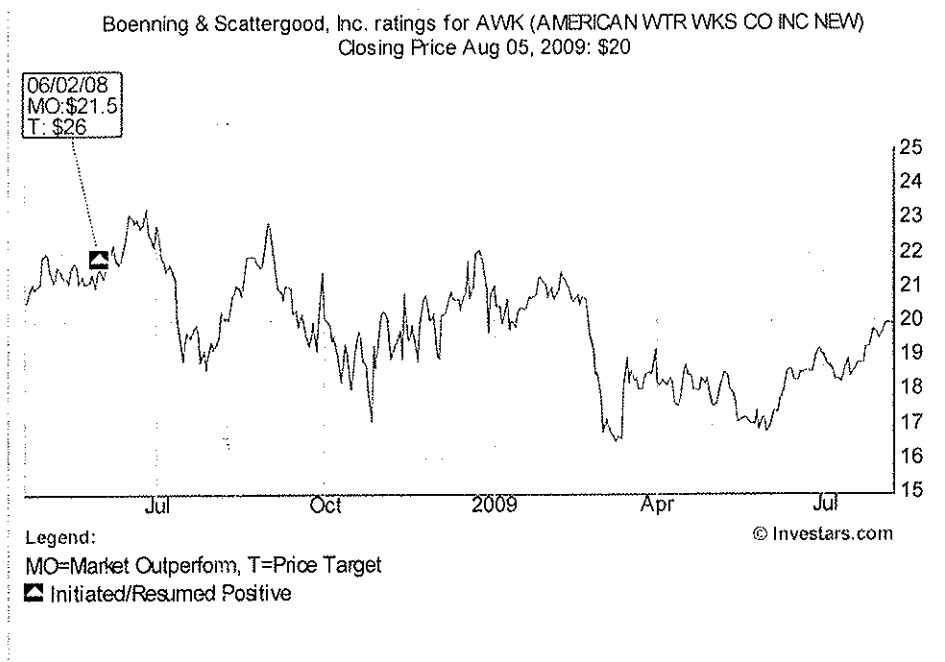
| American Water Works, Inc. | Quarterly Income Statement, 2009E | | | | | | Boenning & Scattergood, Inc | | | |
|---------------------------------|-----------------------------------|---------------|-----------------|--------------|-----------------|--------------|-----------------------------|--------------|------------------|--------------|
| | 1Q09 | Y/Y | 2Q09 | Y/Y | 3Q09E | Y/Y | 4Q09E | Y/Y | FY2009E | Y/Y |
| Revenue: | | | | | | | | | | |
| Regulated Utility Sales | \$492,598 | 9.6% | \$554,948 | | \$630,586 | 4.5% | \$580,796 | 4.5% | \$2,258,929 | 5.8% |
| Non-Regulated Revenue | 57,572 | -5.9% | 64,238 | | 70,915 | -4.0% | 74,803 | -4.0% | \$267,528 | -4.5% |
| Total Operating Revenue | 550,170 | 8.6% | 612,740 | 4.0% | 696,402 | 3.6% | 668,518 | 17.6% | 2,527,829 | 8.2% |
| Operating Expenses: | | | | | | | | | | |
| Operations & Maintenance | 314,402 | | 330,597 | | 348,201 | | 371,027 | | 1,364,227 | 4.6% |
| <i>O&M Ratio</i> | 57.1% | | 54.0% | | 50.0% | | 55.5% | | 54.0% | |
| Depreciation & Amortization | 68,843 | | 73,242 | | 77,000 | | 79,000 | | 298,085 | 9.9% |
| General Taxes | 52,497 | | 51,699 | | 53,000 | | 53,000 | | 210,196 | |
| (Gain) Loss of Sale of Assets | (202) | | 10 | | (100) | | (100) | | (392) | |
| Total Operating Expenses | 435,540 | 2.0% | 455,548 | 2.0% | 478,101 | 3.8% | 502,927 | 14.4% | 1,872,116 | 3.0% |
| Operating Income | 114,630 | 43.9% | 157,192 | 10.2% | 218,301 | 3.1% | 165,590 | 28.3% | 655,713 | 16.4% |
| <i>Operating Margin</i> | 20.8% | | 25.7% | | 31.3% | | 24.8% | | 25.9% | |
| Other Income: | | | | | | | | | | |
| Interest, Net | (71,979) | | (73,688) | | (76,000) | | (80,000) | | (301,667) | |
| Other, Net | 1,114 | | (1,409) | | 800 | | 800 | | 1,305 | |
| Total Other Income | (67,138) | 1.4% | (71,066) | 6.1% | (70,700) | 7.0% | (74,700) | 15.9% | (283,604) | 7.5% |
| Pre-Income Tax Income | 47,492 | 254.0% | 86,126 | 13.8% | 147,601 | 1.3% | 90,890 | 40.6% | 372,109 | 24.3% |
| Taxes | 17,547 | | 34,137 | | 56,088 | | 34,538 | | 142,311 | |
| <i>Tax Rate</i> | 36.9% | | 39.6% | | 38.0% | | 38.0% | | 38.2% | |
| Net Income | 29,945 | 71.0% | 51,989 | 14.3% | 91,513 | 3.8% | 56,352 | 54.8% | 229,799 | 22.5% |
| Earnings Per Share | \$0.19 | 70.9% | \$0.32 | 11.9% | \$0.52 | -5.1% | \$0.32 | 41.6% | \$1.35 | 15.2% |
| Shares Outstanding (Diluted) | 160,011 | | 163,301 | | 175,000 | | 175,000 | | 168,328 | |

*Segment revenue figures preliminary, pending release of 10Q

| American Water Works, Inc. | Quarterly Income Statement, 2010E | | | | | | Boenning & Scattergood, Inc | | | |
|---------------------------------|-----------------------------------|--------------|-----------------|--------------|-----------------|--------------|-----------------------------|--------------|------------------|--------------|
| | 1Q10E | Y/Y | 2Q10E | Y/Y | 3Q10E | Y/Y | 4Q10E | Y/Y | FY2010E | Y/Y |
| Revenue: | | | | | | | | | | |
| Regulated Utility Sales | \$532,006 | 8.0% | \$599,344 | 8.0% | \$681,033 | 8.0% | \$627,260 | 8.0% | \$2,439,643 | 8.0% |
| Non-Regulated Revenue | 59,875 | 4.0% | 66,808 | 4.0% | 73,752 | 4.0% | 77,795 | 4.0% | 278,230 | 4.0% |
| Total Operating Revenue | 587,678 | 6.8% | 659,190 | 7.6% | 749,277 | 7.6% | 719,007 | 7.6% | 2,715,152 | 7.4% |
| Operating Expenses: | | | | | | | | | | |
| Operations & Maintenance | 324,986 | | 355,962 | | 370,892 | | 395,454 | | 1,447,295 | 6.1% |
| <i>O&M Ratio</i> | 55.3% | | 54.0% | | 49.5% | | 55.0% | | 53.3% | |
| Depreciation & Amortization | 75,000 | | 80,000 | | 80,000 | | 80,000 | | 315,000 | 5.7% |
| General Taxes | 53,000 | | 54,000 | | 55,000 | | 55,000 | | 217,000 | |
| (Gain) Loss of Sale of Assets | (150) | | (150) | | (150) | | (150) | | (600) | |
| Total Operating Expenses | 452,836 | 4.0% | 489,812 | 7.5% | 505,742 | 5.8% | 530,304 | 5.4% | 1,978,695 | 5.7% |
| Operating Income | 134,842 | 17.6% | 169,377 | 7.8% | 243,535 | 11.6% | 188,703 | 14.0% | 736,458 | 12.3% |
| <i>Operating Margin</i> | 22.9% | | 25.7% | | 32.5% | | 26.2% | | 27.1% | |
| Other Income: | | | | | | | | | | |
| Interest, Net | (82,000) | | (82,000) | | (82,000) | | (82,000) | | (328,000) | |
| Other, Net | 1,200 | | 1,200 | | 1,200 | | 1,200 | | 4,800 | |
| Total Other Income | (77,800) | 15.9% | (77,800) | 9.5% | (77,550) | 9.7% | (77,550) | 3.8% | (310,700) | 9.6% |
| Pre-Income Tax Income | 57,042 | 20.1% | 91,577 | 6.3% | 165,985 | 12.5% | 111,153 | 22.3% | 425,758 | 14.4% |
| Taxes | 20,535 | | 32,968 | | 59,755 | | 40,015 | | 153,273 | |
| <i>Tax Rate</i> | 36.0% | | 36.0% | | 36.0% | | 36.0% | | 36.0% | |
| Net Income | 36,507 | 21.9% | 58,609 | 12.7% | 106,230 | 16.1% | 71,138 | 26.2% | 272,485 | 18.6% |
| Earnings Per Share | \$0.21 | 11.5% | \$0.33 | 2.3% | \$0.59 | 12.9% | \$0.37 | 16.3% | \$1.50 | 11.3% |
| Shares Outstanding (Diluted) | 175,000 | | 180,000 | | 180,000 | | 190,000 | | 181,250 | |

Disclosure Appendix

Rating and Price Target History:



Associated Risk Factors:

American Water's earnings and ability to reach our price target could be negatively impacted by, among other things: unfavorable weather trends, negative regulatory and/or pricing developments, eminent domain seizure of water utility assets, and declining consumption of water in its service territories due to conservation initiatives. The realization of any or all of the following risk factors, among others, may adversely affect the company's stock price: Commodity Prices, Raw Material Prices, Competition.

Analyst Certification:

The research analysts whose names appears on this research report certify that: (1) all of the views expressed in this research report accurately reflect their personal views about the subject security or issuer, and (2) no part of the research analysts' compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analysts in this research report.

Important Disclosures:

Analyst compensation is based on, in part, Boenning & Scattergood, Inc.'s profitability, which includes revenues from investment banking. Boenning & Scattergood expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.

Boenning & Scattergood has received compensation for investment banking services from AWK in the past 12 months. Boenning & Scattergood, Inc. has co-managed a public offering of the subject company's securities in the past 12 months.

Boenning & Scattergood's Ratings System:

Our three-tier investment ratings are based on a stock's return potential relative to a broad market index:

- **Outperform (Buy):** The security's total return over the year or longer is expected to exceed the total return of the S&P 500™ over the identical period.
- **Neutral (Hold):** The security's total return over the next year or longer is expected to be roughly equivalent to the total return of the S&P 500™ over the identical period.
- **Underperform (Sell):** The security's total return over the next year or longer is expected to be less than the total return of the S&P 500™ over the identical period.

Our four-tier risk ratings are based on a mix of price volatility and fundamental factors relative to the market and peer group.

- **Low:** The security has higher-than-average fundamental predictability and/or lower-than-average price volatility.
- **Moderate:** The security has average fundamental predictability and/or average price volatility.
- **High:** The security has lower-than-average fundamental predictability and/or higher-than-average price volatility.
- **Speculative:** The security has very inconsistent fundamental predictability and/or very high relative price volatility.

Ratings Distribution (6/30/09):

| <u>Coverage Universe</u> | <u>% of Universe</u> | <u>Investment Banking Clients (a)</u> | <u>% of Rating Group</u> |
|--------------------------|----------------------|---------------------------------------|--------------------------|
| Outperform (Buy) | 56% | Outperform (Buy) | 5% |
| Neutral (Hold) | 44% | Neutral (Hold) | 0% |
| Underperform (Sell) | 0% | Underperform (Sell) | 0% |

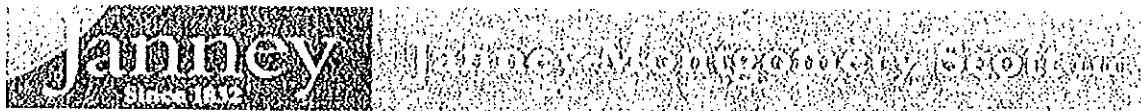
(a) Related to services provided within the past 12 months.

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BOENNING & SCATTERGOOD INSTITUTIONAL CONTACTS

| | | | |
|-----------------------------|----------------------------|--------------------------------|--------------|
| Dir. of Equities & Research | Nancy Zeller-Landau | nzlandau@boenninginc.com | 610.832.5319 |
| ■ RESEARCH ANALYSTS | | | |
| Aerospace and Defense/ | | | |
| Technology | Michael Ciarmoli | mciarmoli@boenninginc.com | 610.684.5413 |
| Biotechnology | Derek Jellinek, Ph.D | djellinek@boenninginc.com | 610.832.5274 |
| Business Services | William Sutherland | wsutherland@boenninginc.com | 610.862.5353 |
| Energy | Michael Schmitz, CFA | mschmitz@boenninginc.com | 610.832.5257 |
| Financial Services | Jason O'Donnell | jodonnell@boenninginc.com | 610.832.5258 |
| Financial Services | Matthew Schultheis, CFA | mschultheis@boenninginc.com | 610.832.5290 |
| Industrials | Ryan Connors | rconnors@boenninginc.com | 610.832.5217 |
| Medical Technology | Gregory Chodaczek | gchodaczek@boenninginc.com | 610.684.5246 |
| Retail | Holly Guthrie | hguthrie@boenninginc.com | 610.684.5412 |
| Technology | Steve Salberta, CFA | ssalberta@boenninginc.com | 610.832.5212 |
| ■ RESEARCH JUNIOR ANALYST | | | |
| Medical Technology | Debjit Chattopadhyay, Ph.D | dchattopadhyay@boenninginc.com | 610.684.5417 |
| ■ RESEARCH ASSOCIATES | | | |
| | Kevin Ciabattoni | kciabattoni@boenninginc.com | 610.684.5414 |
| | William DiTullio | wditullio@boenninginc.com | 610.684.5407 |
| | Michael Roomberg | mroomberg@boenninginc.com | 601.862.5337 |
| ■ INSTITUTIONAL SALES | | | |
| Northeast | Eugene Bodo | ebodo@boenninginc.com | 610.862.5368 |
| Northeast | Rick Johnson | rjohnson@boenninginc.com | 610.832.5306 |
| Northeast | Dan McGlinchey | dmcglinchey@boenninginc.com | 610.832.5264 |
| Northeast | Bobby Clark | rclark@boenninginc.com | 212.922.1459 |
| Northeast/Southeast | Rich Farr | rfarr@boenninginc.com | 610.684.5423 |
| Pittsburgh | Robert Wagner | rwagner@boenninginc.com | 412-254-2209 |
| Pittsburgh | William Wagner | wwagner@boenninginc.com | 412-254-2210 |
| West/Europe | Jeff LaBrot | jlabrot@boenninginc.com | 610.832.5309 |
| Mid-West | Matt Oliver | moliver@boenninginc.com | 610.684.5420 |
| ■ AGENCY TRADING | | | |
| Mark Dengler | | mdengler@boenninginc.com | 610.862.5330 |
| Harry Himes | | hhimes@boenninginc.com | 610.862.5330 |
| Brendan Kenny | | bkenny@boenninginc.com | 212.209.3903 |
| Michael Kinsella | | mkinsella@boenninginc.com | 610.832.5330 |
| Liam Timoney | | ltimoney@boenninginc.com | 610.862.5330 |
| Melissa Donahue | | mdonahue@boenninginc.com | 610.862.5330 |
| Scott Freeze | | sfreeze@boenninginc.com | 610.832.5335 |
| ■ MARKET MAKING | | | |
| Joseph Morrissey | | jmorrissey@boenninginc.com | 610.862.5360 |
| Sean Clair | | sclair@boenninginc.com | 610.862.5360 |
| Jeff McMurray | | jmcmurray@boenninginc.com | 610.862.5360 |
| Joe Budash | | jbudash@boenninginc.com | 610.862.5330 |
| Eric Axelson | | eaxelson@boenninginc.com | 610.862.5360 |
| Adam Booth | | abooth@boenninginc.com | 610.832.5325 |
| ■ DERIVATIVE STRATEGY | | | |
| Louis DePaul | | ldepaul@boenninginc.com | 610.832.5275 |

4 TOWER BRIDGE * 200 BARR HARBOR DRIVE * SUITE 300 * W. CONSHOHOCKEN, PA 19428-2979
WWW.BOENNINGINC.COM
MEMBER FINRA/SIPC



RESEARCH NOTE
November 10, 2008

Debra G. Coy 202-955-4315
dcoy@jmsonline.com
Heike M. Doerr 215-665-4448
hdoerr@jmsonline.com
Christopher J. Purtill 215-665-6601
cpurtill@jmsonline.com

American Water Works Company, Inc. (AWK-\$19.35)
Meeting Expectations; Laying Groundwork for Growth

Company Statistics

| | |
|--------------------------------|-----------|
| Price | \$19.35 |
| Market Capitalization (M) | \$3,095.2 |
| Average Daily Volume (1-month) | 495,730 |
| Dividend | \$0.40 |
| Yield | 2.1% |
| Rating | BUY |

Financials

| | | | |
|---------------|--------|--------|--------|
| FYE Dec | 2007A | 2008E | 2009E |
| EPS | \$1.18 | \$1.17 | \$1.47 |
| Prior EPS | -- | -- | \$1.45 |
| Quarterly EPS | Q1 | \$0.02 | \$0.04 |
| | Q2 | \$0.31 | \$0.30 |
| | Q3 | \$0.59 | \$0.55 |
| | Q4 | \$0.27 | \$0.28 |
| P/E Ratio: | 16.4x | 16.5x | 13.2x |

Research Analyst Certification and Important Disclosures start on page 8 of this document.

INVESTMENT CONCLUSION: Last week's third quarter results reflected American Water's ability to complete rate increases, as the lion's share of revenue growth was generated from rate relief. While uncooperative weather masked revenue and earnings improvement this quarter, we expect the higher rates to fall to the bottom line and boost the company's return on equity in coming quarters. We continue to believe American Water can generate double-digit earnings growth in 2009-2011, as it works through its backlog of pending rate cases. While keeping a close eye on the credit markets, the company remains focused on increasing its rate base through a strong capital investment program and tuck-in acquisitions, as well as expanding its non-regulated contract services segment. While American Water continues to suffer from overhang associated with RWE's ownership, the company is executing on its strategy. We believe the stock is substantially undervalued at its current level and maintain our BUY rating and \$26 fair value.

KEY POINTS:

- **Third Quarter Results.** American Water reported third quarter earnings of \$0.55 per share, a penny ahead of our recently revised estimates, which we had trimmed because of unfavorable weather. The company said it earned \$0.50 per share in the prior year quarter, excluding a large goodwill write-down; we had been carrying a \$0.59 number for last year, backing out unusually high Sarbanes Oxley compliance costs that were incurred last year in preparation for the IPO. As we had expected, wet weather in the Midwest hampered results as consumption fell 4.8% year-over-year. Management said the reduced revenue was about a \$0.04 drag on quarterly earnings.
- **Focus on Regulatory Activity.** American received \$27 million in new rates in the third quarter, and has received awards worth \$74 million year to date. The company has \$268 million in additional rate cases pending in ten states. In particular, we are closely tracking the company's \$125 million rate case in New Jersey, as well as pending approval for the \$100 million proposed acquisition in Trenton, NJ.
- **RWE Ownership/Divestiture Plan.** There has been no recent update from Germany regarding RWE's divestiture plan. RWE had previously indicated that it would decrease its ownership to below 50% before the end of 2008; however, RWE recently said it would no longer tie its planned year end dividend payment to a sale of AWK years, giving it flexibility on timing for an additional transaction. We believe RWE is likely to wait for the volatility in the US stock market to ease before returning to market. As a reminder, the German utility agreed to exit its entire AWK position within 24 months (by April 2010) as a condition of some state



approvals for the IPO, but it is not mandated to reduce its stake below 50% by any specific time. American Water has previously indicated that it would need to issue equity in 2009 to finance part of its capital spending program and that its need for equity would take precedence over a secondary sale of shares by RWE. However, American said last week that while its capital spending plan remains on track so far, it could reduce capex next year if access to debt and equity markets deteriorates further. The company did file a \$50 million debt offering on Nov. 7th.

- **Capital Spending.** American Water has spent \$715 million on capital expenditures year-to-date; our forecast for the year has been about \$950 million. The company has generated \$393 million in cash flow from operations year to date, up \$63 million from last year. Management indicated that the preliminary capex budget for 2009 is \$850-870 million, but it is prepared to adjust downward a little if necessary. American Water's five year capital spending plan remains \$4.0-4.5 billion to replace infrastructure and support anticipated customer growth.
- **Liquidity.** Management said on its conference call Thursday that it believes it has some additional flexibility on the debt side before it needs to issue equity; accordingly, the company filed for an offering of \$50 million, 30-year senior notes on Friday -- a small addition to its \$5.1 billion in net debt as of Sept. 30th. There was a period in September when the company was unable to issue commercial paper, requiring the company to rely on its credit lines for short-term needs, which currently have about \$600 million of capacity. Management said commercial paper access has improved recently.
- **Expansion of Military Base Contracts.** During the third quarter, the company was awarded two 50-year operating contracts at military bases. The Fort Hood Army Installation in Texas is valued at \$329 million and Fort Polk, Louisiana, is estimated to be \$348 million. Similar to a regulated utility, the contract is subject to periodic price re-determinations (rate increases) every two years. The company said it expects to incur some start-up costs in Q4 but that its overall program is on track and meeting internal profit expectations.
- **Estimate Revisions.** We maintain our 2008 estimate of \$1.17 and have slightly increased our 2009 estimate to \$1.47 from \$1.45, due to depreciation expense adjustments. There continue to be an unusually wide range of estimates for American Water next year; our estimate is near the middle of the \$1.34 to \$1.55 range. After a relatively flat 2008, impacted by unfavorable weather and some reinvestment in the employee base post IPO, we expect earnings in 2009 to rebound 25% as new rate case contributions fall to the bottom line.

VALUATION SUMMARY: Although American continues to trade below its April IPO price, the stock has managed to avoid the deep declines witnessed by some of its peers. Year-to-date the shares are down about 5%, compared to the group decline of 20% and S&P contraction of more than 35%.

The stock price remains at a significant discount to peers, due in large part to the RWE overhang. The turbulent market has created further uncertainty regarding RWE's planned sale of its 60% majority stake, but we continue to believe this investor concern will be tempered in the coming year as RWE's ownership position is likely to be reduced.

| American Water Works (AWK) | | | | |
|-----------------------------------|-------------|-------------|--------------|--------------|
| | 2006 | 2007 | 2008E | 2009E |
| Sales (\$ bil) | 2,093.1 | 2,214.2 | 2,366.5 | 2,600.0 |
| Revenue growth | | 5.8% | 6.9% | 9.9% |
| Price/Sales | | 1.4x | 1.3x | 1.2x |
| EBITDA (\$ mil) | 723.2 | 791.0 | 843.6 | 1,008.8 |
| Price/EBITDA | | 3.8x | 3.6x | 3.0x |
| EV/EBITDA | | 10.3x | 9.6x | 8.1x |
| Reported net income | (162.2) | (342.8) | (553.6) | 247.1 |
| Impairment & one-time costs | 254.8 | 531.8 | 741.6 | - |
| Net income ex impairment* | 92.6 | 189.0 | 187.9 | 247.1 |
| EPS ex one-time items | \$0.58 | \$1.18 | \$1.17 | \$1.47 |
| EPS Growth | | 104.2% | -0.7% | 25.4% |
| P/E | | | 16.1x | 12.9x |

*Net income ex impairment and one-time costs, net of tax

Source: Company data, Janney Estimates

| Current Data Points | |
|----------------------------------|---------|
| Price | \$18.93 |
| Shares outstanding | 160.0 |
| Market cap (\$ mil) | 3,028.8 |
| Debt/Total capital | 55.1% |
| Net debt | 5,110.1 |
| Shareholders equity | 4,162.4 |
| Adjusted shareholders equity** | 3,310.2 |
| Est. 2008 ROE, excl goodwill | 4.5% |
| Est. 2008 ROE on adjusted equity | 5.7% |
| Book value/share | \$26.01 |
| Price/Book | 0.7x |
| Goodwill | 1,704.3 |
| Adjusted book value/share | \$20.69 |
| Price/book, adjusted | 0.91x |
| Dividend** | \$0.60 |
| Dividend Payout Ratio | 68% |
| Yield | 4.2% |

**Adjusted equity includes est. portion of goodwill captured in rate base for ROE
 ***Proposed annual dividend; partial payment only in 2008; payout ratio based on 2008 income excl impairment chg

Source: Company data, Janney Estimates



On a P/E basis, American trades at only about 13x our 2009 estimate, compared to the current peer group average of 18.8x. On an EV/EBITDA basis, the company trades at 8.1x our 2009 EBITDA estimates vs. the group average of 8.7x. On a price/book basis, the stock is currently trading below 1x on "adjusted shareholder equity" (including a portion of goodwill that is captured in rate base), a large discount to the group average of 1.7x book value.

We estimate that ROE on adjusted equity should climb to 7.5% in 2009 from 5.7% in 2008; still well below its potential return of 10-10.5% (the historical range of allowed ROEs). Realizing its full ROE is the real goal for American over the next three to five years and will ultimately be the share price driver, in our view. Our recently reduced fair value target of \$26 implies a P/E of about 18x our 2009 estimate, and an EV/EBITDA multiple of approximately 9x, still a discount to our target valuation for peers in the space. Once RWE has fully exited, we believe the discount will dissipate.

ANOTHER GOODWILL IMPAIRMENT CHARGE POSSIBLE IN 4Q

As American Water navigated the IPO process, the company took impairment charges in three of the last five quarters, as it adjusted the value of goodwill based on updated assessments. As of September 30th, the company still had \$1.7 million of goodwill on its balance sheet.

| | 3Q07 | 4Q07 | 1Q08 |
|------------------------|---------|---------|---------|
| AWK Impairment Charges | \$243.3 | \$277.5 | \$738.5 |

The annual impairment test will be undertaken again on November 30th. The 10Q and recent debt filing contain updated language on the subject of goodwill, providing some insight on the impairment test and what factors are considered:

"These [factors] include market price declines such as levels experienced during October 2008, a decline over a period of time of the Company's stock price, a decline over a period of time in valuation multiples of comparable water utilities, and the lack of an increase in the Company's market price consistent with increases in the carrying value or to a level consistent with its peer companies. A decline in the forecasted results in the business plan, such as changes in rate case results or capital investment budgets or changes in our interest rates, may also result in an incremental impairment charge"

However, it remains unclear how the parameters are weighted or how a further impairment would be calculated. Clearly the price of the stock and the valuation multiples of peer companies have fallen in recent weeks. The filings disclosed that the stock price at September 30th was below the company's consolidated carrying value of the company. (The closing price on Sept. 30 was \$21.50, the same as the IPO price.) Along with the market, the share price has been volatile since, briefly dropping below \$18; however, this volatility in itself does not represent a triggering event, as the testing process is also partially forward-looking. So far, the company's business plan outlook and rate case results appear to be on target, and its capital spending program is currently unchanged, though the cost of capital spiked up at least temporarily earlier this fall.

Adding all of these factors together, it seems possible that an additional goodwill impairment charge could be taken in the fourth quarter, primarily driven by lower share prices for AWK and other water utilities. However, we believe the company can manage a somewhat lower level of shareholders equity (currently at 45%) and remain within parameters required by state regulators. On the debt side, we believe rating agencies will be more focused on EBITDA and interest coverage ratios than the debt/equity ratio per se. Given its ability to move rate cases through the process so far, the company should see strong EBITDA growth in the coming year.

REGULATORY UPDATE:

3Q Rate Awards. American Water Works received \$27 million in new rates in the third quarter, mainly due to a \$21.6 million award in Illinois and two smaller awards in Virginia and Tennessee, bringing its total new rate awards to \$74 million since January. Infrastructure surcharges have been enacted in Pennsylvania, Indiana, Missouri, and Illinois, contributing an additional \$12.3 million in annualized increases.

Pending Rate Cases. Currently, the company has \$268 million in additional rate cases pending in ten states. With awards typically coming in at 55%-65%, we would expect about \$145-\$175 million in new relief to take effect over the next 12 months. The largest rate proceeding is the \$125 million request in New Jersey, which we expect to be decided by the end of this year or early in 2009. Our recent discussion with the NJ Board of Public Utilities (BPU) indicates that New Jersey American and the commission staff are still in settlement discussions. Once the two parties reach a settlement, the case will go to an Administrative Law Judge (ALJ) for approval before final signoff is granted by the Commission. Historically the rate review process takes 11-12 months in New Jersey, consistent with the timeline of this case, which was filed in January 2008.

Trenton Acquisition Approval. The proposed acquisition of four suburban Trenton systems is tied with the NJ rate case. As we have noted previously, American Water proposed to pay \$100 million for the systems, based on its assessed valuation, but stipulated that its ultimate purchase price would be no higher than what the BPU allowed into rate base for the systems. Opposition to the transaction from activists concerned about rate increases has created increased media attention. In mid-October a city official was quoted as saying the transaction is "all but dead", but that assessment appears to be premature, as negotiations are still ongoing. Both parties, numerous interveners, and the BPU will need to come to agreeable terms on the acquisition in order to complete the rate filing, so we expect some news before year end, though the two matters could be separated if need be.

The following chart provides an outline and status for American's key pending cases, excluding small cases (below \$5 million/each) in Hawaii, New Mexico, and Pennsylvania.

| State | File Date | % Increase | \$ Increase (M) | Requested ROE | Status Summary |
|-------|------------|-----------------------|-----------------|---------------|-------------------------------------------------------------------------------------------------------------------|
| NJ | 1/14/2008 | 23% | \$125.0 | 11.50% | Case suspended for public advocate. Public hearings are ongoing. |
| CA | 1/30/2008 | 83.47%, 6.3%, 6.4% | \$44.4 | 11.50% | ALJ Bushey was assigned to the case and the 3 dockets were consolidated. |
| MO | 3/31/2008 | 26.4% & 28.7% | \$49.8 | 11.25% | Prehearings held in April. Proposed schedule indicated evidentiary hearings in Oct. and Nov. |
| PA | 4/28/2008 | 111% | \$2.7 | 11.50% | The proceeding is still in the discovery phase. |
| WV | 5/30/2008 | 12% | \$14.7 | 11.75% | Case suspended until 3-26-2009. |
| OH | 11/13/2008 | 16% | \$5.5 | 11.25% | Company direct testimony and numerous complaints filed. Ongoing hearings. Final decision was expected 10-15-2008. |
| KY | 10/31/2008 | NA | \$18.5 | 11.50% | Recently filed |
| AZ | 5/1/2008 | 26.4% 169% | \$20.0 | 11.75% | Currently in data request phase (consumer comments). |

THIRD QUARTER REVIEW:

EPS. American Water reported third quarter earnings of \$0.55 per share, a penny ahead of our expectations and the consensus estimate of \$0.54. As expected, wet weather in the Midwest negatively impacted results, as consumption fell 4.8% year-over-year, trimming about \$0.04 from EPS.

Revenues. Consolidated revenue increased 6.2% over the same period in 2007 to \$672.2 million, in line with our expectation, mainly due to \$43 million in new rates, offset by an \$11.4 million decrease associated with reduced customer consumption. Revenue in the regulated business was up 5.5%, while the unregulated services business grew 11.3%, with an additional \$7.6 million in revenues from contract operations and \$1.7 million from the homeowner services segment.

Operating Expenses. Consolidated operating expenses increased 4.2%, coming in a little below our expectation. The following chart breaks out the O&M expense line items compared to last year and our expectations. Water production costs were a little below our forecast, due to lower consumption levels. Employee related costs make up the largest component of O&M costs, as the company has been re-staffing up to meet growth plans and customer service requirements, though the increase this quarter was less than we anticipated. Operating supplies & services costs decreased 14%, or \$11.8 million, primarily the result of lower Sarbanes-Oxley compliance costs and the absence of various pre-IPO costs. Maintenance materials costs rose more than our forecast, mostly due to higher emergency repair costs in the regulated business. Customer billing expenses increased dramatically, though the absolute numbers are relatively small, mainly due to higher uncollectible accounts expense in the regulated and unregulated businesses related to the housing market slowdown. The company has imposed stricter turn-off and collection practices for delinquent accounts.

| Third Quarter Results <i>(amounts in millions, except per share data)</i> | American Water Works | | | | | |
|------------------------------------------------------------------------------|----------------------|----------|----------|--------|--------------------------|------------------|
| | 3Q07 | 3Q08A | 3Q08E | YOY | % Change EST/ 3Q07 | Act. Vs. Est. |
| Total Operating Revenue | \$633.12 | \$672.19 | \$674.27 | 6.2% | 6.5% | -0.3% |
| Expenses | | | | | | |
| <i>Production costs</i> | 83.50 | 84.08 | 85.63 | 0.7% | 2.6% | -1.8% |
| <i>Employee-related costs</i> | 112.82 | 127.38 | 130.13 | 12.9% | 15.4% | -2.1% |
| <i>Operating supplies & services</i> | 83.94 | 72.15 | 74.17 | -14.0% | -11.6% | -2.7% |
| <i>Maintenance materials</i> | 27.65 | 32.05 | 30.34 | 15.9% | 9.8% | 5.6% |
| <i>Customer billing</i> | 8.62 | 13.45 | 12.81 | 55.9% | 48.6% | 4.9% |
| <i>Other</i> | 11.79 | 13.10 | 10.52 | 11.2% | -10.8% | 24.6% |
| Total Operation & Maintenance | 328.31 | 342.23 | 343.61 | 4.2% | 4.7% | -0.4% |

D&A. Depreciation & amortization decreased about 2% year-over-year, versus our expectation of a 2.5% increase. D&A expense has been moving around over the last couple of quarters, as a result of adjustments caused by certain state regulatory classifications. We continue to expect depreciation costs to increase over the next two years, as the capital expenditure program accelerates.

Credit Facilities: American has access to unsecured revolving credit facilities of \$810 million. As of September 30th, \$596 million of the total capacity was still available for borrowing and \$132 million in commercial paper debt was outstanding. The company has generated \$393 million in internal cash year-to-date, \$63 million over last year's comparable level. The company filed for a \$50 million, 30-year notes offering on November 7.

| Third Quarter Results | | | American Water Works | | |
|----------------------------------------------------------------------------------------------------------|----------------|----------------|----------------------|---------|---------------|
| (amounts in millions, except per share data) | | | % Change | | |
| | 3Q07 | 3Q08A | 3Q08E | YOY | Act. Vs. Est. |
| Total Operating Revenue | \$633.12 | \$672.19 | \$674.27 | 6.2% | -0.3% |
| Expenses | | | | | |
| Production costs | 83.50 | 84.09 | 85.63 | 0.7% | -1.8% |
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| Operating supplies & services | 83.94 | 72.15 | 74.17 | -14.0% | -2.7% |
| Maintenance materials | 27.65 | 32.05 | 30.34 | 15.9% | 5.6% |
| Customer billing | 8.62 | 13.45 | 12.81 | 55.9% | 4.9% |
| Other | 11.79 | 13.10 | 10.52 | 11.2% | 24.6% |
| Total Operation & Maintenance | 328.31 | 342.23 | 343.61 | 4.2% | -0.4% |
| Depreciation & Amortization | 69.70 | 68.38 | 71.47 | -1.9% | -4.3% |
| General Taxes | 47.09 | 49.38 | 50.53 | 4.9% | -2.3% |
| (Gain) loss on sale of assets | (0.71) | 0.46 | - | | |
| Impairment charges | 243.35 | - | - | | |
| Total Expenses | 687.73 | 460.44 | 465.61 | -33.0% | -1.1% |
| Income from Operations | (54.61) | 211.75 | 208.66 | -487.7% | 1.5% |
| Operating Margin (%) | -8.6% | 31.5% | 30.9% | -465.2% | 1.8% |
| AFUDC | 2.03 | 4.44 | 3.60 | 119.0% | 23.4% |
| Allowance for borrowed funds used during const | 0.85 | 2.97 | 1.85 | 251.1% | 60.5% |
| Amortization of debt expense | (1.23) | (1.60) | (1.50) | 30.5% | 6.7% |
| Dividends on Preferred Stock of Subs. | (0.06) | (0.06) | (0.06) | -1.8% | -1.8% |
| Other, net | 1.36 | 0.88 | - | | |
| EBIT | (51.66) | 218.39 | 212.55 | -522.7% | 2.7% |
| Adjusted EBIT* | 187.40 | 211.75 | 208.66 | 13.0% | 1.5% |
| EBITDA | 257.1 | 280.1 | 280.1 | 9.0% | 0.0% |
| EBITDA Margin % | 40.6% | 41.7% | 41.5% | 2.6% | 0.3% |
| Interest Expense, net | 68.74 | 72.68 | 71.00 | 5.7% | 2.4% |
| Income Before Taxes | (120.40) | 145.71 | 141.55 | -221.0% | 2.9% |
| Extraord. Item--merger expenses | | | | | |
| Provision for Income Taxes | 39.72 | 57.55 | 55.21 | 44.9% | 4.2% |
| Implied Tax Rate | NM | 39.5% | 39.0% | | 1.3% |
| Income (cont ops) | (160.12) | 88.16 | 86.35 | -155.1% | 2.1% |
| Income (loss) on discontinued ops | - | - | - | | |
| Net Income Available to Common | (160.12) | 88.168 | 86.348 | -155.1% | 2.1% |
| One time impairment charges, SOX and divestiture costs, net of tax 2006-07; impairment charges only 2008 | 254.35 | - | - | | |
| Net income, ex impairment charges | <u>\$94.23</u> | <u>\$88.16</u> | <u>\$86.35</u> | -6.4% | 2.1% |
| EPS (fully diluted) | \$0.59 | \$0.55 | \$0.54 | -6.4% | 2.4% |
| Weighted Avg. Shares | 160.0 | 160.0 | 160.5 | 0.0% | -0.3% |

Source: American Water Works and Janney Montgomery Scott



EARNINGS OUTLOOK:

We are trimming our 4Q estimate by a penny, to \$0.28 from \$0.29, accounting for higher anticipated expenses related to the start-up of the new military base operations contracts at Fort Hood and Fort Polk. This compares to pro-forma EPS of \$0.27 last year, excluding goodwill charges and one-time pre-IPO expenses. We assume revenue growth of 8% and an improved operating expense ratio, but higher tax rates relative to last year's level, which was impacted by the reported loss.

Overall, we believe American Water is in position to achieve 9-10% revenue growth in 2009 and 20% EPS growth, showing the inherent leverage in the regulated water utility model. Our estimate is \$1.47, tweaked up a couple of pennies from \$1.45 previously, due to a downward adjustment in depreciation expense. With its 2008 earned return on equity likely to come in under 6%, American Water still has plenty of upside potential on earnings. We believe American Water Works can show above sector-average earnings growth over the next three to four years, as it continues to win rate increases that will bring its earned returns closer to the regulatory allowed rates of 10-11% in most states.

COMPANY DESCRIPTION: *American Water is the largest investor-owned water and wastewater utility in the U.S., serving approximately 15.6 million people in 32 states across the U.S. & Ontario, Canada. Its primary business as a regulated utility operation accounts for 90% of revenue, supplemented by small but growing non-regulated businesses.*

IMPORTANT DISCLOSURES

Research Analyst Certification

Each of the primarily responsible analysts for this research report, Debra G. Coy and Heike M. Doerr, certify that all the views in this research report accurately reflect her personal views about any and all of the subject securities or issuers. No part of her compensation was, is, or will be directly or indirectly, related to the specific recommendations or views expressed in this research report.

Janney Montgomery Scott LLC Equity Research Disclosure Legend November 10, 2008

| <u>Company</u> | <u>Disclosure(s)</u> |
|------------------------------------------|----------------------|
| American Water Works Company, Inc. (AWK) | 4,5,7,8 |

Janney Montgomery Scott LLC ("JMS") Equity Research Disclosure Legend

1. JMS is a market maker in the securities of the company and may at any time hold a long or short position in this security.
2. The research analyst primarily responsible for preparing this research report or a member of the research analyst's household has a financial interest in the securities of the company in the form of a long position in such securities.
3. The research analyst primarily responsible for preparing this research report or a member of the research analyst's household has a financial interest in the securities of the company in the form of options (O), warrants (W), futures (F), and/or a short position (S).
4. JMS or an affiliate managed or co-managed a public offering of securities for the company in the past 12 months.
5. JMS or an affiliate received compensation for investment banking services from the company in the past 12 months.
6. JMS or an affiliate received compensation for products or services other than investment banking services from the company in the past 12 months.
7. JMS may seek compensation for investment banking services from the subject company (ies) in the next 3 months.
8. The research analyst is compensated based on, in part, JMS's profitability, which includes its investment banking revenues.
9. JMS or an affiliate beneficially owns 1% or more of any class of common equity securities of the company.
10. An Employee or Director of JMS is an officer or Director of subject company.
11. Other:

Definition of Ratings

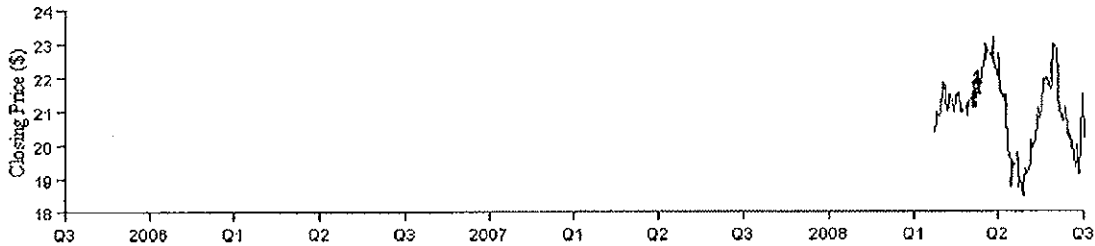
- BUY** Janney expects that the subject company will appreciate in value. Additionally, we expect that the subject company will outperform comparable companies within its sector.
- NEUTRAL** Janney believes that the subject company is fairly valued and will perform in line with comparable companies within its sector. Investors may add to current positions on short-term weakness and sell on strength as the valuations or fundamentals become more or less attractive.
- SELL** Janney expects that the subject company will likely decline in value and will underperform comparable companies within its sector.



Price Charts

AWK

| | |
|-------------|-------------|
| 1) 00/02/08 | 2) 00/03/08 |
| Buy | Buy \$28 |



Janney Montgomery Scott Ratings Distribution as of September 30, 2008*

| | | |
|------------|----------------|-------------|
| <u>BUY</u> | <u>NEUTRAL</u> | <u>SELL</u> |
| 49% | 49% | 2% |

*As a percent of total coverage. See ratings definition above.

Janney Montgomery Scott Ratings of Investment Banking Relationships as of September 30, 2008**

| | | |
|------------|----------------|-------------|
| <u>BUY</u> | <u>NEUTRAL</u> | <u>SELL</u> |
| 6% | 4% | 0% |

**Percentages of each rating category where JMS has performed Investment Banking services over the past 12 months.

Other Disclosures

Investment opinions are based on each stock's 6-12 month return potential. Our ratings are not based on formal price targets, however our analysts will discuss fair value and/or target price ranges in research reports. Decisions to buy or sell a stock should be based on the investor's investment objectives and risk tolerance and should not rely solely on the rating. Investors should read carefully the entire research report, which provides a more complete discussion of the analyst's views.

This research report is provided for informational purposes only and shall in no event be construed as an offer to sell or a solicitation of an offer to buy any securities. The information described herein is taken from sources which we believe to be reliable, but the accuracy and completeness of such information is not guaranteed by us. The opinions expressed herein may be given only such weight as opinions warrant. This Firm, its officers, directors, employees, or members of their families may have positions in the securities mentioned and may make purchases or sales of such securities from time to time in the open market or otherwise and may sell to or buy from customers such securities on a principal basis. Supporting information related to the recommendation, if any, made in the research report is available upon request.





Morning Meeting Notes

Friday, November 7, 2008

| AMERICAN WATER WORKS CO INC (AWK - USD 18.93) | Currency - USD | | | |
|----------------------------------------------------------------------------------------------------------|---------------------------------|-------------------|--------------------|-------|
| | Capitalization (in millions) | Financial Metrics | | |
| Tony Fritz, CFA Ph: 914 921-7792 tfritz@gabelli.com | Number of Shares | 160 | 2009 PMV/sh | 26.00 |
| | Price | 18.93 | EPS | |
| | | | 2009P | 1.30 |
| Recommendation: BUY | Market Cap | 3,029 | 2008E | 1.15 |
| Previous Recommendation: N/A | Net Debt(Cash) | 5,110 | 2007A | 1.04 |
| As of: | Other | 5 | EBITDA (mm) | |
| | | | 2009P | 910 |
| | | | 2008E | 840 |
| | Total Enterprise Value | 8,143 | 2007A | 785 |
| | | | PE Ratio | |
| | | | 2009P | 14.4 |
| | | | 2008E | 16.3 |
| | | | 2007A | 18.1 |

Asset Base Drives Growth - Buy

- American Water is the largest water utility company in the US. The company serves about 15.6 million people in 32 states and Ontario, Canada.
- We are recommending American Water Works as a Buy. We believe that rising capital expenditures and more frequent rate case filings should lead to outsized earnings growth for the company over the next 3-5 years. Management's current capex plan of \$4-4.5 billion between 2007 and 2011 implies about a 5.5% growth rate in rate base. This, coupled with rate recovery from past investments should allow the company to grow revenue 7-9% and earnings 10-13% over the next few years before slowing to high single digit earnings growth. At 14.5x our 2009 EPS estimate, AWK trades significantly below its peers while it offers one of the most attractive growth opportunities in the industry. We believe this is an attractive entry point for long-term investors.
- American Water reported Q3 earnings:
 - Revenue up 6.2% to \$672 million due mostly to rate increases over the previous year.
 - EPS (ex items): \$0.55 vs. \$0.50; Margins expanded almost two percentage points on higher revenue and slower growing expenses
 - Growth in the non-regulated business, a small portion of the total, was strong at 11.5%, driven by new contracts and expanded operations in homeowner services.
- Outlook: The company has pending rate cases for an additional \$267.6 million of revenue. It is unlikely that the company will realize all that it has asked for, but if it is awarded just half (which would be low), this would lead to run-rate revenue growth of over 5% in the next 12 months. Moderating costs could also help the margin picture going forward. We expect the company to earn \$1.30 in 2009 and \$1.45 in 2010.

Please see the last page for important disclosures.

Important Disclosures

To obtain a price chart for any security in this report, please contact 1-800-422-2274.

Gabelli & Company, Inc. ("we" or "us") attempts to provide timely, value-added insights into companies or industry dynamics for institutional investors. Our research reports generally contain a recommendation of "buy," "hold," "sell" or "non-rated". We do not undertake to "upgrade" or "downgrade" ratings after publishing a report. We currently have reports on 797 companies, of which 42%, 42%, 2% and 15% have a recommendation of buy, hold, sell or non-rated, respectively. The percentage of companies so rated for which we provided investment banking services within the past 12 months is 0%, 0%, 0% and less than 1%.

Ratings - Analysts' ratings are largely (but not always) determined by our "private market value," or PMV methodology. Our basic goal is to understand in absolute terms what a rational, strategic buyer would pay for an asset in an open, arms-length transaction. At the same time, analysts also look for underlying catalysts that could encourage those private market values to surface.

A **Buy** rated stock is one that in our view is trading at a meaningful discount to our estimated PMV. We could expect a more modest private market value to increase at an accelerated pace, the discount of the public stock price to PMV to narrow through the emergence of a catalyst, or some combination of the two to occur.

A **Hold** is a stock that may be trading at or near our estimated private market value. We may not anticipate a large increase in the PMV, or see some other factors at work.

A **Sell** is a stock that may be trading at or above our estimated PMV. There may be little upside to the value, or limited opportunity to realize the value. Economic or sector risk could also be increasing.

We prepared this report as a matter of general information. We do not intend for this report to be a complete description of any security or company and it is not an offer or solicitation to buy or sell any security. All facts and statistics are from sources we believe to be reliable, but we do not guarantee their accuracy. We do not undertake to advise you of changes in our opinion or information. Unless otherwise noted, all stock prices reflect the closing price on the business day immediately prior to the date of this report. We do not use "price targets" predicting future stock performance. We do refer to "private market value" or PMV, which is the price that we believe an informed buyer would pay to acquire 100% of a company. There is no assurance that there are any willing buyers of a company at this price and we do not intend to suggest that any acquisition is likely. Additional information is available on request.

Because the portfolio managers at our affiliates make individual investment decisions with respect to the client accounts they manage, these accounts may have transactions inconsistent with the recommendations in this report. These portfolio managers may know the substance of our research reports prior to their publication as a result of joint participation in research meetings or otherwise. The analyst who wrote this report may receive commissions from customers' transactions in the securities mentioned in this report.

Our affiliates may receive compensation from the companies referred to in this report for non-investment banking securities-related services, or may be soliciting these companies as clients for non-investment banking securities-related services.

- **AMERICAN WATER WORKS CO INC**

I, Tony Fritz, CFA hereby certify that the views expressed in this report accurately reflect the analyst's personal views about the subject companies and their securities. I have not been, and will not be receiving direct or indirect compensation for expressing the specific recommendation or view in this report.

Our affiliates beneficially own on behalf of their investment advisory clients or otherwise less than 1% of the common stock of AMERICAN WATER WORKS CO INC as of September 30, 2008.



August 14, 2008
Timothy M. Winter, CFA
Senior Analyst
(314) 238-1203
twinter@jesuplamont.com

American Water Works (AWK)

Initiating Coverage Report

Current Price: \$21.09

Target Price: \$25

BUY

| Revenues and Earnings | F2007A | F2008E | F2009E |
|----------------------------|-----------|-----------|-----------|
| Sales (\$ mil.) | \$2,214.0 | \$2,456.6 | \$2,626.3 |
| 1Q | \$468.5 | \$506.8 | A \$545.0 |
| 2Q | \$558.7 | \$589.4 | A \$615.0 |
| 3Q | NA | \$933.5 | E \$998.0 |
| 4Q | NA | \$426.9 | E \$468.3 |
| Prev. Sales Est. (\$ mil.) | | | |
| EPS | \$0.99 | \$1.15 | \$1.25 |
| 1Q | \$0.02 | \$0.04 | A \$0.07 |
| 2Q | \$0.29 | \$0.28 | A \$0.34 |
| 3Q | \$0.46 | \$0.57 | E \$0.58 |
| 4Q | \$0.19 | \$0.26 | E \$0.26 |
| Prev. EPS Est. | | | |
| P/E (x) | 21.3 | 18.3 | 16.9 |
| Book Value | NA | \$14.97 | \$15.37 |
| ROE | NA | 8.2% | 8.2% |

| Stock Data | |
|------------------------------|-------------------|
| 52-Week Range | \$18.09 - \$23.65 |
| Shares Outstanding (mil.) | 159.96 |
| Market Capitalization (mil.) | \$3,338.4 |
| Enterprise Value (mil.) | \$8,381.6 |
| Debt to Capital | 151.1% |
| Insider Ownership | 60.5% |
| Institutional Ownership | 5% |
| Short Interest (mil. shares) | 2.72 |
| Average Daily Volume | 893,241 |

Highlights

- We have initiated coverage of American Water Works with a BUY rating and a \$25 price objective.
- Shares currently trade at 16.9X our 2009 EPS estimate and 141% of book value, which represent material discounts to group median/averages of 20.2X and 210%, respectively.
- We regard AWK as a high quality conservative utility with unique growth opportunities. AWK shares offer investors a competitive 3.8% dividend yield, the likelihood of consistent annual dividend increases and, more importantly, earnings growth through rate base additions and consolidation/privatization opportunities.
- Following an IPO of 63.2 million shares, or 39.5% of total shares outstanding, the storied water company has reinstated a strategic focus of earning its allowed ROE's from its regulated business and profitably consolidating and privatizing the U.S. water and wastewater sector.
- AWK will materially benefit from public and regulatory support of significant investment in water and wastewater infrastructure. In addition, the company's national presence, diverse geographic footprint, technical expertise, operating reputation and financial resources favorably position it to consolidate and privatize the extremely fragmented and municipally-dominated water and wastewater industry.
- AWK received rate increases totaling \$158.9 million annually in 2007, which compares to \$41 million in 2006 and \$35 million in 2005. In the first six months of 2008, AWK subsidiaries were authorized \$47.2 million in annual revenue increases. AWK subsidiaries have filed rate applications requesting \$271 million in total annual revenue increases. Larger subsidiaries with requests pending, include the states of New Jersey, California, Virginia, Tennessee and Missouri, Pennsylvania, West Virginia, Arizona, and New Mexico.
- We expect the rate relief to lead to a period of accelerated EPS growth over the 2007-2010 period. With roughly 90% of earnings generated from the low-risk regulated water utility business, we assume reasonable regulatory treatment leads to an EPS rebound of roughly \$1.40 by 2010, which results in a nearly 10% return on common equity. Our 2008 and 2009 EPS estimates are \$1.15 and \$1.25, respectively.

Company Description

American Water Works (AWK) is the largest investor-owned water and wastewater utility company in the United States.

See Last Page for Disclosure

**Coverage Initiated With
BUY Rating and \$25
Price Objective**

Investment Appraisal

We have initiated coverage of American Water Works (AWK) with a BUY rating and a \$25 price objective. AWK is the largest investor-owned water and wastewater utility company in the United States. The company provides water and wastewater services to approximately 15.6 million people in 32 states and Ontario, Canada. Its regulated utilities generate roughly 90% of revenues and operate in 20 states in the United States, including larger utility franchises in Pennsylvania, New Jersey, Missouri, California, Indiana and West Virginia.

**Largest U.S. Water
Utility**

**Regulated Franchises in
20 States**

We regard AWK as a high quality conservative utility with unique growth opportunities. AWK shares offer investors a competitive 3.8% dividend yield, the likelihood of consistent annual dividend increases and, more importantly, earnings growth through rate base additions and consolidation/privatization opportunities. As the largest water utility in the United States, AWK will materially benefit from public and regulatory support of significant investment in water and wastewater infrastructure. In addition, the company's national presence, diverse geographic footprint, technical expertise, operating reputation and financial resources favorably position it to consolidate and privatize the extremely fragmented and municipally-dominated water and wastewater industry.

**Low Risk, Conservative
Utility With Significant
Growth Potential**

**Regulated Business has
Under-earned Its
Allowed Profit Levels**

Following a 117-year history as a private and publicly-traded water utility, AWK was purchased by the German multi-utility RWE in 2003 for \$4.6 billion in cash. During the 2003-2007 period, AWK's earnings and strategy were hampered by regulatory rate stay-out provisions and patriotic attitudes from regulators, interveners and owners of smaller private and municipal water utilities. Rate stay-out provisions were a prerequisite from several state Public Utility Commissions (PUCs) for merger approval. In addition, we believe RWE management under-estimated the dynamics of the U.S. water industry and the savoir-faire necessary to operate in the local politics. As a result, earnings and customer growth suffered.

**New Management
Focused on Improving
Earned ROE's**

In preparation for its April 23rd 2008 initial public offering, the storied water company appointed new management and re-instated a strategic focus on improving the profit levels (ROE's) of its regulated utility business, profitably consolidating the fragmented water and wastewater sector as well as pursuing growth opportunities throughout North America.

The current executive management team is headed by President and CEO Don Correll, with roughly 30-years of experience managing large water utilities, and CFO Ellen Wolf, who was CFO of AWK prior to the RWE acquisition. Over the past two years, AWK has diligently focused efforts on requesting and implementing rate recognition of investments in its business and earning reasonable returns on equity at its subsidiaries. The company received rate increases totaling \$158.9 million annually in 2007, which compares to \$41 million in 2006 and \$35 million in 2005.

In the first six months of 2008, AWK subsidiaries were authorized \$47.2 million in annual revenue increases. AWK subsidiaries currently have filed rate applications requesting \$271 million in total annual revenue increases with the majority of increases expected within the next twelve-months. Larger subsidiaries with requests pending, include those in the states of New Jersey, California, Virginia, Tennessee,

Missouri, Pennsylvania, West Virginia, Arizona, and New Mexico.

EPS Rebound Expected Over 2007-2010

We expect the rate relief to lead to a period of accelerated EPS growth over the 2007-2010 period. With roughly 90% of earnings generated from the low-risk regulated water utility business, we assume reasonable regulatory treatment leads to an EPS rebound to roughly \$1.40 by 2010, which results in a 10% return on common equity. Our 2008 and 2009 EPS estimates are \$1.15 and \$1.25, respectively. Water utility allowed returns on equity have averaged roughly 10-10.5% over the past few years. In addition, management has instilled the growth-through-acquisition culture that marked the "Water Works" of yore and we expect an acceleration of growth opportunities.

Attractively Valued

At the current price, we consider AWK shares to be remarkably inexpensive relative to the other publicly-traded water utilities. AWK shares trade at 16.9X our 2009 EPS estimate of \$1.25 and 14.7X our 2010 EPS estimate, which compares to group multiples of 20.2X and 19.0X, respectively, and historical water utility multiples of 20-25X. On a price-to-book value basis, AWK shares trade at 141% of tangible book value (includes the write-off of all goodwill) versus group average multiples of 210%. We believe AWK shares warrant at least an industry-average multiple. Please see Valuation section for a detailed discussion of valuation.

Water's Unique Characteristics Under-Estimated

We believe the market and investment community have under-estimated the value of the growth-oriented water utility. Based on the published research reports, we believe the unique characteristics of American Water Works and the sector have been somewhat neglected. These unique characteristics include a greater certainty of rate base growth than typically achieved in the regulated electric and gas utility sector as well as greater opportunity for customer growth through consolidation and privatization opportunities. We discuss these unique characteristics in greater detail throughout the report.

Competition Sheet

| Company | Symbol | Market Data | | | | | | Valuation Data | | | | | | | | | |
|-------------------------------|--------|-------------|---------------|-----------|-----------------|------------|---------------|----------------|----------|----------|----------|-------------|--------------|-----------|------------|--|--|
| | | Price | Pk. Chg. 2003 | Ret. 2003 | Cap. Exp. (mil) | Div. Yield | Inv. Holdings | PE 2007A | PE 2009E | PE 2010E | PE 2011E | Price/Share | EBITDA/Share | EV/EBITDA | Price/Book | | |
| | | \$ | % | % | \$ | (%) | % | X | X | X | X | \$ | \$ | X | X | | |
| American States Water | AWK | 40.55 | 9 | 107 | 617 | 139 | 34 | 26.4 | 23.4 | 21.5 | 20.4 | 33.4 | 3.66 | 9.60 | 2.33 | | |
| American Water Works | AWK | 21.39 | NA | NA | 3,006 | 1,131 | 2 | 21.5 | 18.5 | 17.0 | 14.3 | 31.3 | 3.56 | 8.69 | 1.42 | | |
| Aqua America | WTR | 17.50 | (16) | -31 | 2,007 | 1,152 | 31 | 24.2 | 20.3 | 21.1 | 18.7 | 25.3 | 2.50 | 10.53 | 2.34 | | |
| Arizona Water Resources | ARTNA | 17.45 | 01 | 101 | 109 | 6 | 23 | 19.4 | 19.2 | 18.6 | NA | 29.6 | 2.91 | 10.16 | 1.50 | | |
| California Water Service Grp. | CWTF | 19.39 | 6 | 164 | 264 | 173 | 52 | 26.1 | 23.2 | 20.2 | 19.2 | 33.0 | 4.29 | 10.16 | 2.12 | | |
| Consolidated Water Svcs. | CWCO | 29.10 | 15 | 7 | 214 | 34 | 29 | 25.6 | 21.6 | 22.2 | NA | 39.0 | 2.23 | 15.64 | 2.27 | | |
| Consolidated Water Co. | CWCO | 20.63 | (16) | 2 | 266 | 89 | 61 | 26.4 | 25.3 | 20.4 | NA | 19.3 | 10.7 | 24.65 | 2.51 | | |
| MHGreen Water | MSEX | 14.16 | (4) | 4 | 229 | 21 | 34 | 20.9 | 19.3 | 18.2 | NA | 28.6 | 2.40 | 11.33 | 1.51 | | |
| Pennsylvania Water | PENW | 23.13 | (13) | 16 | 59 | 4 | 14 | 27.2 | NA | NA | NA | 16.5 | 4.04 | 4.90 | 2.07 | | |
| SJW Corp. | SJW | 25.02 | (22) | (6) | 374 | 124 | 44 | 26.0 | 22.2 | 19.1 | NA | 34.4 | 3.92 | 10.33 | 2.09 | | |
| Southwest Water Company | SWWC | 11.41 | (7) | (7) | 294 | 141 | 51 | 36.9 | 34.7 | 28.6 | NA | 15.3 | 1.10 | 13.93 | 1.77 | | |
| York Water | YORW | 14.54 | (6) | (11) | 376 | 5 | 16 | 25.6 | 23.4 | 21.3 | NA | 1.97 | 1.57 | 1.45 | 1.45 | | |
| Average | | 18.3 | 1 | 70.1 | | 49 | | 24.4 | 23.3 | 20.3 | 18.3 | | | 11.1 | 1.98 | | |
| Median | | 19.1 | (1) | 25.0 | | 45 | | 25.7 | 21.1 | 19.4 | 19.0 | | | 10.8 | 2.10 | | |

| Company | Symbol | Financial Performance | | | | | | Key Ratios | | | | | Relative Sheet | | |
|-------------------------------|--------|-----------------------|-------|-------|-------|-------|-------|---------------------|---------------|--------------|------------------|--------------------|----------------|-----------------|------------|
| | | EPS | EPS | EPS | EPS | CFPS | ROE | Current Annual Rate | Current Yield | Payout 2009E | Div. as % of EPS | Fgr. Growth Rate Q | Book Value PS | Eqty/Book Value | Div. Yield |
| | | 2007A | 2009E | 2009E | 2010E | (TTM) | (TTM) | % | % | % | % | % | \$ | % | % |
| American States Water | AWK | 1.35 | 1.75 | 1.93 | 2.01 | 2.79 | 8.92 | 3.70 | 2.4 | 31 | 6.7 | 6.4 | 17.93 | 51 | A |
| American Water Works | AWK | 0.99 | 1.15 | 1.24 | 1.15 | 1.13 | 7.52 | 15.40 | 3.5 | 64 | 8.3 | 14.91 | 11 | B6B | |
| Aqua America | WTR | 0.22 | 0.33 | 0.51 | 0.55 | 1.13 | 9.69 | 0.50 | 2.8 | 59 | 6.6 | 7 | 6.2 | 11 | A |
| Arizona Water Resources | ARTNA | 0.81 | 0.91 | 1.04 | 1.04 | 2.04 | 6.29 | 12.91 | 4.1 | 68 | 6.1 | 5.8 | 11.04 | 18 | A |
| California Water Service Grp. | CWTF | 1.50 | 1.70 | 1.83 | 2.05 | 3.30 | 8.37 | 1.37 | 3.0 | 60 | 4.1 | 10.60 | 58 | A | |
| Consolidated Water Svcs. | CWTF | 1.06 | 1.15 | 1.32 | - | 2.07 | 9.11 | 0.42 | 3.2 | 74 | 7.3 | 12 | 11.91 | 57 | A |
| Consolidated Water Co. | CWCO | 0.73 | 0.82 | 1.01 | - | 0.72 | 4.24 | 0.26 | 1.5 | 28 | 3.2 | 3.3 | 8.21 | 9.1 | - |
| MHGreen Water | MSEX | 0.67 | 0.94 | 1.00 | - | 1.45 | 4.94 | 0.70 | 3.9 | 70 | 7.0 | 13 | 10.04 | 5.0 | A |
| Pennsylvania Water | PENW | 0.85 | - | - | - | 1.13 | 12.92 | 0.66 | 2.9 | NA | 8.9 | 0 | 11.15 | 18 | - |
| SJW Corp. | SJW | 1.00 | 1.22 | 1.42 | - | - | 4.84 | 0.63 | 2.4 | 6 | 4.0 | 11 | 12.96 | 52 | - |
| Southwest Water Company | SWWC | 0.31 | 0.33 | 0.47 | - | 1.14 | 10.16 | 0.24 | 2.1 | 52 | 3.7 | 12 | 6.43 | 46 | - |
| York Water | YORW | 0.53 | 0.65 | 0.69 | - | 0.55 | 9.18 | 0.44 | 3.1 | 31 | 5.1 | 2.5 | 4.95 | 10 | - |
| Average | | 0.72 | | | | | 7.12 | | | 29 | 5.9 | 4.4 | | | |
| Median | | 0.52 | | | | | 8.52 | | | 29 | 6.0 | 6.1 | | | |

* Earnings for AWK, AWK, CWTF, and WTR are for 2006 & 2007. All other data is for 2006.
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IPO of 39.5% of Shares Outstanding

IPO and Future Offerings

RWE sold roughly 63.2 million shares, or 39.5%, of a total 160 million shares outstanding, in the April 23rd initial public offering. RWE has stated its intention for full divestiture as soon as reasonably practical and we believe the general market opinion is for a second offering by year-end 2008. We believe the over-hang of additional share offerings as well as RWE control issues have resulted in a discounted valuation. We remind investors that any such discount should theoretically diminish following the share issuances.

The offering was initially delayed from its original year-end 2007 target date due to market conditions. The number of shares initially issued was also modestly reduced due to weaker-than-anticipated market demand. In addition to weak market conditions, we attribute the less-than-desired demand to the overall size of the offering, which was \$1.2 billion, relative to the \$5 billion market capitalization of the entire publically-traded water utility universe.

Water Sector Characterized By Municipal Ownership, Fragmentation and Significant Capital Needs

The Water Utility Sector

The U.S. water and wastewater sector is vastly different from the electric and gas utility sectors in terms of ownership, number of utilities and size of utilities. However, it is very similar in how it is economically-regulated and requires significant capital to maintain service. The water/wastewater sector is characterized by the following major features:

- (1) municipally-dominated,
- (2) extremely fragmented
- (3) infrastructure in need of repair or improvement.
- (4) economically regulated by the state Public Utility Commission (PUCs)

As of 2005, the Environmental Protection Agency's (EPA) most recent data, there were roughly 53,000 separate community water systems in the United States with roughly 49,000-plus serving population bases of less than 3,300 people. Notably, 80- to 85% of the nation is served by 24,000 municipally-owned and operated systems, including most of the major cities and population bases. Nearly every major city in the U.S. owns its water and wastewater system.

As shown in the charts below, the majority of the approximately 53,000 community water systems are very small and serve populations of 500 or less. There are tens of thousands of private utilities ranging in size from small single utilities, including many owned by developers and families, to large companies, operating hundreds of separate utilities in multiple states. There are only 12 publicly-traded water utilities with an equity market capitalization of greater than \$100 million, including AWK, which is the largest and most geographically diverse.

| 2005 Water System Inventory | | | | |
|-----------------------------|---------------------|--------------------|------------------------|----------------------|
| | Very Small 0-500 | Small 501-3,300 | Medium 3,300-10,000 | Large Over 10,000 |
| Number of Systems | 29,666 | 14,389 | 4,748 | 4,034 |
| Population Served | 4,926 | 20,851 | 27,515 | 229,053 |
| % of Population | 2 | 7 | 10 | 81 |

Safe Drinking Water Information System

Source---EPA

Significant Capital Needed to Upgrade Infrastructure

The aging water and wastewater infrastructure in the United States is in constant need of modernization and facilities replacement. Increased regulations to improve water quality and the management of wastewater discharges, which began with passage of the Clean Water Act in 1972 and the Safe Drinking Water Act in 1974, have been among the primary drivers. The EPA estimates that approximately \$277 billion of capital spending will be necessary between 2003 and 2022 to replace aging infrastructure and to comply with quality standards to ensure quality water systems across the United States. In addition, the EPA estimates that approximately \$388 billion of capital spending will be necessary between 2000 and 2019 to replace aging infrastructure and ensure quality wastewater systems across the United States.

| Water Infrastructure Needs | | |
|----------------------------|--------------------------------|------------|
| Type of Investment | Estimate Cost (\$ billions) | % of Total |
| Distribution | 183.6 | 66 |
| Treatment | 53.2 | 19 |
| Storage | 24.8 | 9 |
| Source | 12.8 | 5 |
| Other | 2.3 | >1 |
| Total | 276.7 | 100 |

Source: EPA

Similar to electric and gas utilities, investor-owned water and wastewater systems are economically regulated by the state PUCs in the states in which they operate. As a result, capital investment in infrastructure improvement provides rate base growth potential. The federal government and the states also regulate environmental, health and safety and water quality matters for both investor-owned and government-owned water and wastewater utilities.

Subject to Economic Regulation by State Public Utility Commissions We Expect the Sector to Consolidate and Privatize

Eventual Restructuring

We believe the combination of fragmentation, heavy capital needs and government ownership will lead to the eventual restructuring (consolidation and privatization) of the \$500 billion sector and result in significant value-creation. The inefficiency resulting from excessive fragmentation leads to higher water rates, neglected infrastructure and poor quality service. Smaller utilities simply do not have the operating, financial and technological capability or economies of scale to provide services or raise capital as efficiently as larger utilities. We contend that a "handful" of publicly-traded water utilities possess strategically positioned assets, outstanding operating track records and reputations, managerial and professional talent and are

poised to capitalize on the eventual restructuring of the industry.

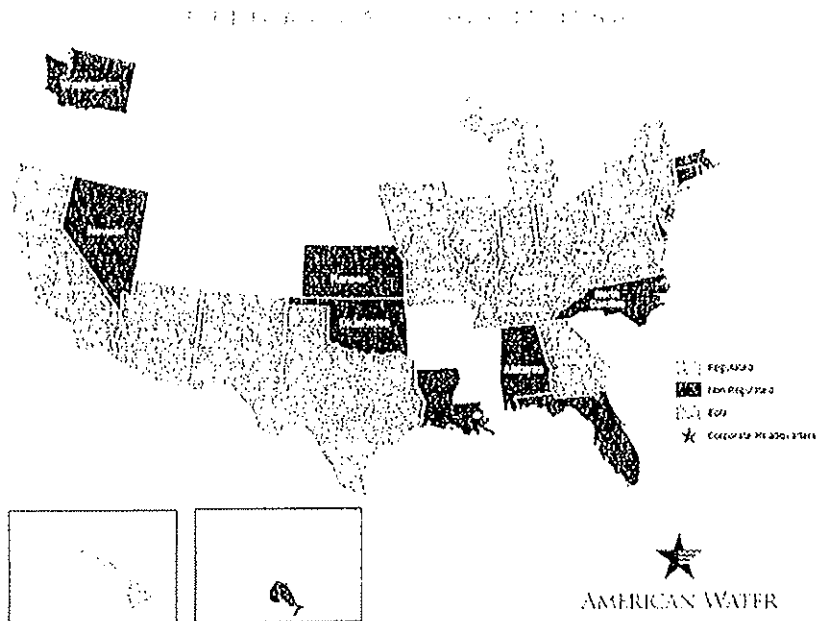
However, these dynamics have existed for years and only a handful of companies have successfully executed profitable growth-through-acquisition and/or privatization strategies. The massive inefficiency of the multi-hundred-billion dollar sector has been largely neglected primarily due to comparatively low residential water utility bills. With minimal impact on the individual consumer's "pocketbook" and an absence of public health emergencies, the water and wastewater business has been "out of sight and out of mind" to most of the general public.

Description

AWK's primary business is the ownership of regulated utilities that provide water and wastewater services to residential, commercial and industrial customers. Its regulated utilities operate in approximately 1,625 communities spread out across 375 individual service areas in 20 states in the United States. AWK is organized as a holding company with subsidiaries in each of the 20 states it serves. Each regulated subsidiary is subject to economic regulation by state Public Utility Commissions (PUCs) in the states in which they operate. In 2007, regulated operations generated \$1.988 billion in revenues, or roughly 89% of consolidated revenues.

| AWK Subsidiaries 2007 | | | | |
|---------------------------|----------------------------------------|-------|---------------------|-------|
| Subsidiary | Regulated Operating Revenue (millions) | % | Regulated Customers | % |
| New Jersey | \$ 505 | 25.4 | 634,957 | 19.2 |
| Pennsylvania | \$ 416 | 20.9 | 644,720 | 19.5 |
| Missouri | \$ 180 | 9.1 | 465,087 | 14.0 |
| Illinois | \$ 179 | 9.0 | 306,740 | 9.3 |
| Indiana | \$ 147 | 7.4 | 283,088 | 8.5 |
| California | \$ 124 | 6.3 | 171,445 | 5.2 |
| West Virginia | \$ 106 | 5.3 | 167,744 | 5.1 |
| Top Seven States | \$ 1,657 | 83.4 | 2,673,781 | 80.7 |
| Other | \$ 331 | 16.6 | 638,847 | 19.3 |
| | \$ 1,988 | 100.0 | 3,312,628 | 100.0 |
| Source: Company documents | | | | |
| Non-regulated business | \$ 242.70 | | | |

Non-regulated businesses include Contract Operations Group, Applied Water Management Group and Homeowner Services Group. In 2007, non-regulated businesses generated \$242.7 million in operating revenue, or roughly 11% of consolidated revenues.



Source: Company reports

**AWK's Storied History Dates Back to 1886
RWE Purchased AWK for \$4.6 billion in Cash in 2003**

History as a Public Company. AWK was founded in 1886 as the American Water Works & Guarantee Company, for the purposes of building and purchasing water systems in McKeesport, Pennsylvania. In 1935, the Company was reorganized under its current name, and in 1947 the common stock of the Company became publicly traded on the New York Stock Exchange. Prior to being acquired by RWE in 2003, AWK was the largest publicly traded water utility company in the United States.

In 2003, AWK was acquired by RWE and became a private company. The RWE acquisition resulted in many structural changes. Operations and management were managed through Thames Water, a subsidiary of RWE. In addition, many of AWK's subsidiaries agreed not to file rate cases for specified periods of time as a condition of the acquisition. In 2005, RWE decided to divest American Water. In March 2006, RWE decided to divest American Water through the sale of shares in one or more public offerings.

RWE Owns Roughly 60% of Shares Outstanding

Control issues and additional shares to come public. RWE, the large German multi-utility, owns approximately 96.7 million, or 60.5%, of the 160 million shares of common stock outstanding. As a result, RWE has the potential to significantly influence all matters submitted to a vote of stockholders, including the election of directors. Following the expiration of a 180-day lock-up period, which ends October 23, the remaining common shares will be eligible for future sale. RWE intends to fully divest its ownership of American Water as soon as reasonably practicable, subject to market conditions.

**AWK EPS Strategy:
(1) Rate Base Growth**

The American Water Works Strategy

The American Water Works' strategy is relatively simple and is as follows:

- (2) Control Costs**
- (3) Consolidate**
- (4) Privatize**

- (1) prudently invest in regulated water and wastewater infrastructure
- (2) earn a healthy return on these investments from state PUCs;
- (3) profitably acquire smaller water/wastewater systems/companies; and
- (4) pursue profitable public/private partnerships, including water/wastewater O&M contracts with municipalities, military bases and industrial customers.

We believe AWK has a number of competitive advantages relative to other water private and municipal water companies as it looks to capitalize on the pro-longed restructuring of the industry. These include:

Size and Geographic Footprint Provide Competitive Advantage

1) **Size.** American Water Works (\$3.3 billion of equity market capitalization) is significantly larger than every other investor-owned water utility with the exception of Aqua America (\$2.1 billion of equity market capitalization), which results in numerous competitive advantages. As a result, AWK can pursue acquisition and privatization opportunities of various sizes, including large opportunities that would dilute other investor-owned utilities. Throughout its history, AWK has acquired large water companies, such as the \$400 million acquisition of Pennsylvania Enterprises in 1994, privatized large cities, such as Buffalo, New York, in 1999 and participated in numerous smaller acquisitions and privatization contracts.

AWK's size also results in economies of scale as overhead expenses, including many administrative and support functions, can be spread over a large customer base. The ability to create economies of scale and further its competitive advantage are evident in the two national customer service centers, with personnel located in Alton, Illinois and Pensacola, Florida that process telephone calls from customers across all service areas, and its national research centers in Belleville, Illinois and Delran, New Jersey. By acquiring smaller companies and/or systems, AWK can capitalize on its existing overhead and resources to improve operating efficiencies lower unit costs and improve service.

2) **Geographic diversity and footprint.** With a presence in 23 states, AWK has established beach-heads in most regions to pursue privatization or acquisition growth prospects. In addition, the geographic diversity insulates the consolidated company against adverse state regulatory decisions/environments and/or adverse weather conditions.

Resources and Reputation Serve Well With Regulators, Politicians, and Potential Growth Candidates

3) **Resources.** With over 7,000 employees, including technical, engineering and managerial professionals at 23 subsidiaries, AWK employs among the more sophisticated and experienced people in the industry and can employ best practices across the company. As an example, AWK established a formal research and development program in 1981 with personnel located at two facilities: the regional center in Voorhees, New Jersey and the research laboratory in Delran, New Jersey. In addition, the quality control and testing laboratory in Belleville, Illinois supports research through sophisticated testing and analysis. Since its inception, AWK's research and development program has evolved to become a leading water-related research program, achieving advancements in the science of drinking water, including sophisticated water testing procedures and desalination technologies.

Renowned Testing

4) **Reputation.** With a history dating back to 1886, AWK is well-known as the industry leader with an excellent operating track record of quality service. Its

Facility and Leading-Edge Water Research

reputation materially benefits its strategy of acquiring water systems and partnering with local governments. Examples of the quality reputation include its numerous awards. (Tampa Bay Desalination Plant named Desalination Plant of the Year by Global Water Intelligence and contract with city of Buffalo named 2008 Public/Private Partnership by U.S. Conference of Mayors)

AWK Helps Shape Water Regulatory Policy

Benefits of the AWK History and Resources

These competitive advantages combine to benefit AWK in many ways, including the ability to shape issues on the regulatory and legislative front, ability to receive rate recognition of investments and the ability to participate in water and wastewater infrastructure growth opportunities and projects of various sizes and in various regions.

States and municipalities can look to AWK to solve regional water and wastewater issues or partner with on large projects. Politicians as well as private water and wastewater owners and managers can transfer ownership or operations with confidence that service will be maintained or improved.

AWK's relationship with the EPA and its renowned treatment laboratories has provided early insight into emerging regulatory issues and initiatives. As the largest or among the larger regulated water utilities in many of the states in which it operates, AWK subsidiaries proactively work to implement constructive regulatory policies. Given that 90% of its business is regulated, constructive regulation is key to AWK's ability to earn a reasonable return on investment. Examples of constructive regulatory policy shaped or influenced by AWK and its subsidiaries are discussed in detail later in this report.

These competitive advantages are important as the privatization business is characterized by aggressive competition and market-driven growth and profit margins. In addition, AWK competes with other regulated utilities, as well as strategic and financial buyers, for acquisition opportunities, including tuck-ins.

Above-Average EPS Growth Through 2010

EPS Growth

In addition to normal customer growth and/or operating cost controls, AWK, similar to most water utilities, has three basic methods of EPS growth: (1) rate base growth, (2) consolidation and (3) privatization. We conservatively estimate AWK's long-term EPS growth rate at 5-to-7% per year for the foreseeable future.

Significant Regulatory Activity Over Last Couple of Years and More to Come

Rate Base Growth

With roughly 90% of earnings generated from the low-risk regulated water utility business, we assume reasonable regulatory treatment leads to an EPS rebound of roughly \$1.40 by 2010, which results in an estimated 10% return on common equity. Our 2008, 2009 and 2010 EPS estimates are \$1.15, \$1.25 and \$1.40, respectively. During the 2001-2007 period, AWK's earnings and strategy were hampered by regulatory rate "stay-out" provisions and patriotic attitudes from regulators and interveners of smaller private and municipal water utilities. In addition, we believe RWE management underestimated the U.S. water industry dynamics and the savoir-

AWK's Regulated Rate

Base is Over \$7 Billion

faire necessary to operate in the local politics. As a result, earnings and customer growth suffered.

Over the past eighteen-months, AWK has diligently focused efforts on requesting and implementing rate recognition of investments in the business as well as earning reasonable returns on equity at its subsidiaries. The company received rate increases totaling \$159 million annually in 2007, which compares to \$41 million in 2006 and \$35 million in 2005. In the first six months of 2008, AWK subsidiaries were authorized \$47.2 million in annual revenue increases. AWK subsidiaries currently have filed rate applications requesting \$271 million in total annual revenue increases with the majority of increases expected within the next twelve-months. Larger subsidiaries with requests pending, include those in the states of New Jersey, California, Virginia, Tennessee, Missouri, Pennsylvania, West Virginia, Arizona, and New Mexico.

| Annualized Rate Increases Granted | | | |
|--------------------------------------|---------------|---------------|----------------|
| State | 2005 | 2006 | 2007 |
| | \$ | \$ | \$ |
| New Jersey | | | 56.2 |
| Pennsylvania | 5.8 | 8 | 40.6 |
| Missouri | | 6.8 | 24 |
| Illinois | | 0.9 | 1.7 |
| Indiana | 0.9 | 1.8 | 14 |
| California | 8.4 | 15.1 | 0.5 |
| West Virginia | 10 | | |
| Other | 9.9 | 8.7 | 21.9 |
| Total | \$35.0 | \$41.3 | \$158.9 |

Source: Company Prospectus

Water utility allowed returns on equity have averaged roughly 10-10.5% over the past few years. We estimate American Works regulated rate base at roughly \$7.1 billion at year-end 2007 (grows to \$7.6 billion by year-end 2008) and an assumed 40% equity ratio would result in roughly \$2.86 billion of equity rate base. A 10% earned ROE would result in roughly \$1.78 of 2007 EPS power on 160 million shares outstanding. We note that the difference between actual "EPS power" and AWKs actual 2007 EPS results of \$0.99 is the result of regulatory lag and a 28% common equity ratio (excludes goodwill). AWKs June 30, 2008, equity value per share (excluding goodwill) was \$14.97 per share, which indicates current EPS power of \$1.50 assuming a 10% earned return on equity.

Assuming a conservative 10% allowed ROE, we use the following simple equation as a starting point for projected rate base EPS growth for 2011 and beyond.

| Financial Theory EPS Growth Rate | | | |
|----------------------------------|---|------|-----------------------|
| EPS Growth | = | ROE* | X Retention Rate** |
| EPS Growth | = | 10% | X (1 minus 50-to-70%) |
| 3-to-5% | = | 10% | X (30-to-50%) |

*ROE: return on equity
 ** Retention rate: earnings retained following dividend payout

The assumed 3-to-5% EPS growth rate can be improved upon by increasing prudent infrastructure investment, which requires external capital raises, or by lowering the dividend payout ratio. We emphasize that the greater the multiple of book value that equity is issued, the lower the cost of capital and the greater the return on investment.

Customer Growth and Consolidation Opportunities

In addition to the 3-to-5% rate base growth, water utilities can enhance EPS growth via the consolidation of smaller systems. During 2005, 2006 and 2007, AWK spent \$5.0 million, \$12.5 million and \$15.9 million, respectively, for acquisitions of regulated water and wastewater systems. We consider such a level of acquisition activity to be minimal given AWKs size and the nation's potential opportunities. We attribute the lack of growth activity to an undetermined focus from the parent company, RWE. New AWK management has instilled the growth-through-acquisition culture that marked the "Water Works" of yore and we expect an acceleration of growth opportunities. A "tuck-in" is the acquisition of a water and wastewater utility serving less than 10,000 customers in areas contiguous with existing operations. Tuck-in opportunities allow AWK to integrate and manage acquired systems using existing management to achieve efficiencies. Historically, pursuing tuck-ins has been a fundamental part of AWKs growth strategy.

Renewed Focus on Acquiring Small Systems

Long History of Growth Through Acquisition

Throughout its long history, AWK has executed numerous large acquisitions, including several over the recent past.

- In 1996 Pennsylvania American acquired the regulated water utility operations of Pennsylvania Gas and Water Company, a subsidiary of Pennsylvania Enterprises Inc., for approximately \$409.4 million.
- In 1999, AWK acquired the privately held National Enterprises Inc., in a transaction valued at \$700.0 million.
- In 2002, AWK acquired the water and wastewater facilities in six states from Citizens Communications Company for an aggregate purchase price of \$979.8 million.

Pending City of Trenton Purchase for \$100 Million

On December 21, 2007, New Jersey-American Water, signed an agreement with the city of Trenton, New Jersey to purchase the assets of the city's water system located in Ewing, Hamilton, Hopewell and Lence townships, which serve 39,000 customers. The purchase price is \$100 million, and the agreement was approved by the Trenton



City Council. The agreement is awaiting various regulatory approvals, including the New Jersey Board of Public Utilities.

Customer growth in the regulated businesses is driven by organic population growth within franchised service areas. We consider AWKs regulated business to be less-sensitive to economic cycles than other business. Residential customers account for approximately 91% of the total regulated customers and approximately 58% of total regulated operating revenue and residential water usage tends to be stable. Residential customers consume water for daily health and sanitary needs regardless of economic or other external factors. In addition, residential customers generally do not have the option of switching to another service provider.

Conservation Efforts

However, we believe investors should be aware of a general trend toward declining residential per customer water usage. Increased water conservation, including growing use of more efficient household fixtures and appliances, combined with declining household sizes, has contributed to this trend. The average annual change in residential water usage per customer from January 1998 through December 2007 (as a percentage of January 1998 usage) in the larger subsidiaries and have ranged from 0.66% per year in New Jersey at the low end to as high as 1.63% per year in West Virginia. Declining usage could have a negative impact on revenues between rate cases in most states where revenue de-coupling regulatory principles are not allowed. Normally, a general rate case will reset sales levels to test year levels.

Regulated Utilities Suffer From Regulatory Lag

Finally, regulatory lag is a significant challenge for AWK as well other water utilities. Regulatory lag refers to rising capital and operating costs that can hamper earnings results in the periods between rate cases. PUCs normally use an historical test year to set rates which incorporate historical capital and operating costs. As costs rise following a rate case, AWKs earnings are challenged. Rising operating costs include labor, energy, taxes and treatment chemicals. Generally, the longer the period between rate cases, the further "earned ROE's" diminish, which explains the poor returns under the RWE era. We note and discuss numerous unique constructive water utility regulatory principles which have been designed to constructively deal with this issue, including distribution improvement surcharges, forward test years, revenue de-coupling, and construction work in progress rate increases.

Privatization Opportunities

Non-regulated businesses include Contract Operations Group, Applied Water Management Group and Homeowner Services Group. In 2007, non-regulated businesses generated \$242.7 million in operating revenue, or roughly 11% of consolidated revenues. As noted, the privatization business is highly competitive and has historically resulted in low margins. None-the-less, we anticipate the privatization market to grow at stronger rate than the regulated business and that AWK will be a leading player. We discuss AWK's non-regulated businesses in greater detail later in this report.

Heavy Capital Budget Will Require External Financing

Capital Intensive Business:

We consider the water and wastewater utility business to be the most capital intensive of all the utility businesses. In 2007, AWK expended \$758.6 million to add, replace

and maintain property, plant and equipment. 2007 construction expenditures rose \$69.7 million, or 10.1%, over 2006 driven by infrastructure replacements and upgrades to treatment facilities at several plants including Joplin, Missouri, Maricopa County, Arizona, Franklin Township, New Jersey and Champaign, Illinois. 2006 construction expenditures rose \$130.4 million, or 23.4%, over 2005. These increases occurred due to re-focused efforts to invest in the regulated utility business.

Over the next five years, AWKs capital budget totals approximately \$4.0- \$4.5 billion and is expected to range between \$770 and \$950 million per year. The 5-year budget includes approximately \$1.7 billion to replace aging infrastructure including mains, meters, and supply and treatment facilities, \$1.3 billion for facilities to serve new customer growth and \$700 million for compliance with quality standards and other regulatory requirements. Projects to enhance system reliability, security, and efficiency or to meet other needs are projected to total an additional \$500 million.

Operating cash flow totaled \$473 million in 2007 including \$140 million from Pennsylvania-American and \$123 million from New Jersey American. Subsidiary dividend policy requires all regulated subsidiaries to pay quarterly dividends of 75% of their net income in the previous quarter. Construction expenditures are partially offset by customer advances and contributions for construction (net of refunds) of \$35.8 million, \$47.4 million and \$52.0 million for the years ended December 31, 2007, 2006 and 2005, respectively. Customer advances and contributions are reflected in net cash flows from financing activities.

We estimate operating cash of roughly \$550 million per year over the 2007-2010 period generated primarily from net income, depreciation and advance from customers. With common dividends totaling roughly \$125-150 million per year and construction expenditures of roughly \$800 million, we project AWK will need to externally finance roughly \$400-450 million per year.

Common Equity Ratio is a Low 33% Assuming a Full Write-off of Goodwill

Capital Structure

As of June 30, 2008, common equity represented 45% of total capitalization (includes short-term debt), including goodwill. Common equity excluding goodwill was 33%. As a condition to some PUC approvals of the IPO, AWK is required to maintain a capital structure which included a minimum of 45% equity (includes preferred equity). The annual goodwill impairment test is conducted during the fourth quarter and we do not anticipate any circumstances to trigger a goodwill test prior to year-end 2008.

Goodwill and First Quarter 2008 Impairment Charge

On May 14, AWK took an event-driven impairment charge of \$750 million due to the market price of the company's common stock (both as of the IPO date as well as the market price during subsequent trading) being less than what was anticipated at the completion of the 2007 annual test. On May 13, 2008, RWE transferred \$245.0 million to the company to ensure that the regulatory requirements were met. At June 30, 2008, goodwill totaled \$1.707 billion. The goodwill is associated primarily with the acquisition of American Water by an affiliate of RWE in 2003 and the acquisition of E'town Corporation in 2001, representing the excess of the purchase price the

purchaser paid over the fair value of the net tangible and intangible assets acquired. Annual impairment reviews are performed in the fourth quarter. AWK recorded goodwill impairment in the amounts of \$396.3 million in 2005, \$227.8 million in 2006 and \$509.3 million in 2007. We exclude goodwill from our calculation of capitalization ratios, book value, rate base and hypothetical EPS projections.

Credit Ratings Are Strong Investment Grade

Credit Ratings

| Securities | Moody's | Standard & Poor's |
|-----------------------|----------------|------------------------------|
| Senior unsecured debt | Baa2 | BBB+ |

Standard and Poor's and Moody's rating outlook is stable.

Unique Regulatory Policies to Deal With Water Utility Needs

Water Rate Increases the Key To Earnings Growth

Privately owned utilities are subject to economic regulation at the state level by independent state Public Utility Commissions (PUCs). Water utility rates are set on a cost-of-service or rate-base/rate-of-return methodology where utilities are given the opportunity to earn a fair return on their investment. Allowed returns on investment are set by the PUC's to allow utility equity and debt investors the opportunity to earn a fair return on investment while balancing the needs of customers. Over the past several years, allowed returns on equity have ranged between 9% and 12% and are highly correlated to interest rates. Each individual PUC has differing methods of auditing and determining a utility's capital and operating costs and differing regulatory mechanisms to balance the needs of consumers and water providers.

Frequent Rate Increases Needed

Rate decisions and the timing of those decisions are important determinants of AWK's earnings, cash flow, and capital structure. The water utility industry is the most capital intensive of the major utility industries and significant amounts of capital must be continually invested to build, repair, and rehabilitate water and wastewater infrastructure. Without frequent rate increases and constructive regulatory principles, water utilities are challenged to earn fair ROE's for shareholders as they suffer from regulatory lag (diminishing earned returns on common equity associated with normal increases in operating costs and additional equity and debt costs to fund investment between rate cases).

As a result, numerous regulatory principles have been developed to deal with the unique needs of water utilities. Favorable mechanisms include quarterly distribution improvement charges, acquisition adjustments, balancing account mechanisms or other automatic adjustment mechanisms. While rate cases are generally viewed negatively in the electric and gas utility businesses, water rate cases and frequent increase grants are a general "way of life" for water utilities. Water rate increase requests are generally more frequent and acceptable.

Water Bills Very Low Relative to Other Industries

Water Utility Bills Relatively Insignificant to Overall Household Budget

Utility rate increases are never publicly and politically popular, but we do not expect resistance or price elasticity to be an issue for the foreseeable future. Water utility bills across the U.S. are extremely low. In fact, many household water bills are billed quarterly rather than monthly given their insignificance to the monthly consumer

budget. Willingness to pay for “high-quality” water is readily evident in the prices paid for bottled water. Should one extend the price the consumer is willing to pay at the convenience store to the residential tap, a typical residential household water bill would total in excess of \$50,000 per month. This compares to average-household water bills of roughly \$30-to-\$45 per month and other utility bills often well into the triple digits for cable television, cell phone, electricity and heating services.

Automatic Infrastructure Surcharges to Encourage Infrastructure Investment

Knowledgeable utility regulatory commissions loathe to describe water rate increases in terms of percentages given the headline grabbing attention that say a 15% rate increase can have when in fact a 15% increase on a \$30/per month bill is \$4.50 per month. Our observation is that constructive PUCs and regulatory relationships develop in states where larger and more pro-active water utilities operate. We consider Pennsylvania, Indiana, Ohio California and Illinois to be among the more currently constructive regulatory PUC's. A number of state public utility commissions have adopted constructive rate policies, including some form of single tariff pricing (uniform rates across a service territory), forward-looking test years, pass-through provisions or infrastructure surcharges. The California Public Utility Commission recently adopted several favorable mechanisms including a revenue-decoupling mechanism to promote conservation and an expense stabilization mechanism. These mechanisms were a result of the California Water Action Plan, which was collaborative effort between water utilities, consumer advocates and other regulatory officials designed to promote water quality and investment.

Forward Looking Test Years Minimize Regulatory Lag

Unique Regulatory Mechanisms Developed for Water Utilities

One of the more constructive regulatory principles designed to deal with water utility-specific issues is an infrastructure surcharge mechanism (ISM). An ISM (each state has its own acronym) was designed to encourage pipe replacement by allowing immediate returns on investment. The mechanism allows rate adjustments outside of a general rate proceeding for specific capital expenditures to replace aging infrastructure (pipe replacement). The mechanism was first introduced in Pennsylvania where it is referred to as a Distribution System Improvement Charge (commonly referred to as a “DISC”). We note that Pennsylvania-American recently received authorization to increase its DISC expenditures to allow for 7.5% increase in revenues from previous policy of a 5% increase. These constructive regulatory mechanisms encourage a steady capital expenditure program to repair and improve water and wastewater systems as needed by reducing the regulatory lag on the recovery and earned return on prudent expenditures. Currently, Pennsylvania, Illinois, Missouri, Indiana, New York, California and Ohio have allowed the use of these infrastructure surcharges.

Some states have permitted use of some form of forecast or forward looking test year instead of historical data to set rates. Examples of these states include Hawaii, Illinois, Kentucky, Ohio, Pennsylvania, New York and California. In addition, a number of states have allowed the utility to update historical data for some changes that occur for some limited period of time subsequent to the historical test year. This allows the utility to take account of some more current costs or capital investments in the rate-setting process. Examples of these states include New Mexico, Texas, Missouri, Iowa, Virginia, Maryland, Tennessee, West Virginia, New Jersey and Arizona.

Another regulatory mechanism to address issues of regulatory lag includes the ability, in some circumstances, to recover in rates a return on utility plant before it is actually in service, instead of capitalizing an allowance for funds used during construction. Examples of states that have allowed such recovery include Texas, Pennsylvania, Ohio, Kentucky and California. Pennsylvania, New Jersey, West Virginia, Ohio, Indiana and Illinois have adopted a full or partial single rate policy (also known as uniform rates). The single tariff structure is based on costs that are determined on a statewide basis, thereby moderating the impacts of periodic fluctuations in local costs and lowering administrative costs.

Selected Recent Rate Activity In Larger States

IAWC Authorized \$24 Million Revenue Increase

On July 31, 2008, the Illinois Commerce Commission approved a \$24.9 million revenue increase for Illinois-American (IAWC) premised on a 10.35% allowed ROE. The case was filed August 31, 2007, when IA requested a \$32.8 million revenue increase based on an allowed ROE of 11.25%.

WVAWC Authorized \$14 Million Increase

On March 18, 2008, the Public Service Commission of West Virginia approved a settlement of West Virginia-American rate case that was filed in mid-2007. The settlement called for an increase of \$14.5 million, or 15%. The last rate case was decided in July of 2005. Since 2004, the company invested more than \$63.8 million in its facilities.

PAWC Authorized \$36 Million Increase

On November 30, 2007, the Pennsylvania Public Utility Commission (PUC) approved a settlement calling for a \$36 million, or 8.9% annual revenue increase for Pennsylvania-American (PAWC). The company's original proposal increased water rates by about \$59.2 million (14.7%). The Commission voted 4-0 to approve the settlement, which was reached between the company and the state's Office of Consumer Advocate, the state's Office of Small Business Advocate, the PUC's Office of Trial Staff and consumers who had filed formal complaints. Under the settlement, the company may not file for a rate increase until April 24, 2009. We note that under PPUC approved policy, PAWC can raise rates up to 7.5% related to the DISC between general rate cases.

NJAWC Requested \$125 Million Increase

On January, 14 2008, New Jersey-American (NJAWC) filed for a \$125 million, or 23.4% rate increase premised on a 11.5% allowed ROE with the New Jersey Board of Public Utilities. A decision is expected by year-end 2008. New Jersey American Water will have spent more than \$350 million on investments to replace and upgrade its facilities, infrastructure and sources of supply state-wide since its last rate case. Investments include the replacement of hundreds of miles of water and sewer mains and the expansion of the Company's Canal Road Water Treatment Plant. NJAWC's last rate case was in March of 2006 and authorized a \$56 million annual increase based on a 10% allowed ROE.

MAWC Requested \$49.6 Million Increase

On March 31, 2008, the Missouri-American Water Company (MAWC) filed for a \$49.6 million revenue increase premised on a 11.25% allowed ROE with the Missouri Public Service Commission. MAWC's last rate increase was authorized in October 2007 when it was granted a \$21.4 million increase premised on a 10.0% allowed ROE.

**Contract Services
Business Offers
Significant Growth
Potential, But Margins
Thin**

Non-Regulated Business.

AWK's Contract Operations Group (COG) generated revenue of \$139.0 million in 2007, representing 57.3% of consolidated non-regulated revenues. COG provides services to systems with over 3,000 customers (and in many cases far larger) as distinguished from the O&M services provided by Applied Water Management Group usually to systems with less than 3,000 customers.

COG is party to more than 45 contracts across the United States and Canada, with contracts ranging in term from two to 20 years. The services provided vary in size and scope with annual operating revenue per contract ranging from \$0.26 million to \$9.0 million per contract. For instance, 25 of the O&M contracts are purely operational in nature and do not involve the design or construction of the facilities.

COG is an active participant in the Department of Defense's recently adopted Utility Privatization Program, or UPP. In 2003 it was awarded 50-year contracts for the operation and maintenance of the water and wastewater systems at Forts Leavenworth, Sill and Rucker and in September 2007 was awarded 50-year contracts for the operation and maintenance of the water and wastewater systems at Fort A.P. Hill and Scott Air Force Base worth approximately \$160.0 million in total. Responsibilities under these contracts include system project management, regulatory and environmental compliance, planning and long-term operations and maintenance. Additionally, under a three-year contract awarded in 2006, COG was selected by Harnett County and the City of Fayetteville, North Carolina to operate, maintain and manage the existing water and wastewater treatment plants at Fort Bragg for an interim period until construction of new connections to the Harnett County and City of Fayetteville systems were completed.

The Applied Water Management Group (AWG) works with customers to design, build and operate smaller-scale water and wastewater treatment plants (typically serving up to 3,000 customers). Typical customers are real estate developers, industrial companies and new or expanding communities. Applied Water Management Group generated revenue of \$33.3 million in 2007, representing 13.7% of revenue for our Non-Regulated Businesses.

AWG currently serves the AWK customer base primarily in the Northeastern United States and was responsible for the design, construction and operation of advanced wastewater treatment recycling systems for sites as varied as residential buildings in Battery Park City in New York City and Gillette Stadium in Foxborough, Massachusetts. Approximately 30% of AWG's business involves operating and maintaining smaller-scale water and wastewater plants, made up of a mixture of facilities that we designed and built, and some which we only operate.

The Homeowner Services Group provides services to domestic homeowners to protect against the cost of repairing broken or leaking pipes inside and outside their homes. AWK initially offered these services within territories covered by its regulated subsidiaries, but has expanded to enable other utilities outside our territories to offer the services to their customers. Homeowner Services Group generated revenue of \$40.4 million in 2007, representing 16.6% of non-regulated businesses. In



addition, Service Line Protection Programs offer customers various service contracts for a monthly fee that cover repair of water line leaks and breaks, sewer line clogs and blockages and emergency in-home plumbing

Second Quarter Results Hurt By Wet Weather

Recent Earnings Results

On August 11, 2008, AWK reported second quarter 2008 fully diluted EPS of \$0.28 versus \$0.29 (excludes \$0.02 gain on sale of property) for the same period last year. Wet weather negatively impacted second quarter 2008 results by (\$0.04).

Operating revenues increased rose 5.5% to \$589.4 million due primarily to rate increases of approximately \$26.0 million and an \$11.6 million increase in non-regulated revenues. This increase was offset by a \$4.7 million decrease in revenues related to unusually wet weather, mainly in states in the Midwest region of the United States. Total volume of water sold decreased 2.7% for the three months ended June 30, 2008, to 97.2 billion gallons, from 99.9 billion gallons for the same period in 2007. The volume decline resulted in an approximate \$12.6 million reduction in revenues and a (\$0.04) EPS impact.

Operating expenses increased 9.7% to \$446.7 million primarily related to customer service enhancement projects. Non-recurring general compensation associated with the IPO and employee expenses related to job classifications negatively impacted results by \$2.8 million, or (\$0.02) per share. Non-regulated Businesses' expenses increased \$16 million to correspond with their increased revenues.

AWK Shares Attractively Valued On a Relative P/E and Price-to-Book Value Basis

Valuation

At the current price, we consider AWK shares to be remarkably inexpensive relative to the other publicly-traded water utilities. AWK shares trade at 16.9X our 2009 EPS estimate of \$1.25 and 14.7X our 2010 EPS estimate, which compares to group multiples of 20.2X and 19.0X, respectively, and historical water utility multiples of 20-25X. On a price-to-book value basis, AWK shares trade at 141% of tangible book value (includes the write-off of all goodwill) versus group average multiples of 210%. We believe AWK shares warrant at least an industry-average multiple. Please see Valuation section for a detailed discussion of valuation.

We believe AWK shares warrant at least an industry average multiple. On the one hand, AWKs premier national franchise and associated growth opportunities justify a premium valuation. However, the RWE ownership and leveraged balance sheet warrant discounted multiples.

We believe the market and investment community have under-estimated the value of the growth-oriented water utility. Based on the published research reports, we believe the unique characteristics of American Water Works and the sector have been somewhat neglected. These unique characteristics include a greater certainty of rate base growth than typically achieved in the regulated electric and gas utility sector as well as greater opportunity for customer growth through consolidation and privatization opportunities.

While we believe price-to-earnings and price-to-book value ratios are helpful

measures in our valuation assessment, our \$25 price objective range is derived using a dividend discount model (DDM). We prefer the DDM for water utility valuation given the unique features of a water utility and their application to the model, including frequent setting of allowed ROE's, long-standing dividend policies and predictability of earnings streams. Importantly, a DDM places significant value on risk premium in determining present value.

Our \$25 Price Objective is Achieved Using a Dividend Discount Model

Our \$25 price objective range is achieved by applying a 3.0% risk premium to the 30-year treasury yield of 4.75%, a 12% near-term EPS growth rate and a 4.5% long-term growth rate.

| American Water Works | | | |
|----------------------------|-----------------|----------------|-----------------|
| Period | Annual Dividend | Discount Rate | PV of Dividends |
| 0 | \$0.80 | | |
| 1 | \$0.84 | 0.93 | \$0.78 |
| 2 | \$0.88 | 0.86 | \$0.76 |
| 3 | \$0.92 | 0.80 | \$0.73 |
| 4 | \$0.96 | 0.74 | \$0.71 |
| 5 | \$1.00 | 0.69 | \$0.69 |
| Sum of PV of Dividends | | | \$3.67 |
| 6 | \$1.04 | 0.90 | |
| ROR | 7.80% | LT Growth Rate | 4.5% |
| Terminal Value | | | \$21.38 |
| Present Value of the Stock | | | \$25.05 |
| Price Objective | | | \$25.00 |
| Current Share Price | | | \$21.09 |
| Discount | | | 18.54% |

Water utilities possess many characteristics of the traditional regulated electric or gas utility but are differentiated by unique features often neglected by those reluctant to look any further than relatively-high valuations. Water utilities warrant premium multiples to the electric and gas utility industries for two reasons: lower risk and stronger long-term growth potential.

Lower Risk Profile Than Electric and Gas Utilities

Low Risk. We believe water utilities warrant among the lower risk premiums of any sector in the market based on the following features:

- a monopoly service territory,
- high barriers to entry,

- no alternative product,
- price inelasticity,
- public and regulatory support for price increases,
- regulated rates of return and
- strong financial conditions.

Stronger long-term growth potential through rate base growth, consolidation and privatization opportunities.

Rate Base Growth Opportunity

Rate Base Growth. Cost of Service and/or Rate Base-Rate of Return regulation permits rate adjustments to give utilities the opportunity to earn a fair return on investment in infrastructure. The more cash a utility prudently invests in infrastructure or “plows back into the business”, the greater rate base and earnings grow. According to the EPA and various other organizations, water utilities must invest billions of dollars in water infrastructure to maintain quality service, rehabilitate existing systems, comply with ever-increasing quality standards and build new projects. In recent periods, water utility allowed returns on common equity (ROE's) have been set at reasonable ranges between 9-to-12%.

| American Water Works Estimated Rate Base | |
|------------------------------------------|------------------|
| State | Rate Base* |
| New Jersey-American | \$1,914.4 |
| Pennsylvania-American | 1,705.0 |
| Missouri-American | 738.0 |
| Illinois-American | 282.8 |
| Indiana-American | 492.4 |
| California-American | 300.0 |
| Other | 1,551.0 |
| | \$6,983.6 |

*Estimated as of 6/30/2008

Source: PUC filings & Jesup & Lamont estimates

Assuming a conservative 10% allowed ROE, we assume projected rate base EPS growth of 3-to-5%. The assumed 3-to-5% growth rate can be improved upon by increasing prudent infrastructure investment, which requires external capital raises, or by lowering the dividend payout ratio. We emphasize that the greater the multiple of book value that equity is issued, the lower the cost of capital and the greater the return on investment.

Electric and gas utilities also have the opportunity to grow EPS through investment in rate base and over the next decade or so electric utilities have substantial opportunity to grow through base load generation additions and transmission investments. However, we believe this growth is cyclical in that the industry goes through baseload boom-bust periods. Water and wastewater infrastructure investments appear to be needed for the foreseeable future. In addition, water utility rate increases normally do not face the controversy of an electric or gas utility rate increase primarily due to relatively low cost of water. For most consumers, water and wastewater bills make up a relatively small percentage of household expenditures compared to other utility services.

We expect rate base growth to continue for the foreseeable future given that capital expenditures are required, the regulatory environment is supportive and customer rates are relatively low and price inelastic.

Consolidation Enhances Growth Profile

(2) **Consolidation.** In addition to the 3-to-5% rate base growth, water utilities can enhance EPS growth via the consolidation of smaller systems. The water utility industry is the most fragmented of the utility industries with approximately 53,000 community water systems in the U.S. and nearly 45,000 systems serving customer bases of less than 3,300. AWK pursues the addition of customers through tuck-ins of small water and/or wastewater systems, typically serving fewer than 10,000 customers, in close geographic proximity to existing regulated operations. However, AWK will pursue large acquisition in both contiguous and non-contiguous service areas. Acquisitions are accretive as long as the purchase price is reasonable, cost cutting achievable, profitability enhanced and/or the share price, if trading at a multiple of book, is used as currency to fund the proposed purchase.

Privatization Opportunity

(3) **Privatization activity.** Water utilities can also grow revenues, customers and EPS without significant capital investment and regulatory oversight by partnering with the nation's "24,000 or so" municipal water and wastewater systems. Privatization activity can range anywhere from the "outright sale" of municipal assets to a private company to a contract for the outsourcing of a particular function, such as billing or meter reading. Public-private partnerships or contract arrangements generally consist of a private firm operating/managing all or part of a municipally-owned system under contract. The private company benefits from the opportunity to generate revenues and cash flow with minimal capital investment, while the municipality benefits from better quality service, technical expertise and potential lower costs. The municipality owns the system, sets the rates and makes the long-term capital investment decisions. There are currently several thousands of contracts of varying sizes and degrees between municipalities and private water operators. The great majority of these contracts are between smaller towns and municipalities where the politics of privatization are less challenging. We note that contracts with larger cities have generally proven difficult to negotiate and have often resulted in thin or negative profit margins for the private operator.

Intangible Value to Water Utilities

Intangible Value. We argue that water utilities possess an intangible and unquantifiable value related to existing infrastructure, water resources, and rights and expertise to the further development of infrastructure. We expect this intangible value to be realized over a period of decades through the regulatory framework, but could be realized quicker through a takeover and/or in the unlikely event of deregulation or development of a competitive water resource market.

We liken water supply and "water rights" in a theoretically-unregulated water environment to a nuclear power plant in today's competitive power markets. With tight supply-demand margins and limited base-load generation competition (variable costs well-below natural gas or coal and the extremely-long time frame of adding new nuclear plants), nuclear power plants have the potential to earn "excessive" profits for the foreseeable future. However, unlike a nuclear plant, water supply is finite and has absolutely no substitute. In addition, water consumption (demand) is a necessity for life. As a result, the price of water could theoretically become completely price-



inelastic, or in many ways, the ultimate commodity. In our opinion, the social and political ramifications of such a scenario are too great and will ensure water resources are always heavily regulated.

While the resource will never be competitively traded like oil, gold or diamonds, we believe certain elements of the water distribution value-add-chain are "competitive" assets and subject to market prices. These assets include: the technical expertise to treat and distribute water, managerial ability to construct and operate long-term water infrastructure projects and the "savoir-faire" to navigate a politically-charged water and wastewater environment.

**Takeover Multiples
Have Ranged Between
200-300% of Book
Value**

Accepting the real value of a water utility stock requires one to accept that the growth potential may not occur in the next one-to-five years. Value and growth potential lies not only in the existing hard assets in the ground but also in the "rights expertise" to maintain and grow infrastructure. We believe many larger companies have considered this value when acquiring water utilities over the last several years. The water utility sector has undergone considerable consolidation over the past decade-or-so as major players attempt to strategically position themselves to capitalize on the eventual consolidation and privatization of the industry. Takeover multiples have generally been in the 200-300% of book value and 20-30X EPS multiple ranges.

**Share Price Highly
Correlated With
Interest Rates**

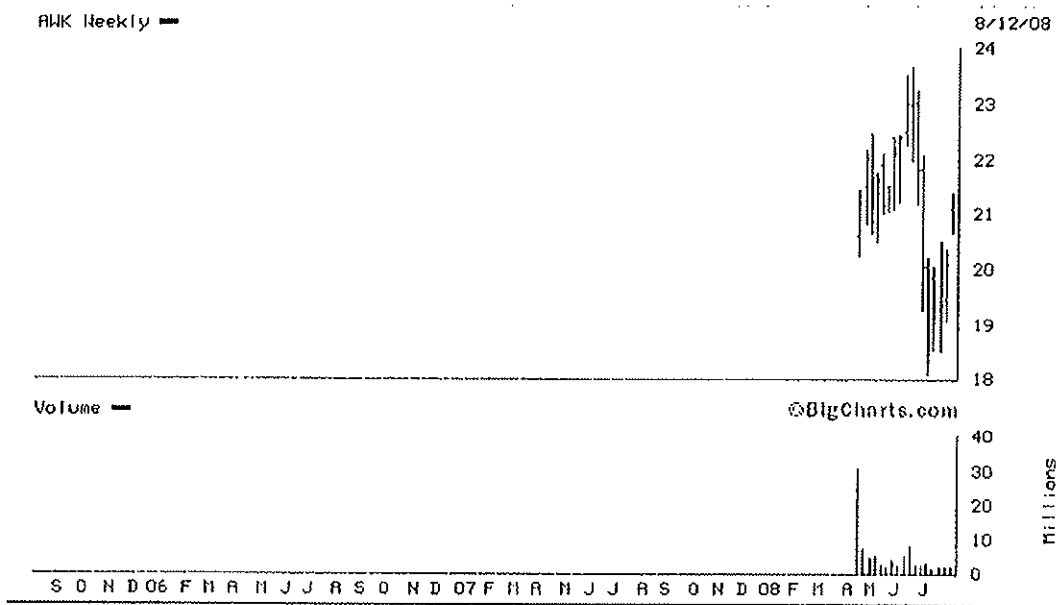
Water utility share prices are inversely correlated with interest rates due to the relatively stable nature of earnings, cash flow and dividend streams. Should interest rates rise, water utility share prices would likely come under pressure. However, we note that allowed returns on common equity are also highly correlated with interest rates and higher rates typically result in larger rate increases and higher authorized allowed returns on common equity.

American Water Works
 Financial Statements (2005-2010)
 (In \$ millions unless otherwise noted)

| Income Statement | 2005A | 2006A | 2007A | 2008E | 2009E | 2010E |
|------------------------------------------|-----------------|-----------------|-----------------|-----------------|---------------|---------------|
| Operating revenues | 2,137 | 2,093 | 2,214 | 2,270 | 2,326 | 2,384 |
| Rate increases | | | | 187 | 300 | 402 |
| Operating revenues | 2,137 | 2,093 | 2,214 | 2,457 | 2,626 | 2,786 |
| Operating expenses | | | | | | |
| Operation & maintenance | 1,201 | 1,175 | 1,249 | 1,324 | 1,390 | 1,459 |
| Depreciation & amortization | 261 | 259 | 267 | 283 | 300 | 318 |
| General taxes | 183 | 185 | 183 | 189 | 194 | 200 |
| Gain on sale of assets | (7) | 0 | (7) | | | |
| Impairment charge | 385 | 222 | 509 | 750 | | |
| Total operating expenses | 2,025 | 1,841 | 2,201 | 2,546 | 1,885 | 1,978 |
| Operating income | 112 | 253 | 13 | (89) | 742 | 808 |
| Operating income excl. impairment | 491 | 474 | 515 | 661 | 742 | 808 |
| Other income | | | | | | |
| Interest | 345 | 366 | 281 | 300 | 300 | 301 |
| New interest expense | | | | 26 | 50 | 74 |
| Other | (10) | (5) | (12) | 29 | 59 | 59 |
| Total other income | 336 | 361 | 269 | 354 | 409 | 434 |
| Income from continuing operations | 155 | 113 | 245 | 306 | 333 | 375 |
| Provision for income taxes | 51 | 47 | 86 | 122 | 133 | 150 |
| Tax rate | 0 | 0 | 0 | 0 | 0 | 0 |
| Net income | (275) | (156) | (343) | (566) | 200 | 225 |
| Net income, excluding impairment | 104 | 66 | 159 | 184 | 200 | 225 |
| Shares outstanding | 160 | 160 | 160 | 160 | 160 | 161 |
| EPS | (\$1.72) | (\$0.97) | (\$2.14) | (\$3.54) | \$1.25 | \$1.40 |
| EPS excluding non-recurring | \$0.65 | \$0.41 | \$0.99 | \$1.15 | \$1.25 | \$1.40 |
| Cash Flow Statement | 2005A | 2006A | 2007A | 2008E | 2009E | 2010E |
| Net income | (275) | (156) | (343) | (566) | 200 | 225 |
| Depreciation | 261 | 259 | 267 | 283 | 300 | 318 |
| Other | 539 | 220 | 549 | 850 | 75 | 75 |
| Operating cash flow | 525 | 324 | 474 | 567 | 575 | 618 |
| Capital expenditures | (558) | (689) | (759) | (800) | (800) | (800) |
| Other | 28 | 3 | 12 | | | |
| Investing cash flow | (530) | (691) | (747) | (800) | (800) | (800) |
| Debt issuance | | | | 425 | 400 | 400 |
| Common dividends | | | | (128) | (134) | (141) |
| Other | | | | | | |
| Financing cash flow | | | | 297 | 266 | 259 |
| Balance sheet | 2005A | 2006A | 2007A | 2008E | 2009E | 2010E |
| Common equity | 2,805 | 3,817 | 4,543 | 4,103 | 4,169 | 4,253 |
| Goodwill | 3,188 | 2,966 | 2,457 | 1,709 | 1,709 | 1,709 |
| Preferred equity | 1,779 | 1,779 | 29 | 29 | 29 | 29 |
| Short-term debt | 0 | 0 | 317 | 317 | 317 | 317 |
| Long-term debt | 5,030 | 4,104 | 4,675 | 5,100 | 5,500 | 5,900 |
| Total capitalization | 12,802 | 12,666 | 12,020 | 11,258 | 11,723 | 12,207 |



American Water Works (AWK) – 3 Year Price Chart



Price Target and Ratings Changes over the Past 3 Years:

| Date | Stock Price | Rating | Target Price | Initiation |
|-----------|-------------|--------|--------------|------------|
| 8/14/2008 | \$21.09 | Buy | \$25.00 | X |

Companies Mentioned in Report:

- American States Water (AWR)
- Aqua America (WTR)
- Artesian Water Resources (ARTNA)
- California Water Service Gp. (CWT)
- Connecticut Water Service (CTWS)
- Consolidated Water Co. (CWCO)
- Middlesex Water (MSEX)
- Pennichuck Water (PNNW)
- SJW Corp. (SJW)
- Southwest Water Company (SWWC)
- York Water (YORW)

Analyst Disclosure

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- 2) **Neutral** means the stock is expected to perform generally in line with the S&P 500 over the next 12-18 months; and
- 3) **Sell** means the stock is expected to under perform the S&P 500 over the next 12-18 months and should be sold.

Ratings distributions: Of the securities subject to research coverage by Jesup & Lamont, the percentage rated as "Buy" is 62%, the percentage rated as "Neutral" is 38%; and the percentage rated as "Sell" is 0%.

In the past 12 months, Jesup & Lamont has provided investment banking services to 0% of the companies we currently rate as "Buy", to 10% of the companies we currently rate as "Neutral"; and to 0% of the companies we currently rate as "Sell".

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COMPANY UPDATE
American Water Works Co., Inc. (AWK)

Neutral

Reducing 2008 estimates for weather hit in 2Q

What's changed

American Water reported 2Q EPS of \$0.28, below our forecast of \$0.41. The key difference with our forecast was lower revenue due to flooding and therefore lower water consumption in the Midwest during the quarter. O&M expenses generally came in line with our forecast reflecting the inflation we expected in items including employee/pension related expenses, chemicals, fuel, and purchased water costs. Rate cases appear to be coming in consistent with our expectations supporting the ROE recovery story. The company also announced 3 small tuck-in acquisitions, which although too small to impact the revenue line in a meaningful way, does demonstrate the company's commitment to this strategic initiative.

Implications

We have reduced our 2008 EPS estimate to \$1.13 from \$1.24 principally to reflect the shortfall in the second quarter. We maintain our 2009 EPS estimate of \$1.34 and modestly increase our 2010 EPS estimate to \$1.47 from \$1.45. We continue to believe that American Water is in the early stages of a significant turnaround. The company has an important opportunity to increase its rate base and returns through infrastructure investment and filing rate cases. Upside to our estimates could be driven by faster-than-expected price recovery through rates, incremental acquisitions, and lower O&M expenses than we have forecasted.

Valuation

We maintain our Neutral Rating and our \$24 price target, which is based on P/E multiples and our DDM. We use a P/E multiple of 20X our 2009 EPS estimate of \$1.34 less a 10% discount for share overhang. Our DDM assumes an 8.5% cost of equity and a 5% dividend growth rate.

Key risks

Key risks include adverse regulatory decisions and regulatory lag that limit ROE expansion, financing risk associated with funding the large capital investment program, and unfavorable weather conditions.

INVESTMENT LIST MEMBERSHIP

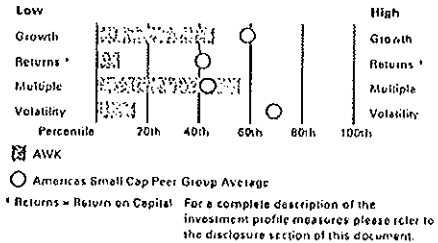
Neutral

Coverage View: Neutral

United States
 Water

Maria Karahalios, CFA
 (212) 902-6737 | maria.karahalios@gs.com Goldman, Sachs & Co
Gabriela Bis
 (212) 902-1513 | gabriela.bs@gs.com Goldman, Sachs & Co

Investment Profile: American Water Works Co., Inc.

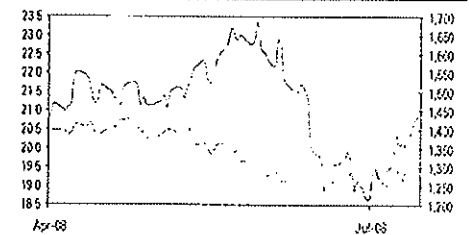


| Key data | Current |
|----------------------------|---------|
| Price (\$) | 20.87 |
| 12 month price target (\$) | 24.00 |
| Market cap (\$ mn) | 3,338.7 |

| | 12/07 | 12/08E | 12/09E | 12/10E |
|---------------------|---------|---------|---------|---------|
| Revenue (\$ mn) New | 2,214.2 | 2,395.4 | 2,639.3 | 2,828.3 |
| Revenue (\$ mn) Old | 2,214.2 | 2,410.2 | 2,631.5 | 2,820.1 |
| EPS (\$) New | 1.00 | 1.13 | 1.34 | 1.47 |
| EPS (\$) Old | 1.00 | 1.24 | 1.34 | 1.45 |
| P/E (X) | 21.0 | 18.5 | 15.5 | 14.2 |
| EV/EBITDA (X) | -- | 10.4 | 9.4 | 8.8 |
| ROE (%) | 3.8 | 4.1 | 5.2 | 5.6 |

| | 6/08 | 9/08E | 12/08E | 3/09E |
|----------|------|-------|--------|-------|
| EPS (\$) | 0.28 | 0.66 | 0.25 | 0.17 |

Price performance chart



| Share price performance (%) | 3 month | 6 month | 12 month |
|-----------------------------|---------|---------|----------|
| Absolute | (2.9) | -- | -- |
| Rel. to S&P 500 | 5.7 | -- | -- |

Source: Compustat, Goldman Sachs Research estimates, Reuters. Prices as of 12/20/07

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Details of our model changes

Exhibit 1 summarizes the key differences between our 2Q estimates and the results reported by American Water.

Exhibit 1: American Water 2Q2008 actuals versus expected \$ in millions, except per-share data

| | 2Q08A | 2Q08E | % Chg | 2Q07A | % Chg | 1Q08A | % Chg |
|--------------------------------|---------|---------|------------|---------|------------|---------|-------------|
| Operating Revenues | 589.4 | 609.2 | -3.3% | 558.7 | 5.5% | 506.8 | 16.3% |
| YY Growth | 5.5% | 9.0% | -355 bps | 2.7% | +280 bps | 8.2% | -268 bps |
| Operating and maintenance | (330.6) | (328.3) | 0.7% | (299.4) | 10.4% | (311.3) | 6.2% |
| Depreciation and amortization | (87.3) | (65.7) | 2.4% | (68.1) | -1.2% | (63.8) | 5.3% |
| General taxes | (49.6) | (48.7) | 1.8% | (45.9) | 8.0% | (52.1) | -4.7% |
| % of revenues | 8.4% | 8.0% | +42 bps | 8.2% | +20 bps | 10.3% | -185 bps |
| Gain/(loss) on sale of assets | 0.8 | 0.7 | 14.3% | 6.2 | -87.1% | 0.1 | 1042.9% |
| Operating Profit | 142.7 | 167.1 | -14.6% | 151.5 | -5.0% | 79.6 | 79.1% |
| Operating Margin | 24.2% | 27.4% | -323 bps | 27.1% | -291 bps | 15.7% | +849 bps |
| Interest, net | (71.5) | (72.3) | -1.2% | (71.9) | -0.6% | (71.3) | 0.3% |
| AFUDC | 5.1 | 5.4 | -5.3% | 1.9 | 164.9% | 3.9 | 30.8% |
| Other inc/exp | (0.6) | 1.5 | -139.9% | 1.2 | -151.9% | 1.1 | -152.1% |
| Pretax Income | 75.7 | 101.7 | -25.6% | 82.6 | -8.4% | 13.4 | 484.1% |
| Provision for Income Taxes | (30.2) | (36.6) | -17.6% | (32.6) | -7.6% | (7.4) | 306.4% |
| Tax Rate | 39.9% | 36.0% | +387 bps | 39.5% | +347 bps | 55.3% | -1,547 bps |
| Net Income, Continuing Ops | 45.5 | 65.1 | -30.1% | 50.0 | -9.0% | 6.0 | 659.4% |
| Shares Outstanding - Basic | 159.9 | 160.0 | 0.0% | 160.0 | 0.0% | 160.0 | 0.0% |
| Shares Outstanding - Diluted | 160.0 | 160.2 | -0.1% | 160.0 | 0.0% | 160.0 | 0.0% |
| EPS - Continuing Ops - Basic | 0.28 | 0.41 | -30.1% | 0.31 | -8.9% | 0.04 | 659.8% |
| EPS - Continuing Ops - Diluted | 0.28 | 0.41 | -30.0% | 0.31 | -9.0% | 0.04 | 668.6% |
| YY EPS Growth (diluted) | -9.0% | 30.1% | 3,902 bps | 32.7% | -4,161 bps | 146.6% | -15,561 bps |
| EBITDA | 210.0 | 232.9 | -9.8% | 219.6 | -4.4% | 143.6 | 46.3% |
| YY Growth | -4.4% | 6.0% | -1,043 bps | 1.4% | -578 bps | 4.1% | -847 bps |
| EBITDA Margin | 35.6% | 38.2% | -260 bps | 39.3% | -368 bps | 28.3% | +730 bps |
| MARGIN ANALYSIS: | | | | | | | |
| O&M as a % of Revenue | 56.1% | 53.9% | +220 bps | 53.6% | +251 bps | 61.4% | -533 bps |
| EBITDA | 35.6% | 38.2% | -260 bps | 39.3% | -368 bps | 28.3% | +730 bps |
| EBIT | 24.2% | 27.4% | -323 bps | 27.1% | -291 bps | 15.7% | +849 bps |
| Pretax | 12.8% | 16.7% | -385 bps | 14.8% | -185 bps | 2.6% | +1,019 bps |
| Net Income - Cont Ops | 7.7% | 10.7% | -296 bps | 8.9% | -123 bps | 1.2% | +654 bps |
| YOY GROWTH | | | | | | | |
| Revenue | 5.5% | 9.0% | -355 bps | 2.7% | +280 bps | 0.2% | -268 bps |
| EBIT | -5.8% | 10.3% | -1,615 bps | -0.5% | -532 bps | 8.6% | -1,446 bps |
| EBITDA | -4.4% | 6.0% | -1,043 bps | 1.4% | -578 bps | 4.1% | -847 bps |
| D&A | -1.2% | -3.5% | +231 bps | 5.9% | -708 bps | -1.1% | -12 bps |
| Pretax Income | -8.4% | 23.1% | -3,149 bps | 28.3% | -3,672 bps | 222.5% | -23,096 bps |
| Net Income - Cont Ops | -9.0% | 30.2% | -3,917 bps | 32.7% | -4,163 bps | 146.6% | -15,562 bps |
| EPS | -9.0% | 30.1% | -3,902 bps | 32.7% | -4,161 bps | 146.6% | -15,561 bps |

Source: Company filings, Goldman Sachs Research estimates.

Exhibits 2 and 3 summarize our expected full year and quarterly forecasts for the Company's income statement. Exhibit 4 provides a detailed breakout of our forecasts and assumptions for the regulated and non-regulated segments of the Company.

Exhibit 2: American Water annual income statement, 2006-2012E
\$ in millions, except per-share data

| INCOME STATEMENT | 2006A | 2007A | 2008E | 2009E | 2010E | 2011E | 2012E |
|---------------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Operating Revenues | 2,093.1 | 2,214.2 | 2,395.4 | 2,639.3 | 2,828.3 | 3,004.2 | 3,182.9 |
| Y/Y Growth | -2.0% | 5.8% | 8.2% | 10.2% | 7.2% | 6.2% | 5.9% |
| Operation and maintenance | (1,174.5) | (1,246.5) | (1,358.1) | (1,440.4) | (1,498.0) | (1,557.6) | (1,619.2) |
| Depreciation and amortization | (259.2) | (267.3) | (275.4) | (316.8) | (352.0) | (393.7) | (435.4) |
| General taxes | (185.1) | (183.3) | (205.0) | (211.1) | (226.3) | (240.3) | (254.6) |
| % of revenues | 8.8% | 8.3% | 8.6% | 8.0% | 8.0% | 8.0% | 8.0% |
| Gain (loss) on sale of assets | (0.1) | 7.3 | 2.3 | 0.0 | 0.0 | 0.0 | 0.0 |
| Operating Profit | 474.2 | 524.5 | 558.5 | 670.9 | 752.1 | 812.6 | 873.7 |
| Operating Margin | 22.7% | 23.7% | 23.3% | 25.4% | 26.6% | 27.0% | 27.4% |
| Interest, net | (371.0) | (288.0) | (288.9) | (311.0) | (335.3) | (353.8) | (367.5) |
| AFUDC | 8.6 | 11.2 | 19.8 | 20.0 | 20.0 | 20.0 | 20.0 |
| Other inc/exp | 0.9 | 6.2 | 3.6 | 6.0 | 6.0 | 6.0 | 6.0 |
| Pretax Income | 112.7 | 253.8 | 293.0 | 385.0 | 442.8 | 484.9 | 532.2 |
| Provision for Income Taxes | (51.1) | (94.5) | (111.0) | (154.4) | (177.1) | (193.9) | (212.9) |
| Tax Rate | 45.3% | 37.2% | 37.9% | 40.0% | 40.0% | 40.0% | 40.0% |
| Net Income - Continuing Ops | 61.7 | 159.3 | 182.0 | 231.6 | 265.7 | 290.9 | 319.3 |
| Preferred Dividend | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Non-recurring/Discontinued Ops | (6.4) | (0.6) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Extraordinary Items | (217.5) | (501.5) | (738.5) | 0.0 | 0.0 | 0.0 | 0.0 |
| Net Income - Reported | (162.2) | (342.8) | (556.5) | 231.6 | 265.7 | 290.9 | 319.3 |
| Shares Outstanding - Basic (Avg) | 160.0 | 160.0 | 160.8 | 171.9 | 180.2 | 186.9 | 192.8 |
| Shares Outstanding - Diluted (Avg) | 160.0 | 160.0 | 161.0 | 172.3 | 180.7 | 187.5 | 193.5 |
| Shares Outstanding - Basic (EOP) | 160.0 | 160.0 | 167.2 | 177.0 | 183.5 | 190.3 | 195.3 |
| Shares Outstanding - Diluted (EOP) | 160.0 | 160.0 | 167.5 | 177.4 | 184.0 | 190.9 | 196.0 |
| EPS - Continuing Ops - Basic | 0.39 | 1.00 | 1.13 | 1.35 | 1.47 | 1.56 | 1.66 |
| EPS - Continuing Ops - Diluted | 0.39 | 1.00 | 1.13 | 1.34 | 1.47 | 1.55 | 1.65 |
| Y/Y EPS Growth (diluted) | -40.1% | 158.4% | 13.5% | 18.9% | 9.4% | 5.6% | 6.1% |
| EPS - Net Income - Reported - Basic | -1.01 | -2.14 | -3.46 | 1.35 | 1.47 | 1.56 | 1.66 |
| EPS - Net Income - Reported - Diluted | -1.01 | -2.14 | -3.46 | 1.34 | 1.47 | 1.55 | 1.65 |
| EBITDA | 733.4 | 791.8 | 833.8 | 987.8 | 1,104.1 | 1,206.3 | 1,309.0 |
| Y/Y Growth | -3.3% | 8.0% | 5.3% | 18.4% | 11.8% | 9.3% | 8.5% |
| EBITDA Margin | 35.0% | 35.8% | 34.8% | 37.4% | 39.0% | 40.2% | 41.1% |
| MARGIN ANALYSIS: | | | | | | | |
| O&M as % of Revenue | 56.1% | 56.3% | 56.7% | 54.6% | 53.0% | 51.8% | 50.9% |
| EBITDA as % of Revenue | 35.0% | 35.8% | 34.8% | 37.4% | 39.0% | 40.2% | 41.1% |
| EBIT as % of Revenue | 22.7% | 23.7% | 23.3% | 25.4% | 26.6% | 27.0% | 27.4% |
| Pretax as % of Revenue | 5.4% | 11.5% | 12.2% | 14.6% | 15.7% | 16.1% | 16.7% |
| Net Income - Cont Ops as % of Revenue | 2.9% | 7.2% | 7.6% | 8.8% | 9.4% | 9.7% | 10.0% |
| Net Income - Reported as % of Revenue | -7.8% | -15.5% | -23.2% | 8.8% | 9.4% | 9.7% | 10.0% |
| YOY GROWTH | | | | | | | |
| Revenue | -2.0% | 5.8% | 8.2% | 10.2% | 7.2% | 6.2% | 5.9% |
| EBIT | -4.6% | 10.6% | 6.5% | 20.1% | 12.1% | 8.0% | 7.5% |
| EBITDA | -3.3% | 8.0% | 5.3% | 18.4% | 11.8% | 9.3% | 8.5% |
| D&A | -0.8% | 3.1% | 3.0% | 15.0% | 11.1% | 11.8% | 10.6% |
| Pretax Income | -30.1% | 125.1% | 15.4% | 31.7% | 14.7% | 9.5% | 9.8% |
| Net Income - Cont Ops | -40.1% | 158.4% | 14.3% | 27.2% | 14.7% | 9.5% | 9.8% |
| EPS | -40.1% | 158.4% | 13.5% | 18.9% | 9.4% | 5.6% | 6.4% |

Source: Company filings, Goldman Sachs Research estimates.

Exhibit 3: American Water quarterly income statement, 2007-2009E

\$ in millions, except per-share data

| INCOME STATEMENT | 1Q07A | 2Q07A | 3Q07A | 4Q07A | 1Q08A | 2Q08A | 3Q08E | 4Q08E | 1Q09E | 2Q09E | 3Q09E | 4Q09E |
|---------------------------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Operating Revenues | 460.5 | 558.7 | 633.1 | 553.8 | 506.8 | 589.4 | 690.3 | 608.9 | 573.1 | 659.8 | 747.3 | 650.1 |
| YY Growth | 1.1% | 2.7% | 6.8% | 12.4% | 8.2% | 5.5% | 9.0% | 10.0% | 13.1% | 11.9% | 8.3% | 8.2% |
| Operational and maintenance | (282.6) | (299.4) | (328.3) | (336.2) | (311.3) | (330.6) | (359.7) | (356.6) | (337.8) | (353.8) | (376.1) | (372.8) |
| Depreciation and amortization | (64.6) | (68.1) | (69.7) | (64.9) | (63.0) | (67.3) | (70.3) | (73.9) | (75.7) | (77.5) | (80.4) | (83.2) |
| General taxes | (47.9) | (45.9) | (47.1) | (42.3) | (52.1) | (49.6) | (55.2) | (48.7) | (45.8) | (52.8) | (59.8) | (52.7) |
| % of revenues | 10.2% | 8.2% | 7.4% | 7.6% | 10.3% | 8.4% | 8.0% | 8.0% | 8.0% | 8.0% | 8.0% | 8.0% |
| Gain (loss) on sale of assets | (0.1) | 6.2 | 0.7 | 0.5 | 0.1 | 0.8 | 0.7 | 0.7 | 0.0 | 0.0 | 0.0 | 0.0 |
| Operating Profit | 73.3 | 151.5 | 188.7 | 110.9 | 79.6 | 142.7 | 205.8 | 130.5 | 113.8 | 175.7 | 231.1 | 150.4 |
| Operating Margin | 15.6% | 27.1% | 29.8% | 20.0% | 15.7% | 24.2% | 29.6% | 21.4% | 19.9% | 26.6% | 30.9% | 22.8% |
| Interest, net | (73.4) | (71.9) | (70.0) | (72.7) | (71.3) | (71.5) | (72.6) | (73.5) | (73.7) | (76.5) | (79.9) | (80.9) |
| AFUDC | 2.8 | 1.9 | 2.9 | 3.7 | 3.9 | 5.1 | 5.4 | 5.4 | 5.0 | 5.0 | 5.0 | 5.0 |
| Other inc/exp | 1.5 | 1.7 | 1.3 | 2.2 | 1.1 | (0.6) | 1.6 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| Pretax Income | 4.2 | 62.6 | 122.9 | 44.1 | 13.4 | 75.7 | 140.1 | 63.8 | 46.6 | 105.7 | 157.7 | 70.0 |
| Provision for Income Taxes | (1.7) | (32.6) | (43.5) | (16.7) | (7.4) | (30.2) | (50.4) | (23.0) | (18.6) | (42.3) | (63.1) | (30.4) |
| Tax Rate | 41.6% | 39.5% | 35.3% | 37.9% | 55.3% | 39.8% | 36.0% | 36.0% | 40.0% | 40.0% | 40.0% | 40.0% |
| Net Income, Continuing Ops | 2.4 | 50.0 | 79.5 | 27.4 | 8.0 | 45.5 | 89.6 | 40.6 | 28.0 | 63.4 | 94.6 | 45.6 |
| Preferred Dividend | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Non-recurring/Discontinued Ops | 0.3 | (0.6) | (0.3) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Extraordinary Items | 0.0 | 0.0 | (239.6) | (261.9) | (738.5) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net Income - Reported | 2.7 | 49.4 | (160.4) | (234.5) | (732.5) | 45.5 | 89.6 | 40.6 | 28.0 | 63.4 | 94.6 | 45.6 |
| Shares Outstanding - Basic (Avg) | 160.0 | 160.0 | 160.0 | 160.0 | 160.0 | 159.9 | 159.9 | 163.5 | 168.6 | 170.7 | 172.8 | 175.6 |
| Shares Outstanding - Diluted (Avg) | 160.0 | 160.0 | 160.0 | 160.0 | 160.0 | 160.0 | 160.1 | 163.9 | 168.9 | 171.1 | 173.2 | 176.0 |
| Shares Outstanding - Basic (EOP) | 160.0 | 160.0 | 160.0 | 160.0 | 160.0 | 159.9 | 159.9 | 167.1 | 169.9 | 171.4 | 174.2 | 177.0 |
| Shares Outstanding - Diluted (EOP) | 160.0 | 160.0 | 160.0 | 160.0 | 160.0 | 159.9 | 160.3 | 167.5 | 170.3 | 171.8 | 174.6 | 177.5 |
| EPS - Continuing Ops - Basic | 0.02 | 0.31 | 0.50 | 0.17 | 0.04 | 0.28 | 0.56 | 0.25 | 0.17 | 0.37 | 0.55 | 0.26 |
| EPS - Continuing Ops - Diluted | 0.02 | 0.31 | 0.50 | 0.17 | 0.04 | 0.28 | 0.56 | 0.25 | 0.17 | 0.37 | 0.55 | 0.26 |
| YY EPS Growth (diluted) | -125.6% | 32.7% | 84.8% | 0.0% | 146.6% | -9.0% | 12.7% | -15.6% | 342.0% | 30.3% | -2.5% | 3.9% |
| EPS - Net Income - Reported - Basic | 0.02 | 0.31 | -1.00 | -1.47 | -4.58 | 0.28 | 0.56 | 0.25 | 0.17 | 0.37 | 0.55 | 0.26 |
| EPS - Net Income - Reported - Diluted | 0.02 | 0.31 | -1.00 | -1.47 | -4.58 | 0.28 | 0.56 | 0.25 | 0.17 | 0.37 | 0.55 | 0.26 |
| EBITDA | 137.9 | 219.6 | 258.4 | 175.8 | 143.6 | 210.0 | 276.1 | 204.4 | 189.5 | 253.2 | 311.5 | 233.6 |
| YY Growth | 1.4% | 1.4% | 7.2% | 25.8% | -4.1% | -4.4% | 6.8% | 16.2% | 32.0% | 20.6% | 12.8% | 14.3% |
| EBITDA Margin | 29.4% | 39.3% | 40.8% | 31.7% | 28.3% | 35.6% | 40.0% | 33.6% | 33.1% | 38.4% | 41.7% | 35.4% |
| MARGIN ANALYSIS: | | | | | | | | | | | | |
| O&M as a % of Revenue | 60.3% | 53.6% | 51.9% | 60.7% | 61.4% | 56.1% | 52.1% | 58.6% | 58.9% | 53.6% | 50.3% | 56.8% |
| EBITDA as % of Revenue | 29.4% | 39.3% | 40.8% | 31.7% | 28.3% | 35.6% | 40.0% | 33.6% | 33.1% | 38.4% | 41.7% | 35.4% |
| EBIT as % of Revenue | 15.8% | 27.1% | 29.8% | 20.0% | 15.7% | 24.2% | 29.8% | 21.4% | 19.9% | 26.6% | 30.9% | 22.8% |
| Pretax as % of Revenue | 0.9% | 14.8% | 19.4% | 8.0% | 2.6% | 12.8% | 20.3% | 10.5% | 8.1% | 18.0% | 21.1% | 11.5% |
| Net Income - Cont Ops as % of Revenue | 0.5% | 8.9% | 12.6% | 4.9% | 1.2% | 7.7% | 13.0% | 6.7% | 4.9% | 9.6% | 12.7% | 6.9% |
| Net Income - Reported as % of Revenue | 0.6% | 8.8% | -25.3% | -42.3% | -144.5% | 7.7% | 13.0% | 6.7% | 4.9% | 9.6% | 12.7% | 6.9% |
| YOY GROWTH | | | | | | | | | | | | |
| Revenue | 1.1% | 2.7% | 6.8% | 12.4% | 8.2% | 5.5% | 9.0% | 10.0% | 13.1% | 11.9% | 8.3% | 8.2% |
| EBIT | 2.3% | -0.5% | 7.1% | 49.9% | 8.6% | -5.8% | 9.0% | 17.6% | 42.8% | 23.2% | 12.3% | 15.3% |
| EBITDA | 1.4% | 1.4% | 7.2% | 25.8% | -4.1% | -4.4% | 6.8% | 16.2% | 32.0% | 20.6% | 12.8% | 14.3% |
| O&A | 0.4% | 5.9% | 7.7% | -1.3% | -1.1% | -1.2% | 0.9% | 13.9% | 18.4% | 15.2% | 14.4% | 12.6% |
| Pretax Income | -125.7% | 28.3% | 86.6% | -575.8% | 222.5% | -8.4% | 13.9% | 44.8% | 247.3% | 39.6% | 12.6% | 19.1% |
| Net Income - Cont Ops | -125.6% | 32.7% | 84.8% | -386.4% | 146.6% | -9.0% | 12.8% | 49.2% | 366.6% | 39.3% | 5.5% | 11.6% |
| EPS | -125.6% | 32.7% | 84.8% | -386.4% | 146.6% | -9.0% | 12.7% | 45.6% | 342.0% | 30.3% | -2.5% | 3.9% |

Source: Company filings. Goldman Sachs Research estimates.

Exhibit 4: American Water segment summary, 2006-2012E

\$ in millions

| REGULATED SEGMENT | 2006A | 2007A | 2008E | 2009E | 2010E | 2011E | 2012E |
|---------------------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Prior Year Revenues | 1,836.1 | 1,854.6 | 1,987.6 | 2,135.4 | 2,362.8 | 2,537.6 | 2,698.4 |
| Core growth/new customers | (36.7) | 27.8 | (16.8) | 19.1 | 1.1 | (0.3) | (0.3) |
| Acquisitions | 29.2 | 29.5 | 30.5 | 34.2 | 37.8 | 40.6 | 43.2 |
| DSIC | 13.7 | 16.2 | 9.5 | 16.0 | 17.7 | 19.0 | 20.2 |
| Rate case adjustments | 12.4 | 59.4 | 124.7 | 158.2 | 116.1 | 101.5 | 99.8 |
| Total Regulated Revenue | 1,854.6 | 1,987.6 | 2,135.4 | 2,362.8 | 2,637.6 | 2,698.4 | 2,861.3 |
| Operation & Maintenance expenses | (1,144.1) | (1,235.8) | (1,331.7) | (1,384.9) | (1,433.4) | (1,483.6) | (1,535.5) |
| Depreciation & Amortization | (243.3) | (255.0) | (260.3) | (299.7) | (336.3) | (376.1) | (415.9) |
| EBIT | 467.2 | 496.8 | 543.5 | 678.3 | 767.9 | 838.7 | 909.9 |
| Revenue Drivers (% of prior year revenues) | | | | | | | |
| Core growth/new customers | -2.0% | 1.5% | -0.8% | 0.9% | 0.0% | 0.0% | 0.0% |
| Acquisitions | 1.6% | 1.6% | 1.5% | 1.6% | 1.6% | 1.6% | 1.6% |
| DSIC | 0.7% | 0.9% | 0.5% | 0.8% | 0.8% | 0.8% | 0.8% |
| Rate case adjustments | 0.7% | 3.2% | 6.3% | 7.4% | 5.0% | 4.0% | 3.7% |
| Total yoy increase | 1.0% | 7.2% | 7.4% | 10.6% | 7.4% | 6.3% | 6.0% |
| Cost Drivers | | | | | | | |
| O&M expenses (yoy increase) | 1.5% | 8.0% | 7.8% | 4.0% | 3.5% | 3.5% | 3.5% |
| NON-REGULATED SEGMENT | 2006A | 2007A | 2008E | 2009E | 2010E | 2011E | 2012E |
| Total Non-regulated Revenue | 248.6 | 242.7 | 272.8 | 266.6 | 300.8 | 316.8 | 331.8 |
| Operation & Maintenance expenses | (239.9) | (215.3) | (250.4) | (260.4) | (269.6) | (279.0) | (286.8) |
| Depreciation & Amortization | (14.0) | (10.3) | (7.3) | (8.8) | (9.8) | (11.0) | (12.2) |
| EBIT | (5.3) | 17.1 | 15.1 | 17.3 | 21.4 | 25.6 | 30.7 |
| Revenue Drivers | | | | | | | |
| Core growth (yoy increase) | -20.0% | -2.4% | 12.4% | 5.0% | 5.0% | 5.0% | 5.0% |
| Cost Drivers | | | | | | | |
| O&M expenses (yoy increase) | -21.1% | -10.2% | 16.3% | 4.0% | 3.5% | 3.5% | 3.5% |

Source: Company filings, Goldman Sachs Research estimates.

Rate case summary:

Exhibit 5 outlines American Water's rate case requests from 2006 to the present. We have assumed that American Water receives approximately 50% of the amount requested for each pending rate case. For cases that have already been concluded, the percentage has been higher at closer to 62%, but we believe it is prudent to assume a lower rate for the next round of rate cases, as this is the second round of meaningful increases following large increases only a year or two ago.

Exhibit 5: American Water rate case requests from 2006 to present
 \$ in millions

| State | Date Filed | Amount Filed | Amount Granted | % | Expected Grant Date | Status |
|-----------------------------------------|------------|--------------|----------------|--------|---------------------|-----------|
| General Rate Cases Filed in 2006 | | | | | | |
| Texas | 10/16/06 | \$0.8 | \$0.7 | 87.5% | 1/1/07 | Completed |
| Ohio | 3/1/06 | 5.1 | 3.4 | 66.7% | 3/1/07 | Completed |
| New Jersey | 3/31/06 | 99.0 | 56.2 | 56.8% | 4/1/07 | Completed |
| New Mexico | 5/30/06 | 1.3 | 1.3 | 100.0% | 5/1/07 | Completed |
| Tennessee | 11/22/06 | 6.4 | 4.1 | 64.1% | 5/23/07 | Completed |
| Missouri | 12/15/06 | 41.5 | 21.4 | 51.6% | 11/1/07 | Completed |
| Indiana | 12/5/06 | 24.7 | 14.0 | 56.7% | 12/1/07 | Completed |
| Arizona (Sun City) - wastewater | 7/28/06 | 3.9 | 2.4 | 61.5% | 4/1/08 | Completed |
| Arizona (Anthem) | 6/16/06 | 7.0 | 4.3 | 61.4% | 7/1/08 | Completed |

| | | | |
|-----------------------------|----------------|----------------|--------------|
| Total Granted (2006) | \$189.7 | \$107.8 | 56.8% |
| Total Pending (2006) | \$0.0 | \$0.0 | |

| State | Date Filed | Amount Filed | Amount Granted | % | Expected Grant Date | Status |
|-----------------------------------------|------------|--------------|----------------|--------|---------------------|-----------|
| General Rate Cases Filed in 2007 | | | | | | |
| Michigan | 1/8/07 | \$0.2 | \$0.2 | 100.0% | 1/8/07 | Completed |
| Maryland | 3/29/07 | 0.6 | 0.6 | 100.0% | 10/1/07 | Completed |
| Pennsylvania | 4/27/07 | 59.2 | 36.0 | 60.8% | 11/30/07 | Completed |
| Kentucky | 4/30/07 | 13.2 | 8.0 | 60.6% | 12/1/07 | Completed |
| California * | 1/1/07 | 16.4 | 13.0 | 79.3% | 1/1/08 | Completed |
| Iowa | 8/30/07 | 6.1 | 4.3 | 70.5% | 2/1/08 | Completed |
| Long Island ** | 6/1/07 | 9.6 | 6.6 | 68.8% | 4/1/08 | Completed |
| West Virginia | 6/1/07 | 24.1 | 14.5 | 60.2% | 4/1/08 | Completed |
| Arizona (Sun City) - water | 4/30/07 | 2.2 | 1.9 | 86.4% | 6/1/08 | Completed |
| Illinois | 8/31/07 | 32.8 | 24.9 | 75.9% | 8/8/08 | Completed |
| Ohio | 10/1/07 | 6.5 | 2.8 | 50.0% | 10/1/08 | Pending |
| Hawaii | 11/1/07 | 1.3 | 0.7 | 50.0% | 11/1/08 | Pending |

* California rate increase includes step increase of \$2.0m effective in 2009 and \$2.5m effective in 2010

** Long Island rate increase includes step increase of \$1.0m effective in 2009 and \$1.0m effective in 2010

| | | | |
|-----------------------------|----------------|----------------|--------------|
| Total Granted (2007) | \$164.4 | \$110.0 | 66.9% |
| Total Pending (2007) | \$6.8 | \$3.4 | 50.0% |

| State | Date Filed | Amount Filed | Amount Granted | % | Expected Grant Date | Status |
|-----------------------------------------|------------|--------------|----------------|--------|---------------------|-----------|
| General Rate Cases Filed in 2008 | | | | | | |
| Michigan | 1/1/08 | \$0.2 | \$0.2 | 100.0% | 1/1/08 | Completed |
| Tennessee | 3/14/08 | 7.8 | 3.8 | 50.0% | 10/1/08 | Pending |
| Virginia | 1/30/08 | 4.3 | 2.2 | 50.0% | 1/1/09 | Pending |
| New Jersey | 1/14/08 | 125.0 | 62.5 | 50.0% | 1/1/09 | Pending |
| California | 1/30/08 | 44.4 | 22.2 | 50.0% | 1/1/09 | Pending |
| Missouri | 3/31/08 | 49.8 | 24.9 | 50.0% | 1/1/09 | Pending |
| Pennsylvania | 4/28/08 | 2.7 | 1.4 | 50.0% | 1/1/09 | Pending |
| Arizona | 5/1/08 | 20.0 | 10.0 | 50.0% | 5/1/09 | Pending |
| West Virginia | 6/30/08 | 14.8 | 7.4 | 50.0% | 6/30/09 | Pending |
| New Mexico | 7/1/08 | 2.2 | 1.1 | 50.0% | 7/1/08 | Pending |

| | | | |
|-----------------------------|----------------|----------------|---------------|
| Total Granted (2008) | \$0.2 | \$0.2 | 100.0% |
| Total Pending (2008) | \$270.8 | \$135.4 | 50.0% |

| | | | |
|---------------------------------------|----------------|----------------|--------------|
| Total Granted (2006 - present) | \$354.3 | \$218.0 | 61.5% |
| Total Pending (2006 - present) | \$277.6 | \$138.8 | 50.0% |

Source: Company filings, various State Public Utility Commission news releases, Goldman Sachs Research estimates.

Reg AC

I, Maria Karahalidis, CFA, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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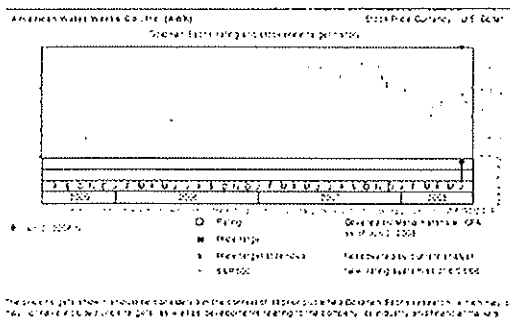
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Definitions

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Pennsylvania-American Water Company
 Coatesville Wastewater Operations
 Data Requirements of the Pennsylvania Public Utility Commission

FR VII.23

**Pennsylvania-American Water Company
 Coatesville Wastewater Operations**

VII. Rate of Return

23. If applicable, please supply a listing of all common equity infusions from the parent to the Company over the past five years. In each case, identify date and dollar amount.

Answer:

| YEAR | AMOUNT (000) | DATE |
|------|--------------------|--------------|
| 2009 | \$35,900; \$17,800 | 10/09; 12/09 |
| 2008 | \$33,000 | 12/08 |
| 2007 | \$32,500 | 12/07 |
| 2006 | \$30,000 | 12/06 |
| 2005 | \$30,000 | 12/05 |

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.24

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

24. If applicable, please identify the Company's common dividend payments to its parent for each of the last five years.

Answer:

| YEAR | AMOUNT (000) |
|------|--------------|
| 2009 | \$55,331 |
| 2008 | \$54,667 |
| 2007 | \$48,215 |
| 2006 | \$42,701 |
| 2005 | \$51,343 |

Pennsylvania-American Water Company
Coatesville Wastewater Operations

Data Requirements of the Pennsylvania Public Utility Commission

FR VII.25

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

25. Provide the latest year-by-year financial projections for the Company for the next five years. Also, please indicate the date these projections were prepared; whether approved by management; and whether the projections have been submitted to bond rating agencies. The information will be treated in a confidential manner, if requested by the Company in writing, as wet forth in 52 PA Code § 5.423.

Answer:

These total Company's projections were approved by management in 2009.

| DESCRIPTION | 2010 | 2011 | 2012 |
|-------------------------------|------------|------------|------------|
| Revenues | \$ 503,353 | \$ 517,488 | \$ 560,615 |
| Operating Expenses | 224,596 | 245,128 | 256,695 |
| Depreciation and Amortization | 59,087 | 60,280 | 67,004 |
| Taxes Other Than Income | 13,926 | 13,256 | 13,431 |
| Income Taxes | 58,070 | 54,438 | 60,773 |
| Utility Operating Income | 147,674 | 144,386 | 162,712 |
| Income Deductions | 60,077 | 62,806 | 71,629 |
| Net Income to Common | \$ 87,597 | \$ 81,580 | \$ 91,083 |

* The Company is currently in the process of updating the projections for 2011 – 2012 through its normal annual budgeting process.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.26

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

26. Please provide the Company's five-year construction budget.

Answer: The total Company's construction budget net of customer contributions and advances.

| | |
|------|---------------|
| 2010 | \$192,445,000 |
| 2011 | \$251,952,000 |
| 2012 | \$220,373,000 |
| 2013 | \$207,473,000 |
| 2014 | \$217,734,000 |

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.27

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

27. Please identify the Company's and, if applicable, its parent's capital structure targets (percentages of capital types). Provide the complete basis for the capital structure targets.

Answer: Pennsylvania-American strives to maintain a common equity ratio in the range of 45% - 50% of its total permanent capital structure. This target is based upon the desire to maintain a capital structure which facilitates access to capital markets at favorable rates.

The parent's capital structure targets are not applicable to the Company.

Pennsylvania-American Water Company
 Coatesville Wastewater Operations
 Data Requirements of the Pennsylvania Public Utility Commission

FR VII.28

**Pennsylvania-American Water Company
 Coatesville Wastewater Operations**

VII. Rate of Return

28. For each month, of the most recent 24 months, please supply the Company's
- a. Short-term debt balance;
 - b. Short-term debt interest rate;
 - c. Balance of construction work in progress; and
 - d. Balance of construction work in progress which is eligible for AFUDC accrual.

Answer:

Short Term Debt Balance

| | Balance 2009 | Interest Rate | Balance 2008 | Interest Rate |
|-----|-----------------|------------------|-----------------|------------------|
| Jan | 83,813,458 | .871% | 71,989,437 | 4.12% |
| Feb | 133,528,640 | .915% | 75,072,933 | 5.16% |
| Mar | 150,350,299 | 1.026% | 96,932,008 | 3.48% |
| Apr | 123,771,011 | .966% | 87,461,992 | 3.22% |
| May | 80,775,210 | .864% | 9,011,110 | 3.28% |
| Jun | 90,969,594 | .802% | 26,236,738 | 3.04% |
| Jul | 85,152,292 | .672% | 23,693,034 | 2.96% |
| Aug | 79,435,181 | .534% | 22,808,846 | 2.96% |
| Sep | 97,127,763 | .463% | 45,771,510 | 3.27% |
| Oct | 60,967,614 | .392% | 45,329,935 | 4.08% |
| Nov | 63,186,606 | .343% | 55,571,275 | 3.33% |
| Dec | 7,496,277 | .359% | 84,577,892 | 2.80% |

**Construction Work in Progress Total
Water & Sewer**

| | Balance 2009 | Balance 2008 |
|-----|-----------------|-----------------|
| Jan | 40,678,519 | 33,759,218 |
| Feb | 42,490,828 | 32,298,294 |
| Mar | 48,358,967 | 33,683,567 |
| Apr | 56,870,770 | 36,158,036 |
| May | 60,776,020 | 43,573,162 |
| Jun | 34,624,956 | 49,294,336 |
| Jul | 39,875,059 | 56,198,425 |
| Aug | 37,622,458 | 50,370,024 |
| Sep | 37,302,271 | 56,269,066 |
| Oct | 41,822,405 | 55,567,588 |
| Nov | 36,042,642 | 60,736,988 |
| Dec | 36,915,108 | 36,081,696 |

**Construction Work in Progress Eligible for AFUDC Accrual
Water & Sewer**

| | Balance 2009 | Balance 2008 |
|-----|-----------------|-----------------|
| Jan | 28,114,137 | 13,628,263 |
| Feb | 29,357,873 | 12,844,167 |
| Mar | 34,899,261 | 13,488,944 |
| Apr | 41,401,394 | 14,763,943 |
| May | 46,892,047 | 14,900,885 |
| Jun | 51,570,198 | 16,272,110 |
| Jul | 22,301,856 | 18,695,359 |
| Aug | 25,150,829 | 20,991,798 |
| Sep | 24,807,047 | 18,321,715 |
| Oct | 19,739,753 | 20,900,661 |
| Nov | 23,380,416 | 24,681,620 |
| Dec | 20,051,909 | 26,472,424 |

Pennsylvania-American Water Company
 Coatesville Wastewater Operations
 Data Requirements of the Pennsylvania Public Utility Commission

FR VII.29

**Pennsylvania-American Water Company
 Coatesville Wastewater Operations**

VII. Rate of Return

29. Fully identify all debt, other than instruments traded in public markets, owed to all shareholders, corporate officers, or members of the board of directors, its affiliates, parent company, or subsidiaries.

Answer:**Inside Dept at December 31, 2009****Short-Term Debt Inside**

| Description | Rate | Principal | Affiliate |
|-------------------------------------|----------|---------------------|-----------|
| Short-Term Notes Payable - AWCC* | Variable | \$ 7,496,277 | AWCC |
| Total Inside Short-term Debt | | \$ 7,496,277 | |

Long-Term Debt Inside

| Description | Rate | Principal | Issued | Maturity | Affiliate |
|------------------------------------|------|-----------------------|-----------|------------|-----------|
| 6.87% 10 Year LTD Series | 6.87 | \$ 6,800,000 | 3/29/2001 | 3/29/2011 | AWCC |
| 5.52% 9 Year LTD Series | 5.52 | 13,800,000 | 1/31/2007 | 12/21/2016 | AWCC |
| 6.25% 10 Year LTD Series | 6.25 | 81,000,000 | 5/15/2008 | 5/15/2018 | AWCC |
| 6.00% 9 Year LTD Series | 6.00 | 18,250,000 | 5/21/2009 | 9/1/2018 | AWCC |
| 6.10% 10 Year LTD Series | 6.10 | 17,950,000 | 5/21/2009 | 3/15/2019 | AWCC |
| 6.75% 22 Year LTD Series | 6.75 | 16,700,000 | 5/21/2009 | 7/1/2031 | AWCC |
| 5.62% 11 Year LTD Series | 5.62 | 65,900,000 | 1/31/2007 | 12/21/2018 | AWCC |
| 5.77% 14 Year LTD Series | 5.77 | 100,300,000 | 1/31/2007 | 12/21/2021 | AWCC |
| 5.77% 15 Year LTD Series | 5.77 | 80,000,000 | 3/29/2007 | 3/29/2022 | AWCC |
| Total Inside Long Term Debt | | \$ 400,700,000 | | | |

Reconciliation

| General Ledger Balances | Account | Balance |
|-----------------------------|---------|--------------------|
| Notes Payable Inside - AW46 | 231200 | \$ 7,496,277 |
| Current Portion LTD - AW46 | 232200 | 3,400,000 |
| Bonds Inside - AW46 | 221120 | 397,300,000 |
| Total G/L | | 408,196,277 |

Pennsylvania-American Water Company
 Coatesville Wastewater Operations
 Data Requirements of the Pennsylvania Public Utility Commission

FR VII.30

**Pennsylvania-American Water Company
 Coatesville Wastewater Operations**

VII. Rate of Return

30. Provide a summary statement of all stock dividends, splits, or par value changes during the two (2) year calendar period preceding the rate case filing.

Answer:

Stock Dividends for American Water Works Company, Inc.:

| Fiscal year ended December 31, 2008 | Year | 1Q | 2Q | 3Q | 4Q | Total |
|--------------------------------------------|-------------|-----------|-----------|-----------|-----------|--------------|
| Dividends paid per common share | --- | \$0.00 | \$0.00 | \$0.20 | \$0.20 | \$0.40 |
| Dividends declared per common share | --- | \$0.00 | \$0.00 | \$0.20 | \$0.20 | \$0.40 |

Fiscal Year ended in December 31, 2009

| | | | | | | |
|-------------------------------------|-----|--------|--------|--------|--------|--------|
| Dividends paid per common share | --- | \$0.20 | \$0.20 | \$0.21 | \$0.21 | \$0.82 |
| Dividends declared per common share | --- | \$0.20 | \$0.20 | \$0.21 | \$0.21 | \$0.82 |

Splits or Par Value Changes – There were no stock splits or par value changes during the period of time requested.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.31

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

31. If a claim of the filing utility is based on utilization of the capital structure or capital costs of the parent company and consolidated system, the reasons for this claim must be fully stated and supported.

Answer: Not applicable.

Pennsylvania-American Water Company
Coatesville Wastewater Operations
Data Requirements of the Pennsylvania Public Utility Commission

FR VII.32

**Pennsylvania-American Water Company
Coatesville Wastewater Operations**

VII. Rate of Return

32. To the extent not provided elsewhere, supply financial data of the Company and parent, if applicable, for the last five (5) years.
- a. Times interest earned ratio--pre and post tax basis.
 - b. Preferred stock dividend coverage ratio--post tax basis.
 - c. Times fixed charges earned ratio--pre tax basis.
 - d. Dividend payout ratio.
 - e. AFUDC as a percent of earnings available for common equity.
 - f. Construction work in progress as a percent of net utility plant.
 - g. Effective income tax rate.
 - h. Internal cash generations as a percent of total capital requirements.

Answer: Please refer to Exhibit No. 9-A.