

American Water Works Company, Inc.

Form 10-Q

May 07, 2013

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2013

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file: number 001-34028

**AMERICAN WATER WORKS COMPANY, INC.**

(Exact name of registrant as specified in its charter)

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|   |  |
|---|--|
| <b>Delaware</b><br>(State or other jurisdiction of<br>incorporation or organization)  | <b>51-0063696</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>1025 Laurel Oak Road, Voorhees, NJ</b><br>(Address of principal executive offices) | <b>08043</b><br>(Zip Code)                                   |
| <b>(856) 346-8200</b><br>(Registrant's telephone number, including area code)         |  |

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer   
Non-accelerated filer

Accelerated filer   
Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class                                    | Outstanding at May 2, 2013 |
|--|----------------------------|
| Common Stock, \$0.01 par value per share | 177,700,586 shares         |

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**AMERICAN WATER WORKS COMPANY, INC.**

**REPORT ON FORM 10-Q**

**FOR THE QUARTER ENDED MARCH 31, 2013**

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS****American Water Works Company, Inc. and Subsidiary Companies****Consolidated Balance Sheets (Unaudited)****(In thousands, except per share data)**

|   | <b>March 31,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|---|---------------------------|------------------------------|
| <b>ASSETS</b>   |                           |                              |
| Property, plant and equipment   |                           |                              |
| Utility plant at original cost, net of accumulated depreciation of \$3,717,562 at March 31 and \$3,657,221 at December 31 | \$ 11,641,442             | \$ 11,584,944                |
| Nonutility property, net of accumulated depreciation of \$207,858 at March 31 and \$199,467 at December 31                | 151,493                   | 154,420                      |
| <b>Total property, plant and equipment</b>  | <b>11,792,935</b>         | <b>11,739,364</b>            |
| Current assets  |                           |                              |
| Cash and cash equivalents   | 21,181                    | 24,433                       |
| Restricted funds  | 31,623                    | 29,756                       |
| Accounts receivable   | 208,276                   | 221,655                      |
| Allowance for uncollectible accounts  | (25,425)                  | (26,874)                     |
| Unbilled revenues   | 170,742                   | 180,628                      |
| Income taxes receivable   | 13,137                    | 9,594                        |
| Materials and supplies  | 31,150                    | 29,772                       |
| Other   | 41,166                    | 30,483                       |
| <b>Total current assets</b>   | <b>491,850</b>            | <b>499,447</b>               |
| Regulatory and other long-term assets   |                           |                              |
| Regulatory assets   | 1,207,967                 | 1,199,114                    |
| Restricted funds  | 7,246                     | 10,791                       |
| Goodwill  | 1,207,161                 | 1,207,250                    |
| Other   | 62,057                    | 63,010                       |
| <b>Total regulatory and other long-term assets</b>  | <b>2,484,431</b>          | <b>2,480,165</b>             |
| <b>TOTAL ASSETS</b>   | <b>\$ 14,769,216</b>      | <b>\$ 14,718,976</b>         |

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

**Table of Contents****American Water Works Company, Inc. and Subsidiary Companies****Consolidated Balance Sheets (Unaudited)****(In thousands, except per share data)**

|   | March 31,<br>2013    | December 31,<br>2012 |
|---|----------------------|----------------------|
| <b>CAPITALIZATION AND LIABILITIES</b>   |                      |                      |
| Capitalization  |                      |                      |
| Common stock (\$.01 par value, 500,000 shares authorized, 177,674 and 176,988 shares outstanding at March 31 and December 31, respectively) | \$ 1,777             | \$ 1,770             |
| Paid-in-capital   | 6,232,815            | 6,222,644            |
| Accumulated deficit   | (1,607,321)          | (1,664,955)          |
| Accumulated other comprehensive loss  | (114,286)            | (116,191)            |
| Treasury stock  | (5,043)              | 0                    |
| Common stockholders' equity   | 4,507,942            | 4,443,268            |
| Preferred stock without mandatory redemption requirements   | 1,720                | 1,720                |
| Total stockholders' equity  | 4,509,662            | 4,444,988            |
| Long-term debt  |                      |                      |
| Long-term debt  | 5,184,943            | 5,190,509            |
| Redeemable preferred stock at redemption value  | 17,652               | 18,861               |
| Total capitalization  | 9,712,257            | 9,654,358            |
| Current liabilities   |                      |                      |
| Short-term debt   | 333,786              | 269,985              |
| Current portion of long-term debt   | 115,924              | 115,919              |
| Accounts payable  | 166,723              | 279,613              |
| Taxes accrued   | 51,152               | 35,555               |
| Interest accrued  | 101,101              | 53,810               |
| Other   | 189,646              | 239,950              |
| Total current liabilities   | 958,332              | 994,832              |
| Regulatory and other long-term liabilities  |                      |                      |
| Advances for construction   | 379,280              | 379,737              |
| Deferred income taxes   | 1,518,408            | 1,471,153            |
| Deferred investment tax credits   | 27,533               | 27,909               |
| Regulatory liabilities  | 370,340              | 364,181              |
| Accrued pension expense   | 448,563              | 461,647              |
| Accrued postretirement benefit expense  | 253,318              | 254,147              |
| Other   | 98,777               | 114,876              |
| Total regulatory and other long-term liabilities  | 3,096,219            | 3,073,650            |
| Contributions in aid of construction  | 1,002,408            | 996,136              |
| Commitments and contingencies (See Note 10)   |                      |                      |
| <b>TOTAL CAPITALIZATION AND LIABILITIES</b>   | <b>\$ 14,769,216</b> | <b>\$ 14,718,976</b> |

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

**Table of Contents****American Water Works Company, Inc. and Subsidiary Companies****Consolidated Statements of Operations and Comprehensive Income (Unaudited)****(In thousands, except per share data)**

|   | <b>Three Months Ended<br/>March 31,</b> |             |
|---|---|-------------|
|   | <b>2013</b>                             | <b>2012</b> |
| Operating revenues  | \$ 636,137                              | \$ 618,554  |
| Operating expenses  |   |             |
| Operation and maintenance                                       | 312,203                                 | 310,004     |
| Depreciation and amortization                                   | 99,649                                  | 92,104      |
| General taxes   | 60,146                                  | 57,121      |
| (Gain) loss on asset dispositions and purchases                 | (94)                                    | (413)       |
| Total operating expenses, net                                   | 471,904                                 | 458,816     |
| Operating income  | 164,233                                 | 159,738     |
| Other income (expenses)   |   |             |
| Interest, net   | (78,114)                                | (79,654)    |
| Allowance for other funds used during construction              | 3,396                                   | 4,362       |
| Allowance for borrowed funds used during construction           | 1,653                                   | 2,081       |
| Amortization of debt expense                                    | (1,581)                                 | (1,266)     |
| Other, net  | (776)                                   | (616)       |
| Total other income (expenses)                                   | (75,422)                                | (75,093)    |
| Income from continuing operations before income taxes           | 88,811                                  | 84,645      |
| Provision for income taxes                                      | 31,168                                  | 35,393      |
| Income from continuing operations                               | 57,643                                  | 49,252      |
| Loss from discontinued operations, net of tax                   | 0                                       | (7,498)     |
| Net income  | \$ 57,643                               | \$ 41,754   |
| Other comprehensive income, net of tax:                         |   |             |
| Pension plan amortized to periodic benefit cost:                |   |             |
| Prior service cost, net of tax of \$28 and \$28, respectively   | 43                                      | 44          |
| Actuarial loss, net of tax of \$1,424 and \$1,167, respectively | 2,228                                   | 1,825       |
| Foreign currency translation adjustment                         | (366)                                   | 259         |
| Other comprehensive income                                      | 1,905                                   | 2,128       |
| Comprehensive income  | \$ 59,548                               | \$ 43,882   |
| Basic earnings per common share:(a)                             |   |             |
| Income from continuing operations                               | \$ 0.32                                 | \$ 0.28     |
| Loss from discontinued operations, net of tax                   | \$ 0.00                                 | \$ (0.04)   |



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|  |         |           |
|--|---------|-----------|
| Net income   | \$ 0.32 | \$ 0.24   |
| Diluted earnings per common share:(a)                |         |           |
| Income from continuing operations                    | \$ 0.32 | \$ 0.28   |
| Loss from discontinued operations, net of tax        | \$ 0.00 | \$ (0.04) |
| Net income   | \$ 0.32 | \$ 0.24   |
| Average common shares outstanding during the period: |         |           |
| Basic  | 177,327 | 175,914   |
| Diluted  | 178,465 | 177,028   |
| Dividends per common share                           | \$ 0.00 | \$ 0.23   |

(a) Amounts may not sum due to rounding.

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

**Table of Contents****American Water Works Company, Inc. and Subsidiary Companies****Consolidated Statements of Cash Flows (Unaudited)****(In thousands, except per share data)**

|   | <b>Three Months Ended<br/>March 31,</b> |             |
|---|---|-------------|
|   | <b>2013</b>                             | <b>2012</b> |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |   |             |
| Net income  | \$ 57,643                               | \$ 41,754   |
| Adjustments   |   |             |
| Depreciation and amortization   | 99,649                                  | 92,104      |
| Provision for deferred income taxes   | 29,446                                  | 39,669      |
| Amortization of deferred investment tax credits   | (376)                                   | (380)       |
| Provision for losses on accounts receivable   | 3,041                                   | 2,357       |
| Allowance for other funds used during construction  | (3,396)                                 | (4,362)     |
| (Gain) loss on asset dispositions and purchases   | (94)                                    | (413)       |
| Pension and non-pension postretirement benefits   | 19,518                                  | 20,141      |
| Stock-based compensation expense  | 2,042                                   | 2,268       |
| Other, net  | (8,160)                                 | (5,649)     |
| Changes in assets and liabilities   |   |             |
| Receivables and unbilled utility revenues   | 18,775                                  | 12,650      |
| Taxes receivable, including income taxes  | (3,543)                                 | 4,370       |
| Other current assets  | (12,060)                                | (12,038)    |
| Pension and non-pension post retirement benefit contributions   | (29,766)                                | (40,427)    |
| Accounts payable  | (37,278)                                | (45,684)    |
| Taxes accrued, including income taxes   | 14,854                                  | 20,055      |
| Interest accrued  | 47,291                                  | 43,818      |
| Change in book overdraft  | (21,960)                                | 0           |
| Other current liabilities   | (26,001)                                | (22,134)    |
| Net cash provided by operating activities   | 149,625                                 | 148,099     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |   |             |
| Capital expenditures  | (213,086)                               | (233,366)   |
| Acquisitions  | (2,836)                                 | (104)       |
| Proceeds from sale of assets and securities   | 280                                     | 461,375     |
| Removal costs from property, plant and equipment retirements, net   | (10,721)                                | (10,927)    |
| Net funds (restricted) released   | (1,347)                                 | 12,627      |
| Net cash provided by (used in) investing activities   | (227,710)                               | 229,605     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |   |             |
| Proceeds from long-term debt  | 1,378                                   | 14,372      |
| Repayment of long-term debt   | (2,392)                                 | (6,229)     |
| Net borrowings (repayments) under short-term debt agreements  | 63,801                                  | (347,951)   |
| Proceeds from issuances of employee stock plans and DRIP  | 8,141                                   | 9,634       |
| Advances and contributions for construction, net of refunds of \$4,477 and \$3,607 at March 31, 2013 and 2012, respectively | 5,105                                   | 7,820       |
| Change in bank overdraft position   | 0                                       | (20,570)    |
| Redemption of preferred stocks  | (1,200)                                 | (1,100)     |
| Dividends paid  | 0                                       | (40,414)    |
| Other   | 0                                       | 2,029       |

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|  |           |           |
|--|-----------|-----------|
| Net cash provided by (used in) financing activities                | 74,833    | (382,409) |
| Net increase (decrease) in cash and cash equivalents               | (3,252)   | (4,705)   |
| Cash and cash equivalents at beginning of period                   | 24,433    | 14,207    |
| Cash and cash equivalents at end of period                         | \$ 21,181 | \$ 9,502  |
| <b>Non-cash investing activity:</b>                                |           |           |
| Capital expenditures acquired on account but unpaid at quarter-end | \$ 81,455 | \$ 75,755 |
| <b>Non-cash financing activity:</b>                                |           |           |
| Advances and contributions   | \$ 2,756  | \$ 1,182  |
| Dividends accrued  | \$ 0      | \$ 40,526 |

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

**Table of Contents****American Water Works Company, Inc. and Subsidiary Companies****Consolidated Statement of Changes in Stockholders' Equity (Unaudited)**

(In thousands, except per share data)

|  | Common Stock<br>Shares | Common Stock<br>Par<br>Value | Paid-in<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury Stock<br>Shares | Treasury Stock<br>At Cost | Preferred<br>Stock<br>of<br>Subsidiary<br>Companies<br>Without<br>Mandatory<br>Redemption<br>Requirements | Total<br>Stockholders<br>Equity |
|--|------------------------|------------------------------|--------------------|------------------------|---|--------------------------|---------------------------|---|---------------------------------|
| <b>Balance at<br/>December 31, 2012</b>                                  | 176,988                | \$ 1,770                     | \$ 6,222,644       | \$ (1,664,955)         | \$ (116,191)                                  | 0                        | \$ 0                      | \$ 1,720  | \$ 4,444,988                    |
| Net income   |                        |                              |                    | 57,643                 |   |                          |                           |   | 57,643                          |
| Direct stock reinvestment and<br>purchase plan, net of expense<br>of \$5 | 10                     | 0                            | 387                |                        |   |                          |                           |   | 387                             |
| Employee stock purchase plan   | 25                     | 0                            | 989                |                        |   | 0                        | 0                         |   | 989                             |
| Stock-based compensation<br>activity                                     | 651                    | 7                            | 8,795              | (9)                    |   | (132)                    | (5,043)                   |   | 3,750                           |
| Other comprehensive income,<br>net of tax of \$1,452                     |                        |                              |                    |                        | 1,905   |                          |                           |   | 1,905                           |
| <b>Balance at March 31, 2013</b>   | 177,674                | \$ 1,777                     | \$ 6,232,815       | \$ (1,607,321)         | \$ (114,286)                                  | (132)                    | \$ (5,043)                | \$ 1,720  | \$ 4,509,662                    |

|  | Common Stock<br>Shares | Common Stock<br>Par<br>Value | Paid-in<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury Stock<br>Shares | Treasury Stock<br>At Cost | Preferred<br>Stock<br>of<br>Subsidiary<br>Companies<br>Without<br>Mandatory<br>Redemption<br>Requirements | Total<br>Stockholders<br>Equity |
|--|------------------------|------------------------------|--------------------|------------------------|---|--------------------------|---------------------------|---|---------------------------------|
| <b>Balance at<br/>December 31, 2011</b>                                  | 175,664                | \$ 1,757                     | \$ 6,180,558       | \$ (1,848,801)         | \$ (97,677)                                   | 0                        | \$ 0                      | \$ 4,547  | \$ 4,240,384                    |
| Net income   |                        |                              |                    | 41,754                 |   |                          |                           |   | 41,754                          |
| Direct stock reinvestment and<br>purchase plan, net of expense<br>of \$1 | 17                     | 0                            | 570                |                        |   |                          |                           |   | 570                             |
| Employee stock purchase plan   | 0                      | 0                            | 132                |                        |   | 31                       | 1,046                     |   | 1,178                           |
| Stock-based compensation<br>activity                                     | 519                    | 5                            | 11,166             | (165)                  |   | (31)                     | (1,046)                   |   | 9,960                           |
| Other comprehensive income,<br>net of tax of \$1,195                     |                        |                              |                    |                        | 2,128   |                          |                           |   | 2,128                           |
| Dividends  |                        |                              |                    | (40,538)               |   |                          |                           |   | (40,538)                        |
| <b>Balance at March 31, 2012</b>   | 176,200                | \$ 1,762                     | \$ 6,192,426       | \$ (1,847,750)         | \$ (95,549)                                   | 0                        | \$ 0                      | \$ 4,547  | \$ 4,255,436                    |

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



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### **American Water Works Company, Inc. and Subsidiary Companies**

#### **Notes to Consolidated Financial Statements (Unaudited)**

**(In thousands, except per share data)**

##### **Note 1: Basis of Presentation**

The accompanying Consolidated Balance Sheet of American Water Works Company, Inc. and Subsidiary Companies (the Company) at March 31, 2013, the Consolidated Statements of Operations and Comprehensive Income for the three months ended March 31, 2013 and 2012, the Consolidated Statements of Cash Flows for the three months ended March 31, 2013 and 2012, and the Consolidated Statements of Changes in Stockholders' Equity for the three months ended March 31, 2013 and 2012, are unaudited, but reflect all adjustments, which are, in the opinion of management, necessary to present fairly the consolidated financial position, the consolidated changes in stockholders' equity, the consolidated results of operations and comprehensive income, and the consolidated cash flows for the periods presented. All adjustments are of a normal, recurring nature, except as otherwise disclosed. Because they cover interim periods, the unaudited consolidated financial statements and related notes to the consolidated financial statements do not include all disclosures and notes normally provided in annual financial statements and, therefore, should be read in conjunction with the Company's Consolidated Financial Statements and related Notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the year, due primarily to the seasonality of the Company's operations.

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

##### **Note 2: New Accounting Pronouncements**

**The following recently issued accounting standards have been adopted by the Company and have been included in the consolidated results of operations, financial position or footnotes of the accompanying Consolidated Financial Statements:**

###### **Balance Sheet Offsetting**

In December 2011, the Financial Accounting Standards Board (FASB) issued accounting guidance to amend the existing disclosure requirements for offsetting financial assets and liabilities to enhance current disclosures, as well as to improve comparability of balance sheets prepared under U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). In January 2013, the FASB issued additional guidance on the scope of these disclosures. The revised disclosure guidance applies to derivative instruments and securities borrowing and lending transactions that are either offset in the financial statements or subject to an enforceable master netting arrangement or similar agreement. The revised disclosure guidance is effective on a retrospective basis for interim and annual periods beginning January 1, 2013. As this guidance provides for additional disclosure requirements only, the adoption of this guidance did not have an impact on the Company's results of operations, financial position or cash flows.

###### **Testing Indefinite-Lived Intangible Assets for Impairment**

In July 2012, the FASB updated the accounting guidance related to testing indefinite-lived intangible assets for impairment. This update permits an entity to perform a qualitative assessment to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test under current guidance. This update is effective for annual and interim impairment tests performed by the Company beginning on January 1, 2013. The adoption of this guidance did not have an impact on the Company's results of operations, financial position or cash flows.

###### **Amounts Reclassified Out of Accumulated Other Comprehensive Income**

In February 2013, the FASB updated accounting guidance to add new disclosure requirements for items reclassified out of accumulated other comprehensive income. The update does not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional detail about those amounts. The amendments are required to be applied prospectively for interim and annual reporting periods.

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beginning January 1, 2013. As this guidance provides for additional disclosure requirements only, the adoption of this guidance did not have an impact on the Company's results of operations, financial position or cash flows.

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The following recently announced accounting standards are not yet required to be adopted by the Company or included in the consolidated results of operations, financial position or footnotes of the Company:

**Obligations Resulting from Joint and Several Liability Arrangements**

In February 2013, the FASB issued guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. Examples of obligations within the scope of the updated guidance include debt arrangements, other contractual obligations, and settled litigation and judicial rulings. The update requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date, as the sum of the following: (a) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and (b) any additional amount the reporting entity expects to pay on behalf of its co-obligors. The updated guidance also includes additional disclosures regarding the nature and amount of the obligation as well as other information about those obligations. The update is effective on a retrospective basis for interim and annual periods beginning January 1, 2014. Early adoption is permitted. The Company is evaluating the specific provisions of the updated guidance, but does not expect the adoption of this guidance to have a significant impact on the Company's results of operations, financial position or cash flows.

**Foreign Currency Matters**

In March 2013, the FASB issued guidance for a parent's accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. The amendments resolve differing views in practice and apply to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or a business within a foreign entity. The update is effective prospectively for interim and annual periods beginning January 1, 2014. Early adoption is permitted. The Company does not expect the adoption of the updated guidance to have a significant impact on its results of operations, financial position or cash flows.

**Note 3: Acquisitions and Divestitures****Acquisitions**

As of March 31, 2013, the Company closed on five acquisitions of various regulated water and wastewater systems for a total aggregate purchase price of \$2,836. Assets acquired, principally plant, totaled \$3,535. Liabilities assumed, primarily contributions in aid of construction, totaled \$699.

**Divestitures**

As part of the Company's strategic review of its business investments, prior to 2012 it had entered into agreements to sell its Arizona, New Mexico and Ohio subsidiaries.

In January 2012, the Company completed the close of the sale of its Arizona and New Mexico subsidiaries. Initial sales proceeds were \$461,057, and the Company recorded no gain or loss at the time of the sale closing.

A summary of discontinued operations presented in the Consolidated Statements of Operations and Comprehensive Income follows:

|   |                           |
|---|---------------------------|
|   | <b>March 31,<br/>2012</b> |
| Operating revenues                                      | \$ 16,217                 |
| Total operating expenses, net                           | 12,453                    |
| Operating income  | 3,764                     |
| Other income (expenses), net                            | (120)                     |
| Income from discontinued operations before income taxes | 3,644                     |
| Provision for income taxes                              | 11,142                    |



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|                                   |            |
|-----------------------------------|------------|
| Loss from discontinued operations | \$ (7,498) |
|-----------------------------------|------------|

Provision for income taxes includes the recognition of \$9,705 of tax expense related to the inside basis differences of Arizona and New Mexico that resulted in a taxable gain, since an IRS 338 (h)(10) election was made to treat the sale as an asset sale.

**Table of Contents****Note 4: Goodwill**

The Company's annual goodwill impairment test is conducted at November 30 of each calendar year. Interim reviews are performed when the Company determines that a triggering event that would more likely than not reduce the fair value of a reporting unit below its carrying value has occurred.

The following table summarizes the three-month changes in goodwill of the Company's continuing operations by reporting unit:

|                                      | Regulated Unit |                        | Market-Based Units |                        | Cost         | Consolidated Accumulated Impairment | Total Net    |
|--------------------------------------|----------------|------------------------|--------------------|------------------------|--------------|-------------------------------------|--------------|
|                                      | Cost           | Accumulated Impairment | Cost               | Accumulated Impairment |              |                                     |              |
| Balance at January 1, 2013           | \$ 3,411,549   | \$ (2,332,670)         | \$ 235,990         | \$ (107,619)           | \$ 3,647,539 | \$ (2,440,289)                      | \$ 1,207,250 |
| Reclassifications and other activity | (89)           | 0                      | 0                  | 0                      | (89)         | 0                                   | (89)         |
| Balance at March 31, 2013            | \$ 3,411,460   | \$ (2,332,670)         | \$ 235,990         | \$ (107,619)           | \$ 3,647,450 | \$ (2,440,289)                      | \$ 1,207,161 |
| Balance at January 1, 2012           | \$ 3,399,368   | \$ (2,332,670)         | \$ 235,990         | \$ (107,619)           | \$ 3,635,358 | \$ (2,440,289)                      | \$ 1,195,069 |
| Reclassifications and other activity | 0              | 0                      | 0                  | 0                      | 0            | 0                                   | 0            |
| Balance at March 31, 2012            | \$ 3,399,368   | \$ (2,332,670)         | \$ 235,990         | \$ (107,619)           | \$ 3,635,358 | \$ (2,440,289)                      | \$ 1,195,069 |

**Note 5: Stockholders' Equity****Common Stock**

In March 2010, the Company established American Water Stock Direct, a dividend reinvestment and direct stock purchase plan (the "DRIP"). Under the DRIP, stockholders may reinvest cash dividends and purchase additional Company common stock, up to certain limits, through a transfer agent without commission fees. The Company's transfer agent may buy newly issued shares directly from the Company or shares held in the Company's treasury. The transfer agent may also buy shares in the public markets or in privately negotiated transactions. Purchases generally will be made and credited to DRIP accounts once each week. As of March 31, 2013, there were 4,803 shares available for future issuance under the DRIP.

The following table summarizes information regarding issuances under the DRIP for the three months ended March 31, 2013 and 2012:

|                               | 2013   | 2012   |
|-------------------------------|--------|--------|
| Shares of common stock issued | 10     | 17     |
| Cash proceeds received        | \$ 392 | \$ 571 |

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Cash dividend payments made during the three month periods ended March 31 were as follows:

|  | 2013 | 2012      |
|--|------|-----------|
| Dividends per share, three months ended: March 31  | \$ 0 | \$ 0.23   |
| Total dividends paid, three months ended: March 31 | \$ 0 | \$ 40,414 |

**Accumulated Other Comprehensive Income (Loss)**

The following table presents changes in accumulated other comprehensive income (loss) by component, net of tax, for the three months ended March 31, 2013:

|  | Defined Benefit Plans                     |                       |                   |                                    | Total<br>Accumulated<br>Other<br>Comprehensive<br>Loss |
|--|---|-----------------------|-------------------|------------------------------------|--|
|  | Employee<br>Benefit Plan<br>Funded Status | Prior<br>Service Cost | Actuarial<br>Loss | Foreign<br>Currency<br>Translation |  |
| Beginning balance at January 1, 2013                             | \$ (143,183)                              | \$ 539                | \$ 22,239         | \$ 4,214                           | \$ (116,191)   |
| Other comprehensive income (loss) before reclassifications       | 0   | 0                     | 0                 | (366)                              | (366)  |
| Amounts reclassified from accumulated other comprehensive income | 0   | 43                    | 2,228             | 0                                  | 2,271  |
| Other comprehensive income (loss) for the period                 | 0   | 43                    | 2,228             | (366)                              | 1,905  |
| Ending balance at March 31, 2013                                 | \$ (143,183)                              | \$ 582                | \$ 24,467         | \$ 3,848                           | \$ (114,286)   |

The Company does not reclassify the amortization of defined benefit pension cost components from accumulated other comprehensive income (loss) directly to net income in its entirety. These accumulated other comprehensive income components are included in the computation of net periodic pension cost. (See Note 9)

**Stock-Based Compensation**

The Company has granted stock option and restricted stock unit awards to non-employee directors, officers and other key employees of the Company pursuant to the terms of its 2007 Omnibus Equity Compensation Plan (the "Plan"). As of March 31, 2013, a total of 9,631 shares were available for grant under the Plan. Shares issued under the Plan may be authorized but unissued shares of Company stock or reacquired shares of Company stock, including shares purchased by the Company on the open market for purposes of the Plan.

The Company recognizes compensation expense for stock awards over the vesting period of the award. The following table presents stock-based compensation expense recorded in operation and maintenance expense in the accompanying Consolidated Statements of Operations and Comprehensive Income for the three months ended March 31, 2013 and 2012:

|   | 2013     | 2012     |
|---|----------|----------|
| Stock options   | \$ 752   | \$ 846   |
| Restricted stock units  | 1,157    | 1,290    |
| Employee stock purchase plan                                  | 133      | 132      |
| Stock-based compensation in operation and maintenance expense | 2,042    | 2,268    |
| Income tax benefit  | (796)    | (884)    |
| After-tax stock-based compensation expense                    | \$ 1,246 | \$ 1,384 |

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There were no significant stock-based compensation costs capitalized during the three months ended March 31, 2013 and 2012, respectively.

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**Stock Options**

In the first three months of 2013, the Company granted non-qualified stock options to certain employees under the Plan. The stock options vest ratably over the three-year service period beginning January 1, 2013. These awards have no performance vesting conditions and the grant date fair value is amortized through expense over the requisite service period using the straight-line method.

On April 1, 2013, the Company granted 28 non-qualified options, with a grant date fair value of \$5.64 per share, to its new Chief Financial Officer. Stock-based compensation expense at March 31, 2013 does not include the value of these options.

The following table presents the weighted-average assumptions used in the Black-Scholes option-pricing model and the resulting weighted-average grant date fair value per share of stock options granted through March 31, 2013:

|                                 |          |
|---------------------------------|----------|
| Dividend yield                  | 2.53%    |
| Expected volatility             | 23.61%   |
| Risk-free interest rate         | 0.71%    |
| Expected life (years)           | 4.3      |
| Exercise price                  | \$ 39.45 |
| Grant date fair value per share | \$ 5.79  |

Stock options granted under the Plan have maximum terms of seven years, vest over periods ranging from one to three years, and are granted with exercise prices equal to the market value of the Company's common stock on the date of grant. As of March 31, 2013, \$4,486 of total unrecognized compensation cost related to the non-vested stock options is expected to be recognized over the weighted-average period of 1.8 years.

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The table below summarizes stock option activity for the three months ended March 31, 2013:

|  | Shares | Weighted-Average Exercise Price (per share) | Weighted-Average Remaining Life (years) | Aggregate Intrinsic Value |
|--|--------|---|---|---------------------------|
| Options outstanding at January 1, 2013 | 2,635  | \$ 25.77                                    |   |                           |
| Granted                                | 320    | 39.45                                       |   |                           |
| Forfeited or expired                   | (8)    | 34.15                                       |   |                           |
| Exercised                              | (297)  | 23.23                                       |   |                           |
| Options outstanding at March 31, 2013  | 2,650  | \$ 27.68                                    | 4.4                                     | \$ 36,477                 |
| Exercisable at March 31, 2013          | 1,711  | \$ 24.02                                    | 3.6                                     | \$ 29,796                 |

The following table summarizes additional information regarding stock options exercised during the three months ended March 31, 2013 and 2012:

|                    | 2013     | 2012     |
|--------------------|----------|----------|
| Intrinsic value    | \$ 4,995 | \$ 4,662 |
| Exercise proceeds  | 6,893    | 8,197    |
| Income tax benefit | 1,418    | 1,214    |

**Restricted Stock Units**

During 2010, the Company granted selected employees 255 restricted stock units with internal performance measures and, separately, certain market thresholds. These awards vested in January 2013. The terms of the grants specified that if certain performance on internal measures and market thresholds was achieved, the restricted stock units would vest; if performance was surpassed, up to 175% of the target awards would be distributed; and if thresholds were not met, awards would be cancelled. In January 2013, an additional 148 restricted stock units were granted and distributed because performance was exceeded and 19 restricted stock units were cancelled because thresholds were not met.

In the first three months of 2013, the Company granted restricted stock units, both with and without performance conditions, to certain employees under the Plan. The restricted stock units without performance conditions vest ratably over the three-year service period beginning January 1, 2013 and the restricted stock units with performance conditions vest ratably over the three-year performance period beginning January 1, 2013 (the Performance Period). Distribution of the performance shares is contingent upon the achievement of internal performance measures and, separately, certain market thresholds over the Performance Period. The restricted stock units granted with service-only conditions and those with internal performance measures are valued at the market value of the Company's common stock on the date of grant. The restricted stock units granted with market conditions are valued using a Monte Carlo model.

On April 1, 2013, the Company granted 47 restricted stock units, with a grant date fair value of \$41.27 per share, and 6 restricted stock units, with a per-share grant date fair value of \$39.90, to its new Chief Financial Officer. The value of these restricted stock units is not included in stock-based compensation expense at March 31, 2013.

Weighted-average assumptions used in the Monte Carlo simulation are as follows for restricted stock units with market conditions granted through March 31, 2013:

|                         |        |
|-------------------------|--------|
| Expected volatility     | 19.40% |
| Risk-free interest rate | 0.40%  |
| Expected life (years)   | 3      |

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The grant date fair value of the restricted stock unit awards that vest ratably and have market and/or performance and service conditions is amortized through expense over the requisite service period using the graded-vesting method. Restricted stock units that have no performance conditions are amortized through expense over the requisite service period using the straight-line method. As of March 31, 2013, \$8,686 of total unrecognized compensation cost related to the non-vested restricted stock units is expected to be recognized over the weighted-average remaining life of 1.6 years.

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The table below summarizes restricted stock unit activity for the three months ended March 31, 2013:

|                                     | <b>Shares</b> | <b>Weighted-Average<br/>Grant Date<br/>Fair Value<br/>(per share)</b> |
|-------------------------------------|---------------|---|
| Non-vested total at January 1, 2013 | 540           | \$ 29.48  |
| Granted                             | 335           | 32.52   |
| Vested                              | (347)         | 23.52   |
| Forfeited                           | (3)           | 37.40   |
| Cancelled                           | (19)          | 21.98   |
| Non-vested total at March 31, 2013  | 506           | \$ 35.81  |



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The following table summarizes additional information regarding restricted stock units distributed during the three months ended March 31, 2013 and 2012:

|                    | 2013      | 2012     |
|--------------------|-----------|----------|
| Intrinsic value    | \$ 13,559 | \$ 5,804 |
| Income tax benefit | 2,049     | 798      |

If dividends are declared with respect to shares of the Company's common stock before the restricted stock units are distributed, the Company credits a liability for the value of the dividends that would have been paid if the restricted stock units were shares of Company common stock. When the restricted stock units are distributed, the Company pays the participant a lump sum cash payment equal to the value of the dividend equivalents accrued. The Company accrued dividend equivalents totaling \$9 and \$165 to retained earnings during the three months ended March 31, 2013 and 2012, respectively.

**Employee Stock Purchase Plan**

Under the Nonqualified Employee Stock Purchase Plan (the "ESPP"), employees can use payroll deductions to acquire Company stock at the lesser of 90% of the fair market value of (a) the beginning or (b) the end of each three-month purchase period. As of March 31, 2013 there were 1,449 shares of common stock reserved for issuance under the ESPP. During the three months ended March 31, 2013, the Company issued 25 shares under the ESPP.

**Note 6: Long-Term Debt**

The Company primarily issues long-term debt to fund capital expenditures at the regulated subsidiaries. The components of long-term debt are as follows:

|  | Rate         | Weighted<br>Average Rate | Maturity<br>Date | March 31,<br>2013 | December 31,<br>2012 |
|--|--------------|--------------------------|------------------|-------------------|----------------------|
| Long-term debt of American Water Capital Corp. ( "AWCC" )(a) |              |                          |                  |                   |                      |
| Private activity bonds and government funded debt            |              |                          |                  |                   |                      |
| Fixed rate   | 4.85%-6.75%  | 5.72%                    | 2018-2040        | \$ 322,610        | \$ 322,610           |
| Senior notes   |              |                          |                  |                   |                      |
| Fixed rate   | 4.30%-10.00% | 6.08%                    | 2013-2042        | 3,389,399         | 3,389,399            |
| Long-term debt of other subsidiaries                         |              |                          |                  |                   |                      |
| Private activity bonds and government funded debt            |              |                          |                  |                   |                      |
| Fixed rate   | 0.00%-6.20%  | 4.71%                    | 2013-2041        | 862,012           | 865,969              |
| Mortgage bonds   |              |                          |                  |                   |                      |
| Fixed rate   | 4.29%-9.71%  | 7.41%                    | 2013-2039        | 678,500           | 678,500              |
| Mandatory redeemable preferred stock                         | 8.47%-9.75%  | 8.61%                    | 2019-2036        | 19,352            | 20,552               |
| Notes payable and other(b)                                   | 9.49%-12.17% | 11.65%                   | 2013-2026        | 1,190             | 1,272                |
| Long-term debt   |              |                          |                  | 5,273,063         | 5,278,302            |
| Unamortized debt discount, net(c)                            |              |                          |                  | 38,289            | 39,272               |
| Fair value adjustment to interest rate hedge                 |              |                          |                  | 7,167             | 7,715                |
| Total long-term debt   |              |                          |                  | \$ 5,318,519      | \$ 5,325,289         |

(a) AWCC, which is a wholly-owned subsidiary of the Company, has a strong support agreement with its parent that, under certain circumstances, is the functional equivalent of a guarantee.

(b) Includes capital lease obligations of \$967 and \$1,049 at March 31, 2013 and December 31, 2012, respectively.

(c) Includes fair value adjustments previously recognized in acquisition purchase accounting.



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The following long-term debt was issued in 2013:

| Company            | Type   | Interest Rate | Maturity | Amount   |
|--------------------|--|---------------|----------|----------|
| Other subsidiaries | Private activity bonds and government funded debt fixed rate | 1.59%         | 2033     | \$ 1,378 |
| Total issuances    |  |               |          | \$ 1,378 |

The following long-term debt was retired through optional redemption or payment at maturity during 2013:

| Company                           | Type   | Interest Rate | Maturity  | Amount   |
|-----------------------------------|--|---------------|-----------|----------|
| Other subsidiaries(1)             | Private activity bonds and government funded debt fixed rate | 0.00%-5.50%   | 2013-2041 | \$ 5,335 |
| Other subsidiaries                | Mandatory redeemable preferred stock                         | 8.49%         | 2036      | 1,200    |
| Other                             | Capital leases   |               |           | 82       |
| Total retirements and redemptions |  |               |           | \$ 6,617 |

(1) Includes \$3,025 of non-cash defeasance via use of restricted funds. Interest income included in interest, net is summarized below:

|                 | Three Months Ended |          |
|-----------------|--------------------|----------|
|                 | March 31,          |          |
|                 | 2013               | 2012     |
| Interest income | \$ 2,835           | \$ 2,812 |

The Company has an interest-rate swap to hedge \$100,000 of its 6.085% fixed-rate debt maturing 2017. The Company pays variable interest of six-month LIBOR plus 3.422%. The swap is accounted for as a fair-value hedge and matures with the fixed-rate debt in 2017. The following table provides a summary of the derivative fair value balance recorded by the Company and the line item in the Consolidated Balance Sheets in which such amount is recorded:

| Balance sheet classification          | March 31, 2013 | December 31, 2012 |
|---------------------------------------|----------------|-------------------|
| Regulatory and other long-term assets |                |                   |
| Other                                 | \$ 7,236       | \$ 7,909          |
| Long-term debt                        |                |                   |
| Long-term debt                        | 7,167          | 7,715             |

For derivative instruments that are designated as and qualify as fair-value hedges, the gain or loss on the hedge instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current net income. The Company includes the gain or loss on the derivative instrument and the offsetting loss or gain on the hedged item in interest expense as follows:

| Income Statement Classification | March 31, 2013 | March 31, 2012 |
|---------------------------------|----------------|----------------|
|---------------------------------|----------------|----------------|

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|                          |          |          |
|--------------------------|----------|----------|
| Interest, net            |          |          |
| Gain (loss) on swap      | \$ (673) | \$ (234) |
| (Loss) gain on borrowing | 548      | 277      |
| Hedge Ineffectiveness    | (125)    | 43       |

**Table of Contents****Note 7: Short-Term Debt**

Short-term debt consists of commercial paper borrowings totaling \$333,786 (net of discount of \$14) at March 31, 2013 and \$269,985 (net of discount of \$15) at December 31, 2012 respectively.

**Note 8: Income Taxes**

The Company's estimated annual effective tax rate for the three months ended March 31, 2013 was 39.8% compared to 40.0% for the three months ended March 31, 2012, excluding various discrete items

The Company's actual effective tax rates on continuing operations were as follows:

|  | Three Months Ended<br>March 31, |       |
|--|---------------------------------|-------|
|  | 2013                            | 2012  |
| Actual effective tax rate on continuing operations | 35.1%                           | 41.8% |

Included in 2013 are discrete items including \$3,274 of tax benefits associated with an entity reorganization within the Company's Market-Based segment that allowed for the utilization of state net operating loss carryforwards and the release of a valuation allowance.

**Note 9: Pension and Other Postretirement Benefits**

The following table provides the components of net periodic benefit costs:

|   | Three Months Ended<br>March 31, |           |
|---|---------------------------------|-----------|
|   | 2013                            | 2012      |
| Components of net periodic pension benefit cost |                                 |           |
| Service cost                                    | \$ 9,468                        | \$ 8,507  |
| Interest cost                                   | 17,024                          | 17,521    |
| Expected return on plan assets                  | (22,107)                        | (19,619)  |
| Amortization of:                                |                                 |           |
| Prior service cost                              | 181                             | 181       |
| Actuarial loss                                  | 9,293                           | 7,402     |
| Net periodic pension benefit cost               | \$ 13,859                       | \$ 13,992 |

|  | Three Months Ended<br>March 31, |          |
|--|---------------------------------|----------|
|  | 2013                            | 2012     |
| Components of net periodic other postretirement benefit cost |                                 |          |
| Service cost   | \$ 3,820                        | \$ 3,526 |
| Interest cost  | 7,175                           | 7,858    |
| Expected return on plan assets                               | (7,571)                         | (7,140)  |
| Amortization of:   |                                 |          |
| Prior service credit   | (547)                           | (479)    |
| Actuarial loss   | 2,782                           | 2,384    |
| Net periodic other postretirement benefit cost               | \$ 5,659                        | \$ 6,149 |

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The Company contributed \$22,770 to its defined benefit pension plans in the first three months of 2013 and expects to contribute \$44,005 during the balance of 2013. In addition, the Company contributed \$6,996 for the funding of its other postretirement plans in the first three months of 2013 and expects to contribute \$20,989 during the balance of 2013.

### **Note 10: Commitments and Contingencies**

The Company is routinely involved in legal actions incident to the normal conduct of its business. At March 31, 2013, the Company has accrued approximately \$2,400 as probable costs and it is reasonably possible that additional losses could range up to \$26,700 for these matters. For certain matters, the Company is unable to estimate possible losses. The Company believes that damages or settlements recovered by plaintiffs in such claims or actions, if any, will not have a material adverse effect on the Company's results of operations, financial position or cash flows.

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The Company enters into agreements for the provision of services to water and wastewater facilities for the United States military, municipalities and other customers. The Company's military services agreements expire between 2051 and 2060 and have remaining performance commitments as measured by estimated remaining contract revenue of \$1,914,000 at March 31, 2013. The military contracts are subject to customary termination provisions held by the U.S. Federal Government prior to the agreed upon contract expiration. The Company's Operations and Maintenance agreements with municipalities and other customers expire between 2013 and 2048 and have remaining performance commitments as measured by estimated remaining contract revenue of \$987,000 at March 31, 2013. Some of the Company's long-term contracts to operate and maintain a municipality's, federal government's or other party's water or wastewater treatment and delivery facilities include responsibility for certain maintenance for some of those facilities, in exchange for an annual fee. Unless specifically required to perform certain maintenance activities, the maintenance costs are recognized when the maintenance is performed.

**Note 11: Environmental Matters**

The Company's water and wastewater operations are subject to federal, state, local and foreign 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, on an undiscounted basis, when it is probable that these costs will be incurred and can be reasonably estimated. Remediation costs accrued amounted to \$4,400 at March 31, 2013 and December 31, 2012. The accrual relates to a conservation agreement entered into by a subsidiary of the Company with the National Oceanic and Atmospheric Administration (NOAA) requiring the Company to, among other provisions, implement certain measures to protect the steelhead trout and its habitat in the Carmel River watershed in the state of California. The Company has agreed to pay \$1,100 annually from 2010 through 2016. The Company pursues recovery of incurred costs through all appropriate means, including regulatory recovery through customer rates. The Company's regulatory assets at March 31, 2013 and December 31, 2012 include \$8,547 and \$8,656 respectively, related to the NOAA agreement.

**Note 12: Earnings per Common Share**

Earnings per share is calculated using the two-class method. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security. The Company has participating securities related to restricted stock units, granted under the Company's 2007 Omnibus Equity Compensation Plan, that earn dividend equivalents on an equal basis with common shares. In applying the two-class method, undistributed earnings are allocated to both common shares and participating securities. The following is a reconciliation of the Company's income from continuing operations, loss from discontinued operations, net income and weighted-average common shares outstanding for calculating basic earnings per share:

|   | <b>Three Months Ended<br/>March 31,</b> |             |
|---|---|-------------|
|   | <b>2013</b>                             | <b>2012</b> |
| Basic:  |   |             |
| Income from continuing operations   | \$ 57,643                               | \$ 49,252   |
| Loss from discontinued operations   | 0                                       | (7,498)     |
| Net income  | 57,643                                  | 41,754      |
| Less: Distributed earnings to common shareholders                               | 9                                       | 40,563      |
| Less: Distributed earnings to participating securities                          | 0                                       | 16          |
| Undistributed earnings  | 57,634                                  | 1,175       |
| Undistributed earnings allocated to common shareholders                         | 57,614                                  | 1,175       |
| Undistributed earnings allocated to participating securities                    | 20                                      | 0           |
| Total income from continuing operations available to common shareholders, basic | \$ 57,623                               | \$ 49,236   |
| Total income available to common shareholders, basic                            | \$ 57,623                               | \$ 41,738   |
| Weighted-average common shares outstanding, basic                               | 177,327                                 | 175,914     |
| Basic earnings per share:(a)  |   |             |

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|   |         |           |
|---|---------|-----------|
| Income from continuing operations             | \$ 0.32 | \$ 0.28   |
| Loss from discontinued operations, net of tax | \$ 0.00 | \$ (0.04) |
| Net income                                    | \$ 0.32 | \$ 0.24   |

(a) Amounts may not sum due to rounding.



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Diluted earnings per common share is based on the weighted-average number of common shares outstanding adjusted for the dilutive effect of common stock equivalents related to the restricted stock units, stock options, and employee stock purchase plan. The dilutive effect of the common stock equivalents is calculated using the treasury stock method and expected proceeds on vesting of the restricted stock units, exercise of the stock options and purchases under the employee stock purchase plan. The following is a reconciliation of the Company's income from continuing operations, loss from discontinued operations, net income and weighted-average common shares outstanding for calculating diluted earnings per share:

|   | <b>Three Months Ended<br/>March 31,</b> |             |
|---|---|-------------|
|   | <b>2013</b>                             | <b>2012</b> |
| <b>Diluted:</b>   |   |             |
| Total income from continuing operations available to common shareholders, basic   | \$ 57,623                               | \$ 49,236   |
| Loss from discontinued operations, net of tax                                     | 0                                       | (7,498)     |
| Total income available to common shareholders, basic                              | 57,623                                  | 41,738      |
| Undistributed earnings allocated to participating securities                      | 20                                      | 0           |
| <br>  |   |             |
| Total income from continuing operations available to common shareholders, diluted | \$ 57,643                               | \$ 49,236   |
| <br>  |   |             |
| Total income available to common shareholders, diluted                            | \$ 57,643                               | \$ 41,738   |
| <br>  |   |             |
| Weighted-average common shares outstanding, basic                                 | 177,327                                 | 175,914     |
| <b>Stock-based compensation:</b>  |   |             |
| Restricted stock units  | 381                                     | 492         |
| Stock options   | 755                                     | 620         |
| Employee stock purchase plan  | 2                                       | 2           |
| <br>  |   |             |
| Weighted-average common shares outstanding, diluted                               | 178,465                                 | 177,028     |
| <br>  |   |             |
| <b>Diluted earnings per share:(a)</b>   |   |             |
| Income from continuing operations   | \$ 0.32                                 | \$ 0.28     |
| <br>  |   |             |
| Loss from discontinued operations, net of tax                                     | \$ 0.00                                 | \$ (0.04)   |
| <br>  |   |             |
| Net income  | \$ 0.32                                 | \$ 0.24     |

(a) Amounts may not sum due to rounding.

The following potentially dilutive common stock equivalents were not included in the earnings per share calculations because they were anti-dilutive:

|  | <b>Three Months Ended<br/>March 31,</b> |             |
|--|---|-------------|
|  | <b>2013</b>                             | <b>2012</b> |
| Stock options  | 317                                     | 603         |
| Restricted stock units where certain performance conditions were not met | 139                                     | 101         |

**Note 13: Fair Value of Assets and Liabilities****Fair Value of Financial Instruments**

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

**Current assets and current liabilities** The carrying amounts reported in the accompanying Consolidated Balance Sheets for current assets and current liabilities, including revolving credit debt, due to the short-term maturities and variable interest rates, approximate their fair values.

**Preferred stock with mandatory redemption requirements and long-term debt** The fair values of preferred stock with mandatory redemption requirements and long-term debt are categorized within the fair value hierarchy based on the inputs that are used to value each instrument. The fair value of long-term debt classified as Level 1 is calculated using quoted prices in active markets. Level 2 instruments are valued using observable inputs and Level 3 instruments are valued using observable and unobservable inputs. The fair values of instruments classified as Level 2 and 3 are determined by a valuation model that is based on a conventional discounted cash flow methodology and utilizes assumptions of current market rates. As a majority of the Company's debts do not trade in active markets, the Company calculated a base yield curve using a risk-free rate (a U.S. Treasury securities yield curve) plus a credit spread that is based on the following two factors: an average of the Company's own publicly-traded debt securities and the current market rates for U.S. Utility BBB+ debt securities. The Company used these yield curve assumptions to derive a base yield for the Level 2 and Level 3 securities. Additionally, the Company adjusted the base yield for specific features of the debt securities including call features, coupon tax treatment and collateral for the Level 3 instruments.

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The carrying amounts (including fair value adjustments previously recognized in acquisition purchase accounting) and fair values of the financial instruments are as follows:

| Recurring Fair Value Measures                           | Carrying Amount | At Fair Value as of March 31, 2013 |           |           | Total     |
|---|-----------------|------------------------------------|-----------|-----------|-----------|
|   |                 | Level 1                            | Level 2   | Level 3   |           |
| Preferred stocks with mandatory redemption requirements | \$ 19,302       | \$ 0                               | \$ 0      | \$ 26,150 | \$ 26,150 |
| Long-term debt (excluding capital lease obligations)    | 5,298,250       | 2,415,212                          | 1,669,429 | 2,247,372 | 6,332,013 |

| Recurring Fair Value Measures                           | Carrying Amount | At Fair Value as of December 31, 2012 |           |           | Total     |
|---|-----------------|---------------------------------------|-----------|-----------|-----------|
|   |                 | Level 1                               | Level 2   | Level 3   |           |
| Preferred stocks with mandatory redemption requirements | \$ 20,511       | \$ 0                                  | \$ 0      | \$ 27,263 | \$ 27,263 |
| Long-term debt (excluding capital lease obligations)    | 5,303,729       | 2,400,847                             | 1,677,776 | 2,252,272 | 6,330,895 |

**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 March 31, 2013 and December 31, 2012, respectively:

| Recurring Fair Value Measures    | At Fair Value as of March 31, 2013 |            |         | Total     |
|----------------------------------|------------------------------------|------------|---------|-----------|
|                                  | Level 1                            | Level 2    | Level 3 |           |
| <b>Assets:</b>                   |                                    |            |         |           |
| Restricted funds                 | \$ 38,869                          | \$         |         | \$ 38,869 |
| Rabbi trust investments          |                                    | 719        |         | 719       |
| Deposits                         | 11,627                             |            |         | 11,627    |
| Mark-to-market derivative asset  |                                    | 7,236      |         | 7,236     |
| Total assets                     | 50,496                             | 7,955      |         | 58,451    |
| <b>Liabilities:</b>              |                                    |            |         |           |
| Deferred compensation obligation |                                    | 10,172     |         | 10,172    |
| Total liabilities                |                                    | 10,172     |         | 10,172    |
| Total net assets (liabilities)   | \$ 50,496                          | \$ (2,217) |         | \$ 48,279 |

| Recurring Fair Value Measures   | At Fair Value as of December 31, 2012 |         |         | Total     |
|---------------------------------|---------------------------------------|---------|---------|-----------|
|                                 | Level 1                               | Level 2 | Level 3 |           |
| <b>Assets:</b>                  |                                       |         |         |           |
| Restricted funds                | \$ 40,547                             | \$      |         | \$ 40,547 |
| Rabbi trust investments         |                                       | 481     |         | 481       |
| Deposits                        | 2,103                                 |         |         | 2,103     |
| Mark-to-market derivative asset |                                       | 7,909   |         | 7,909     |
| Total assets                    | 42,650                                | 8,390   |         | 51,040    |

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|                                  |           |               |               |
|----------------------------------|-----------|---------------|---------------|
| <b>Liabilities:</b>              |           |               |               |
| Deferred compensation obligation |           | 10,237        | 10,237        |
| <b>Total liabilities</b>         |           | <b>10,237</b> | <b>10,237</b> |
| Total net assets (liabilities)   | \$ 42,650 | \$ (1,847)    | \$ 40,803     |

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 the balance sheet date are classified as current.

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**Rabbi trust investments** The Company's rabbi trust investments consist primarily of fixed income investments from which supplemental executive retirement plan benefits are paid. The Company includes these assets in other long-term assets.

**Deposits** Deposits include 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 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.

**Mark-to-market derivative asset** The Company utilizes fixed-to-floating interest-rate swaps, typically designated as fair-value hedges, to achieve a targeted level of variable-rate debt as a percentage of total debt. The Company uses a calculation of future cash inflows and estimated future outflows, which are discounted, to determine the current fair value. Additional inputs to the present value calculation include the contract terms, counterparty credit risk, interest rates and market volatility.

**Note 14: Segment Information**

The Company has two operating segments that are also the Company's two reportable segments, referred to as Regulated Businesses and Market-Based Operations.

The following table includes the Company's summarized segment information:

|  | <b>As of or for the Three Months Ended<br/>March 31, 2013</b> |                                    |              |                     |
|--|---|------------------------------------|--------------|---------------------|
|  | <b>Regulated<br/>Businesses</b>                               | <b>Market-Based<br/>Operations</b> | <b>Other</b> | <b>Consolidated</b> |
| Net operating revenues                                       | \$ 573,237  | \$ 67,336                          | \$ (4,436)   | \$ 636,137          |
| Depreciation and amortization                                | 91,857  | 1,759                              | 6,033        | 99,649              |
| Total operating expenses, net                                | 415,516   | 62,381                             | (5,993)      | 471,904             |
| Income (loss) from continuing operations before income taxes | 98,781  | 5,671                              | (15,641)     | 88,811              |
| Total assets   | 12,747,924  | 260,389                            | 1,760,903    | 14,769,216          |
| Capital expenditures   | 212,265   | 821                                | 0            | 213,086             |

|   | <b>As of or for the Three Months Ended<br/>March 31, 2012</b> |                                    |              |                     |
|---|---|------------------------------------|--------------|---------------------|
|   | <b>Regulated<br/>Businesses</b>                               | <b>Market-Based<br/>Operations</b> | <b>Other</b> | <b>Consolidated</b> |
| Net operating revenues  | \$ 541,875  | \$ 80,581                          | \$ (3,902)   | \$ 618,554          |
| Depreciation and amortization                                       | 84,788  | 1,681                              | 5,635        | 92,104              |
| Total operating expenses, net                                       | 394,642   | 70,756                             | (6,582)      | 458,816             |
| Income (loss) from continuing operations before income taxes        | 90,416  | 10,483                             | (16,254)     | 84,645              |
| Total assets  | 12,182,806  | 243,819                            | 1,661,114    | 14,087,739          |
| Assets of discontinued operations (included in total assets above)  | 141,945   | 0                                  | (4,440)      | 137,505             |
| Capital expenditures  | 233,198   | 168                                | 0            | 233,366             |
| Capital expenditures of discontinued operations (included in above) | 2,699   | 0                                  | 0            | 2,699               |

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
FORWARD-LOOKING STATEMENTS**

Certain matters within this Quarterly Report on Form 10-Q include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements included in this Form 10-Q, other than statements of historical fact, may constitute forward-looking statements. Forward-looking statements can be identified by the use of words such as may, should, will, could, estimates, predicts, potential, continue, anticipates, believes, plans, expect, and similar expressions. Forward-looking statements may involve known and unknown risks, uncertainties and other factors that may cause the actual results or performance to differ from those projected in the forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. Factors that could cause or contribute to differences in results and outcomes from those in our forward-looking statements include, without limitation, those items discussed in the Risk Factors section or other sections in the Company's Form 10-K for the year ended December 31, 2012 filed with the Securities and Exchange Commission (SEC), as well as in Item IA of Part II of this Quarterly Report. We undertake no obligation, other than as required by law, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

**General**

American Water Works Company, Inc. (herein referred to as American Water or the Company) is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial, industrial and other customers. Our Regulated Businesses that provide these services are generally subject to economic regulation by state regulatory agencies (PUCs) in the states in which they operate. We report the results of these businesses in our Regulated Business segment. We also provide services that are not subject to economic regulation by state regulatory agencies. We report the results of these businesses in our Market-Based Operations segment. For further description of our businesses see the Business section found in our Form 10-K for the year ended December 31, 2012 filed with the SEC.

You should read the following discussion in conjunction with our Consolidated Financial Statements and related Notes included elsewhere in this Quarterly Report on Form 10-Q and in our Form 10-K for the year ended December 31, 2012 filed with the SEC.

**Overview**

All financial information in this Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) reflects only continuing operations. As previously disclosed in our Form 10-K for the year ended December 31, 2012, as part of our portfolio optimization initiative, we entered into agreements in 2011 to sell our regulated subsidiaries in Arizona, New Mexico and Ohio. In the first quarter of 2012, we completed the divestiture of the Arizona and New Mexico subsidiaries, and on May 1, 2012, we completed the divestiture of our Ohio subsidiary. Therefore, the financial results of these entities have been presented as discontinued operations for all periods, unless otherwise noted.

*Financial Results.* For the three months ended March 31, 2013, we reported net income of \$57.6 million, or diluted earnings per share (EPS) of \$0.32 compared to \$41.8 million, or diluted EPS of \$0.24 for the comparable period in 2012. Income from continuing operations was \$57.6 million for the first quarter of 2013 compared to \$49.3 million in the first quarter of 2012. Diluted income from continuing operations per average common share was \$0.32 for the first quarter of 2013 as compared to \$0.28 for the first quarter of 2012.

The primary factors contributing to the increase in net income from continuing operations for the three months ended March 31, 2013 were increased revenues in our Regulated Businesses resulting from rate increases and lower income tax expense resulting from a \$3.3 million tax benefit. Partially offsetting these increases were higher operation and maintenance expense and depreciation expense. For further details, see Consolidated Results of Operations and Variances and Segment Results below.

In 2013, our goals include actively addressing regulatory lag that impacts return on our investments and promoting constructive regulatory frameworks, continuing to improve our regulated operation and maintenance (O&M) efficiency ratio, making efficient use of our capital and expanding both our Regulated Business segment through focused acquisitions and/or organic growth and our Market-Based segment through core growth, expanded markets and new offerings.

We expect to file up to four general rate cases as well as file for infrastructure surcharges in 2013. Additionally, we expect, as part of our general rate case filings or in separate filings, to seek appropriate pass-through mechanisms for certain costs and forward-looking adjustments or mechanisms including those that recognize declining usage.



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The progress that we have made in the first three months of 2013 with respect to these objectives is described below.

*Addressing Regulatory Lag and Declining Usage.* On January 1, 2013, additional annualized revenue of \$6.5 million resulting from infrastructure charges in our Pennsylvania subsidiary became effective.

Additionally on January 1, 2013, the second step increase of our 2012 California rate case became effective in the amount of \$3.5 million. The last step increase will be effective on January 1, 2014. Also on January 1, 2013, the final step increase of our 2010 Pennsylvania wastewater rate case became effective in the amount of \$2.6 million.

On April 1, 2013, additional annualized revenue of \$2.9 million resulting from infrastructure charges in our Pennsylvania subsidiary became effective. Also, on April 1, 2013 the second step increase of \$1.4 million from our 2012 New York rate case became effective. The final step increase will be effective on April 1, 2014 in the amount of \$1.2 million.

On February 28, 2013, the Company filed for additional annualized revenues of \$5.3 million resulting from infrastructure charges in our Missouri subsidiary. This filing is expected to be effective during the second or third quarter of 2013.

On April 30, 2013, we filed general rate cases in Pennsylvania and Iowa requesting additional annualized revenues of \$58.6 million and \$6.4 million, respectively. On May 10, 2013, \$2.7 million in annualized revenues of the \$6.4 million requested in the Iowa rate case will be put into effect as interim rates under bond and subject to refund. Also on May 1, 2013, we filed a proposed application in California requesting additional annualized revenues of \$32.7 million which includes staged increases in 2016 and 2017 of \$8.0 million and \$6.5 million, respectively. As of May 1, 2013, we are awaiting final orders in five states requesting additional annualized revenues of \$134.6 million. There is no assurance that all, or any portion, of this requested increase will be granted.

*Continuing Improvement in O&M Efficiency Ratio for our Regulated Businesses.* Our O&M efficiency ratio (a non-GAAP measure) is calculated on our Regulated Business operations and is defined as operation and maintenance expense divided by operating revenues where both operation and maintenance expense and operating revenues are adjusted to eliminate the impact of purchased water. We also exclude the allocable portion of non-O&M support services costs, mainly depreciation and general taxes that are reflected in the Regulated Business segment as O&M costs but for consolidated financial reporting purposes are categorized within other line items in the Statement of Operations. Our operating efficiency ratio was 42.9% for the three months ended March 31, 2013, compared to 43.6% for the three months ended March 31, 2012.

The improvement in our O&M efficiency ratio was driven by an increase in revenue. We evaluate our operating performance using this measure because management believes it is a direct measure of the efficiency of our regulated operations. This information is intended to enhance an investor's overall understanding of our operating performance. The O&M efficiency ratio is not a measure defined under GAAP and may not be comparable to other companies' operating measures and should not be used in place of the GAAP information provided elsewhere in this report. The following table provides a reconciliation that compares operation and maintenance expense and operating revenues, as determined in accordance with GAAP, to those amounts utilized in the calculation of our O&M efficiency ratio for the three months ended March 31, 2013 as compared to the same period in 2012:



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Regulated O&M Efficiency Ratio (a Non-GAAP Measure)

|   | For the three months ended<br>March 31, |                   |
|---|---|-------------------|
|   | 2013                                    | 2012              |
|   | (In thousands)                          |                   |
| Total O&M expense                                 | \$ 312,203                              | \$ 310,004        |
| Less:   |   |                   |
| O&M expense Market-Based Operations               | 59,224                                  | 67,765            |
| O&M expense Other                                 | (15,963)                                | (15,692)          |
| <b>Total Regulated O&amp;M expense</b>            | <b>268,942</b>                          | <b>257,931</b>    |
| Less:   |   |                   |
| Regulated purchased water expense                 | 23,984                                  | 22,410            |
| Allocation of internal O&M costs                  | 9,554                                   | 9,245             |
| <b>Adjusted Regulated O&amp;M expense(a)</b>      | <b>\$ 235,404</b>                       | <b>\$ 226,276</b> |
| <br>  |   |                   |
| Total Operating Revenues                          | \$ 636,137                              | \$ 618,554        |
| Less:   |   |                   |
| Operating revenues Market-Based Operations        | 67,336                                  | 80,581            |
| Operating revenues Other                          | (4,436)                                 | (3,902)           |
| <b>Total Regulated operating revenues</b>         | <b>573,237</b>                          | <b>541,875</b>    |
| Less: Regulated purchased water expense*          | 23,984                                  | 22,410            |
| <b>Adjusted Regulated operating revenues(b)</b>   | <b>\$ 549,253</b>                       | <b>\$ 519,465</b> |
| <br>  |   |                   |
| <b>Regulated O&amp;M efficiency ratio (a)/(b)</b> | <b>42.9%</b>                            | <b>43.6%</b>      |

\* Calculation assumes purchased water revenues approximate purchased water expenses.

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*Making Efficient Use of Capital.* We invested approximately \$213 million in Company-funded capital improvements during the three months ended March 31, 2013.

During 2013, we expect to roll-out Phase II of our business transformation project. Phase II consists of the roll-out of a new Enterprise Asset Management system, which will manage an asset's lifecycle, and a Customer Information System, which will contain all billing and data pertaining to our Regulated segment customers. Phase II is expected to be substantially complete by December 31, 2013. Through March 31, 2013, we have spent \$280.1 million, including allowance for funds used during construction ( AFUDC ), on this project with \$23.1 million spent in 2013. Expenditures associated with this project are included in the estimated capital investment spending of \$950 million for 2013.

*Expanding Markets and Developing New Offerings.* For the three months ended March 31, 2013 our Regulated business completed the purchase of four water systems in Pennsylvania, California and Indiana and a wastewater system in Missouri. These acquisitions added approximately 1,600 customers to our regulated operations. Also, during the first quarter of 2013, our Homeowner Services Group ( HOS ) announced that it is expanding its water and sewer line protection programs into seven new states.

On May 2, 2013, we signed an agreement to purchase a wastewater utility company in Virginia for \$12.0 million in cash plus the assumption of approximately \$13.8 million in long-term debt. This acquisition will add approximately 20,000 wastewater customers to our Virginia regulated operations.

**Consolidated Results of Operations and Variances**

|   | <b>For the three months ended<br/>March 31,<br/>(In thousands, except per share data)</b> |             |   |
|---|---|-------------|---|
|   | <b>2013</b>   | <b>2012</b> | <b>Favorable<br/>(Unfavorable)<br/>Change</b> |
| Operating revenues                                    | \$ 636,137  | \$ 618,554  | \$ 17,583                                     |
| Operating expenses                                    |   |             |   |
| Operation and maintenance                             | 312,203   | 310,004     | (2,199)                                       |
| Depreciation and amortization                         | 99,649  | 92,104      | (7,545)                                       |
| General taxes   | 60,146  | 57,121      | (3,025)                                       |
| (Gain) loss on asset dispositions and purchases       | (94)  | (413)       | (319)   |
| Total operating expenses, net                         | 471,904   | 458,816     | (13,088)                                      |
| Operating income                                      | 164,233   | 159,738     | 4,495   |
| Other income (expenses)                               |   |             |   |
| Interest, net   | (78,114)  | (79,654)    | 1,540   |
| Allowance for other funds used during construction    | 3,396   | 4,362       | (966)   |
| Allowance for borrowed funds used during construction | 1,653   | 2,081       | (428)   |
| Amortization of debt expense                          | (1,581)   | (1,266)     | (315)   |
| Other, net  | (776)   | (616)       | (160)   |
| Total other income (expenses)                         | (75,422)  | (75,093)    | (329)   |
| Income from continuing operations before income taxes | 88,811  | 84,645      | 4,166   |
| Provision for income taxes                            | 31,168  | 35,393      | 4,225   |
| Income from continuing operations                     | 57,643  | 49,252      | 8,391   |
| Loss from discontinued operations                     |   | (7,498)     | 7,498   |
| Net income  | \$ 57,643   | \$ 41,754   | \$ 15,889                                     |

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|  |         |           |
|--|---------|-----------|
| <b>Basic earnings per share (a)</b>                        |         |           |
| Income from continuing operations                          | \$ 0.32 | \$ 0.28   |
| Income from discontinued operations                        |         | \$ (0.04) |
| Net income   | \$ 0.32 | \$ 0.24   |
| <b>Diluted earnings per share (a)</b>                      |         |           |
| Income from continuing operations                          | \$ 0.32 | \$ 0.28   |
| Income from discontinued operations                        |         | \$ (0.04) |
| Net income   | \$ 0.32 | \$ 0.24   |
| <b>Average common shares outstanding during the period</b> |         |           |
| Basic  | 177,327 | 175,914   |
| Diluted  | 178,465 | 177,028   |

(a) Amounts may not sum due to rounding

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The following is a discussion of the consolidated results of operations for the three months ended March 31, 2013 compared to the three months ended March 31, 2012:

**Operating revenues.** Consolidated operating revenues for the three months ended March 31, 2013 increased \$17.6 million, or 2.8%, compared to the same period in 2012. The variance is mainly attributable to a \$31.4 million increase in our Regulated Business segment mainly as a result of rate increases partially offset by a \$13.2 million decrease in our Market Based Operations segment related to a decline in our Contract Operations Group revenues mainly as a result of delays in 2013 construction activities associated with our military contracts and the termination of certain municipal and industrial operations and maintenance contracts. For further information, see the respective Operating Revenues discussions within the Segment Results.

**Operation and maintenance.** Consolidated operation and maintenance expense for the three months ended March 31, 2013 increased by \$2.2 million, or 0.7%, compared to the same period in 2012. For further information, see the respective Operation and Maintenance discussions within the Segment Results.

**Depreciation and amortization.** Depreciation and amortization expense increased by \$7.5 million, or 8.2%, for the three months ended March 31, 2013 compared to the same period in the prior year as a result of additional utility plant placed in service, including the expenditures associated with Phase I of our business transformation project that went into service during the third quarter of 2012, and incremental depreciation of \$0.6 million associated with our New York acquisition in 2012.

**Other income (expenses).** Other expenses increased by \$0.3 million, or 0.4%, for the three months ended March 31, 2013 compared to the same period in the prior year. The change is attributable to additional amortization of deferred debt financing costs associated with the new unsecured revolving credit facility that was entered into the fourth quarter of 2012 as well as a reduction in AFUDC attributable to decreased construction activities in the first quarter of 2013 compared to the same period in 2012. Partially offsetting these expense increases was a reduction in interest expense of \$1.5 million.

**Provision for income taxes.** Our consolidated provision for income taxes decreased \$4.2 million, or 11.9%, to \$31.2 million for the three months ended March 31, 2013. The effective tax rates for the three months ended March 31, 2013 and 2012 were 35.1% and 41.8%, respectively. The 2013 rate includes a \$3.3 million tax benefit associated with a legal structure reorganization within our Market-Based segment. This strategic restructuring allows us to utilize state net operating loss carryforwards (NOLCF), which without the restructuring most likely would not have been utilized prior to their expiration.

**Income (loss) from discontinued operations, net of tax.** As noted above, the financial results of our regulated water and wastewater systems in Arizona, New Mexico and Ohio were classified as discontinued operations for the three months ended March 31, 2012. For the three months ended March 31, 2012, income from discontinued operations, net of tax included net income associated with the discontinued operations for the period and a benefit of \$1.6 million related to the cessation of depreciation for our Arizona, New

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Mexico and Ohio subsidiaries. Under GAAP, operations that are considered discontinued operations cease to depreciate their assets. Also reflected in the three months ended March 31, 2012 is a \$9.7 million charge for income taxes resulting from the divestiture of our Arizona and New Mexico subsidiaries.

**Segment Results**

We have two operating segments that are also our reportable segments: the Regulated Businesses and the Market-Based Operations. We evaluate the performance of our segments and allocate resources based on several factors, with the primary measure being income from continuing operations before income taxes. Certain amounts within 2012 operating revenues and operations and maintenance expense categories have been reclassified to conform to the 2013 presentation.

**Regulated Businesses Segment**

The following table summarizes certain financial information for our Regulated Businesses for the periods indicated:

|   | For the three months ended<br>March 31, |                        |                        |
|---|---|------------------------|------------------------|
|   | 2013                                    | 2012<br>(In thousands) | Increase<br>(Decrease) |
| Operating revenues                                    | \$ 573,237                              | \$ 541,875             | \$ 31,362              |
| Operation and maintenance expense                     | 268,942                                 | 257,931                | 11,011                 |
| Operating expenses, net                               | 415,516                                 | 394,642                | 20,874                 |
| Income from continuing operations before income taxes | 98,781                                  | 90,416                 | 8,365                  |

**Operating revenues.** Our primary business involves the ownership of water and wastewater utilities that provide services to residential, commercial, industrial and other customers. This business is generally subject to state regulation and our results of operations are impacted significantly by rates authorized by the regulatory commissions in the states in which we operate.

Operating revenues increased by \$31.4 million, or 5.8%, for the three months ended March 31, 2013 compared to three months ended March 31, 2012. The increase in revenues was primarily due to rate increases obtained through rate authorizations for a number of our operating companies, the impact of which was approximately \$25.3 million. Additional revenues of \$5.1 million are associated with acquisitions, most significant being our New York acquisition in the second quarter of 2012, and increased surcharge and balancing account revenues of \$5.2 million. These increases were partially offset by decreased revenues of approximately \$3.6 million attributable to lower demand in the first quarter of 2013 compared to the first quarter of 2012.

The following table provides information regarding the Regulated Businesses' revenues and billed water sales volume by customer class:

| Customer Class       | For the three months ended<br>March 31,              |       |            |       |  |        |        |        |
|----------------------|--|-------|------------|-------|--|--------|--------|--------|
|                      | 2013<br>Operating Revenues<br>(Dollars in thousands) |       |            |       | 2012<br>Billed Water Sales Volume<br>(Gallons in millions) |        |        |        |
| Water service        |  |       |            |       |  |        |        |        |
| Residential          | \$ 321,664   | 56.1% | \$ 305,897 | 56.5% | 38,064   | 50.4%  | 38,475 | 50.3%  |
| Commercial           | 112,862  | 19.7% | 106,672    | 19.7% | 16,939   | 22.4%  | 17,259 | 22.6%  |
| Industrial           | 27,892   | 4.9%  | 26,481     | 4.9%  | 8,883  | 11.8%  | 8,975  | 11.8%  |
| Public and other     | 74,493   | 13.0% | 71,281     | 13.1% | 11,627   | 15.4%  | 11,726 | 15.3%  |
| Other water revenues | 5,133  | 0.9%  | 3,186      | 0.6%  |  |        |        |        |
| Total water revenues | \$ 542,044   | 94.6% | \$ 513,517 | 94.8% | 75,513   | 100.0% | 76,435 | 100.0% |

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|                     |            |        |            |        |
|---------------------|------------|--------|------------|--------|
| Wastewater revenues | 19,884     | 3.4%   | 19,121     | 3.5%   |
| Other revenues      | 11,309     | 2.0%   | 9,237      | 1.7%   |
|                     | \$ 573,237 | 100.0% | \$ 541,875 | 100.0% |

*Water Services* Water service operating revenues from residential customers for the three months ended March 31, 2013 totaled \$321.7 million, a \$15.8 million increase, or 5.2%, over the same period of 2012, mainly due to rate increases and additional

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revenues resulting from acquisitions, partially offset by a decrease in sales volume. The volume of water sold to residential customers decreased by 1.1% for the three months ended March 31, 2013 to 38.1 billion gallons, from 38.5 billion gallons for the same period in 2012.

Water service operating revenues from commercial water customers for the three months ended March 31, 2013 increased by \$6.2 million, or 5.8%, to \$112.9 million, compared to the same period in 2012. This increase was mainly due to rate increases partially offset by a decrease in sales volume. The volume of water sold to commercial customers decreased by 1.9% for the three months ended March 31, 2013 to 16.9 billion gallons, from 17.3 billion gallons for the three months ended March 31, 2012.

Water service operating revenues from industrial customers totaled \$27.9 million for the three months ended March 31, 2013, an increase of \$1.4 million, or 5.3%, from those recorded for the same period in 2012, mainly due to rate increases partially offset by a decrease in sales volume. The volume of water sold to industrial customers totaled 8.9 billion gallons for the three months ended March 31, 2013, a decrease of 1.0% from 9.0 billion gallons for the three months ended March 31, 2012.

Water service operating revenues from public and other customers, including municipal governments, other governmental entities and resale customers increased \$3.2 million, or 4.5%, to \$74.5 million for the three months ended March 31, 2013, mainly due to rate increases.

**Operation and maintenance.** Operation and maintenance expense increased \$11.0 million, or 4.3%, for the three months ended March 31, 2013, compared to the three months ended March 31, 2012. Included in this increase is \$3.4 million of incremental costs in 2013 associated with our 2012 New York acquisition.

The following table provides information regarding operation and maintenance expense for the three months ended March 31, 2013 and 2012, by major expense category:

|                                    | For the three months ended<br>March 31, |                   |                        | Percentage  |
|------------------------------------|---|-------------------|------------------------|-------------|
|                                    | 2013                                    | 2012              | Increase<br>(Decrease) |             |
|                                    |   |                   |                        |             |
|                                    |   |                   | (In thousands)         |             |
| Production costs                   | \$ 60,450                               | \$ 58,460         | \$ 1,990               | 3.4%        |
| Employee-related costs             | 113,201                                 | 115,655           | (2,454)                | (2.1%)      |
| Operating supplies and services    | 54,360                                  | 48,015            | 6,345                  | 13.2%       |
| Maintenance materials and supplies | 18,279                                  | 16,195            | 2,084                  | 12.9%       |
| Customer billing and accounting    | 10,172                                  | 8,887             | 1,285                  | 14.5%       |
| Other                              | 12,480                                  | 10,719            | 1,761                  | 16.4%       |
| <b>Total</b>                       | <b>\$ 268,942</b>                       | <b>\$ 257,931</b> | <b>\$ 11,011</b>       | <b>4.3%</b> |

Production costs and employee-related costs, which account for approximately 65% and 68% of the total Regulated Businesses operation and maintenance expense, for the three months ended March 31, 2013 and 2012, respectively, are discussed in more detail below.

Production costs by major expense type were as follows:

|                 | For the three months ended<br>March 31, |           |                        | Percentage |
|-----------------|---|-----------|------------------------|------------|
|                 | 2013                                    | 2012      | Increase<br>(Decrease) |            |
|                 |   |           |                        |            |
|                 |   |           | (In thousands)         |            |
| Purchased Water | \$ 23,984                               | \$ 22,410 | \$ 1,574               | 7.0%       |
| Fuel and Power  | 19,978                                  | 20,100    | (122)                  | (0.6%)     |
| Chemicals       | 10,604                                  | 9,508     | 1,096                  | 11.5%      |
| Waste Disposal  | 5,884                                   | 6,442     | (558)                  | (8.7%)     |

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|       |           |           |          |      |
|-------|-----------|-----------|----------|------|
| Total | \$ 60,450 | \$ 58,460 | \$ 1,990 | 3.4% |
|-------|-----------|-----------|----------|------|

Overall, production costs increased for the three months ended March 31, 2013 compared to the same period in the prior year as a result of higher purchased water costs, attributable to supplier price increases in certain of our subsidiaries, as well as incremental expense attributable to an increase in the amount allowed by a cost recovery mechanism in one of our regulated subsidiaries in 2013. The increase in chemicals is attributable to incremental costs associated with our 2012 acquisition in New York, with the remainder mainly due to price increases and increased chemical dosages as a result of unfavorable water conditions.



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Employee-related costs, including salaries and wages, group insurance, and pension expense, decreased \$2.5 million, or 2.1%, for the three months ended March 31, 2013 compared to the same period in the prior year. These employee-related costs represent approximately 42% and 45% of operation and maintenance expense for the three months ended March 31, 2013 and 2012, respectively.

The following table provides information with respect to components of employee-related costs for the three months ended March 31, 2013 and 2012:

|                    | For the three months ended<br>March 31, |                   |                        | Percentage    |
|--------------------|---|-------------------|------------------------|---------------|
|                    | 2013                                    | 2012              | Increase<br>(Decrease) |               |
|                    | (In thousands)                          |                   |                        |               |
| Salaries and wages | \$ 78,845                               | \$ 78,631         | \$ 214                 | 0.3%          |
| Pensions           | 12,371                                  | 13,358            | (987)                  | (7.4%)        |
| Group insurance    | 16,844                                  | 18,930            | (2,086)                | (11.0%)       |
| Other benefits     | 5,141                                   | 4,736             | 405                    | 8.6%          |
| <b>Total</b>       | <b>\$ 113,201</b>                       | <b>\$ 115,655</b> | <b>\$ (2,454)</b>      | <b>(2.1%)</b> |

The overall decrease in employee-related costs was primarily driven by decreased group insurance and pension expense. The reduction in group insurance costs for the three months ended March 31, 2013 compared to the same period in 2012 was mainly attributable to higher capitalization rates. The decrease in pension expense for the three months ended March 31, 2013 was primarily due to decreased contributions in certain of our regulated operating companies whose costs are recovered based on our funding policy, which is to fund at least the minimum amount required by the Employee Retirement Income Security Act of 1974, partially offset by increased pension expense resulting from the finalization of our California rate case. Salaries and wages expense was relatively unchanged for the three months ended March 31, 2013, compared to 2012, with increases related to annual wage increases and increased overtime expense offset by higher capitalization rates and \$2.4 million of severance-related costs included in the 2012 period.

Operating supplies and services include the day-to-day expenses of office operation, legal and other professional services, transportation expenses, information systems rental charges and other office equipment rental charges. These costs increased \$6.3 million, or 13.2%, for the three months ended March 31, 2013. The overall increase was primarily due to higher contracted services, mainly as a result of backfilling positions; the use of contractors for other specific projects; and lastly, additional incremental costs attributable to the continued maturity of our Enterprise Resource Planning systems in conjunction with the implementation of Phase I of our business transformation project. Also, contributing to the increase in operating supplies and services is the 2013 operating costs associated with the New York acquisition. Partially offsetting these increases was lower transportation expenses due to a reduction in leased vehicle costs.

Maintenance materials and supplies, which include emergency repairs as well as costs for preventive maintenance, increased \$2.1 million, or 12.9%, for the three months ended March 31, 2013 mainly as a result of higher than normal main breaks in a number of subsidiaries, increased costs as a result of the 2012 New York acquisition and an increase in tank cleaning costs in California.

Customer billing and accounting expenses, which include uncollectible accounts expense, postage and other customer related expenses, increased \$1.3 million, or 14.5%, for the three months ended March 31, 2013 primarily due to an increase in uncollectible expense associated with the increase in revenues.

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. For the three months ended March 31, 2013, costs increased by \$1.8 million primarily driven by higher casualty insurance costs as a result of historical claims experience and retroactive adjustments.

**Operating expenses.** The increase in operating expenses is due to the increases in operation and maintenance expense for the three months ended March 31, 2013 explained above, higher depreciation and amortization expense of \$7.1 million and higher general tax expense of \$2.8 million. The increase in depreciation and amortization is primarily due to additional utility plant placed in service. The increase in general tax expense is primarily due to \$2.4 million of property taxes incurred as a result of our New York acquisition in the second quarter of 2012.

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*Income from continuing operations before income taxes.* The \$8.4 million increase for the three months ended March 31, 2013 is the result of the aforementioned changes in operating revenue and operating expenses.

**Table of Contents****Market-Based Operations**

The following table provides financial information for our Market-Based Operations segment for the periods indicated:

|   | For the three months ended<br>March 31, |                        |                        |
|---|---|------------------------|------------------------|
|   | 2013                                    | 2012<br>(In thousands) | Increase<br>(Decrease) |
| Operating revenues                                    | \$ 67,336                               | \$ 80,581              | \$ (13,245)            |
| Operation and maintenance expense                     | 59,224                                  | 67,765                 | (8,541)                |
| Operating expenses, net                               | 62,381                                  | 70,756                 | (8,375)                |
| Income from continuing operations before income taxes | 5,671                                   | 10,483                 | (4,812)                |

**Operating revenues.** The net decrease in revenues is primarily attributable to a decrease in the Contract Operations Group revenues of \$14.7 million. Of this decrease, approximately \$9.8 million is due to delays in 2013 of capital activities associated with military construction with the remaining decrease primarily due to the termination of certain municipal and industrial operations and maintenance contracts. The decrease in the Contract Operations Group revenues is partially offset by a \$1.5 million increase in our HOS revenues associated with contract growth.

**Operation and maintenance.** Operation and maintenance expense decreased \$8.5 million, or 12.6%, for the three months ended March 31, 2013.

The following table provides information regarding categories of operation and maintenance expense for the three months ended March 31, 2013 and 2012:

|                                    | For the three months ended<br>March 31, |                        |                        |            |
|------------------------------------|---|------------------------|------------------------|------------|
|                                    | 2013                                    | 2012<br>(In thousands) | Increase<br>(Decrease) | Percentage |
| Production costs                   | \$ 10,059                               | \$ 12,039              | \$ (1,980)             | (16.4%)    |
| Employee-related costs             | 16,331                                  | 17,865                 | (1,534)                | (8.6%)     |
| Operating supplies and services    | 21,470                                  | 27,419                 | (5,949)                | (21.7%)    |
| Maintenance materials and supplies | 10,586                                  | 9,029                  | 1,557                  | 17.2%      |
| Other                              | 778                                     | 1,413                  | (635)                  | (44.9%)    |
| Total                              | \$ 59,224                               | \$ 67,765              | \$ (8,541)             | (12.6%)    |

As noted in the table above, decreases in operating supplies and services, production costs and employee-related costs were partially offset by an increase in maintenance materials and supplies and correspond with the decrease in revenues above. The decrease in production costs and employee-related costs is due to the termination of certain municipal and industrial operations and maintenance contracts. The decrease in operating supplies and services is attributable to the delayed construction activity for our military contracts and is partially offset by increased HOS printing and postage costs associated with marketing campaigns, including New York City. The increase in maintenance materials and services is primarily due to higher HOS repair costs, attributable to new contracts, an increase in the number of claims, as well as an increase in the average cost per claim.

**Operating expense.** The change in operating expenses for the three months ended March 31, 2013 compared to 2012 is primarily due to the variances in the operation and maintenance expense explained above.

**Income from continuing operations before income taxes.** The \$4.8 million decrease for the three months ended March 31, 2013 compared to the same period in 2012 is the result of the aforementioned changes in operating revenues and operating expenses.

**Liquidity and Capital Resources**

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For a general overview of our sources and uses of capital resources, see the introductory discussion under Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources, contained in part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2012.

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We believe that our ability to access the capital markets, our revolving credit facility and our cash flows from operations will generate sufficient cash to fund our short-term capital requirements. We fund liquidity needs for capital investment, working capital and other financial commitments through cash flows from operations, public and private debt offerings, commercial paper markets, and to the extent necessary, our revolving credit facility with a diversified group of banks. We regularly evaluate the capital markets as well as closely monitor the financial condition of the financial institutions associated with the revolving credit facility.

In order to meet our short-term liquidity needs, we, through American Water Capital Corp. ( AWCC ), our financing subsidiary, issue primarily commercial paper, which is supported by the revolving credit facility. The revolving credit facility is also used, to a limited extent, to support our issuance of letters of credit. As of March 31, 2013, AWCC had no outstanding borrowings and \$29.0 million of outstanding letters of credit under the revolving credit facility. As of March 31, 2013, AWCC had \$971.0 million available under the credit facility that we can use to fulfill our short-term liquidity needs, to issue letters of credit and back our \$333.8 million outstanding commercial paper. We can provide no assurances that our lenders will meet their existing commitments or that we will be able to access the commercial paper or loan markets in the future on terms acceptable to us or at all.

**Cash Flows from Operating Activities**

Cash flows from operating activities primarily result from the sale of water and wastewater services and, due to the seasonality of demand, are generally greater during the third quarter of each fiscal year. Cash flows from operating activities for the three months ended March 31, 2013 were \$149.6 million compared to \$148.1 million for the three months ended March 31, 2012.

The following table provides a summary of the major items affecting our cash flows from operating activities for the three months ended March 31, 2013 and 2012:

|   | <b>For the three months ended</b> |             |
|---|-----------------------------------|-------------|
|   | <b>March 31,</b>                  |             |
|   | <b>2013</b>                       | <b>2012</b> |
|   | <b>(In thousands)</b>             |             |
| Net income  | \$ 57,643                         | \$ 41,754   |
| Add (subtract):                                     |                                   |             |
| Non-cash operating activities(1)                    | 141,670                           | 145,735     |
| Changes in working capital(2)                       | (19,922)                          | 1,037       |
| Pension and postretirement healthcare contributions | (29,766)                          | (40,427)    |
| Net cash flows provided by operations               | \$ 149,625                        | \$ 148,099  |

(1) Includes, depreciation and amortization, provision for deferred income taxes, amortization of deferred investment tax credits, provision for losses on accounts receivable, allowance for other funds used during construction, (gain) loss on asset dispositions and purchases, pension and non-pension post retirement benefits expense, stock-based compensation expense and other non-cash items. Details of each component can be found in the Consolidated Statements of Cash Flows.

(2) Changes in working capital include changes to accounts receivable and unbilled utility revenue, taxes receivable including income taxes, other current assets, accounts payable, taxes accrued (including income taxes), interest accrued, book overdraft and other current liabilities.

Our working capital needs are primarily limited to funding the increase in our customer accounts receivable and unbilled revenues which is mainly associated with the revenue increase as a result of rate increases in our Regulated Businesses. We address this timing issue through the aforementioned liquidity funding mechanisms.

*Cash Flows from Investing Activities*

The following table provides information regarding cash flows used in investing activities for the periods indicated:

|  | <b>For the three months ended</b> |                   |
|--|-----------------------------------|-------------------|
|  | <b>March 31,</b>                  |                   |
|  | <b>2013</b>                       | <b>2012</b>       |
|  | <b>(In thousands)</b>             |                   |
| Net capital expenditures                           | \$ (213,086)                      | \$ (233,366)      |
| Proceeds from sale of assets and securities        | 280                               | 461,375           |
| Acquisitions                                       | (2,836)                           | (104)             |
| Other investing activities, net(1)                 | (12,068)                          | 1,700             |
| <b>Net cash flows used in investing activities</b> | <b>\$ (227,710)</b>               | <b>\$ 229,605</b> |

(1) Includes removal costs from property, plant and equipment retirements, net and net funds released.

**Table of Contents****Cash Flows from Financing Activities**

Our financing activities, primarily focused on funding construction expenditures, include the issuance of long-term and short-term debt, primarily through AWCC. We intend to access the capital markets on a regular basis, subject to market conditions. In addition, new infrastructure may be financed with customer advances and contributions for construction (net of refunds).

The following table provides information on long-term debt that was issued during the first three months of 2013:

| Company            | Type   | Interest Rate | Maturity | Amount<br>(In thousands) |
|--------------------|--|---------------|----------|--------------------------|
| Other subsidiaries | Private activity bonds and government funded debt fixed rate | 1.59%         | 2033     | \$ 1,378                 |
| Total issuances    |  |               |          | \$ 1,378                 |

Proceeds from the above issuances were received from Pennsylvania Infrastructure Investment Authority and will be used to fund certain specified projects.

The following long-term debt was retired through optional redemption, sinking fund provisions or payment at maturity during the first three months of 2013:

| Company                           | Type  | Interest Rate | Maturity  | Amount<br>(In thousands) |
|-----------------------------------|---|---------------|-----------|--------------------------|
| Other subsidiaries (1)            | Private activity bonds and government funded debt -fixed rate | 0.00%-5.50%   | 2013-2041 | \$ 5,335                 |
| Other subsidiaries                | Mandatory redeemable preferred stock                          | 8.49%         | 2036      | 1,200                    |
| Other                             | Capital leases and other                                      |               |           | 82                       |
| Total retirements and redemptions |   |               |           | \$ 6,617                 |

(1) Includes \$3,025 thousands of non-cash redemptions via the use of restricted funds.

From time to time, and as market conditions warrant, we may engage in additional long-term debt retirements via tender offers, open market repurchases or other viable transactions.

**Credit Facilities and Short-Term Debt**

Short-term debt at March 31, 2013 consists of the following:

|                       | Amount<br>(In thousands) |
|-----------------------|--------------------------|
| Commercial paper, net | \$ 333,786               |

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Total short-term debt \$ 333,786

The following table provides information as of March 31, 2013 regarding letters of credit sub-limits under our revolving credit facility and available funds under the revolving credit facility, as well as outstanding amounts of commercial paper and borrowings under the revolving credit facilities.

|                | <b>Credit Facility<br/>Commitment</b> | <b>Available<br/>Credit Facility<br/>Capacity</b> | <b>Letter of Credit<br/>Sub-limit</b> | <b>Available<br/>Letter of Credit<br/>Capacity</b> | <b>Outstanding<br/>Commercial<br/>Paper<br/>(Net of Discount)</b> | <b>Credit<br/>Line<br/>Borrowings</b> |
|----------------|---------------------------------------|---|---------------------------------------|--|---|---------------------------------------|
|                |                                       |   | <b>(In thousands)</b>                 |  |   |                                       |
| March 31, 2013 | \$ 1,000,000                          | \$ 970,960  | \$ 150,000                            | \$ 120,960   | \$ 333,786  | \$                                    |

The weighted-average interest rate on short-term borrowings for the three months ended March 31, 2013 was approximately 0.41% compared to 0.52% for the three months ended March 31, 2012.



**Table of Contents****Capital Structure**

The following table provides information regarding our capital structure for the periods presented:

|   | At<br>March 31,<br>2013 | At<br>December 31,<br>2012 |
|---|-------------------------|----------------------------|
| Common stockholders' equity and preferred stock without mandatory redemption rights | 44%                     | 44%                        |
| Long-term debt and redeemable preferred stock at redemption value                   | 51%                     | 52%                        |
| Short-term debt and current portion of long-term debt                               | 5%                      | 4%                         |
|   | 100%                    | 100%                       |

**Debt Covenants**

Our debt agreements contain financial and non-financial covenants. To the extent that we are not in compliance, we or our subsidiaries may be restricted in the ability to pay dividends, issue new debt or access our revolving credit facility. We were in compliance with our covenants as of March 31, 2013. Our failure to comply with restrictive covenants under our credit facility could accelerate repayment obligations. Our long-term debt indentures contain a number of covenants that, among other things, limit the Company from issuing debt secured by the Company's assets, subject to certain exceptions.

Certain long-term notes and the revolving credit facility require us to maintain a ratio of consolidated debt to consolidated capitalization of not more than 0.70 to 1.00. As of March 31, 2013, our ratio was 0.56 to 1.00 and therefore we were in compliance with the covenant.

**Security Ratings**

Our access to the capital markets, including the commercial paper market, and respective financing costs in those markets, is directly affected by securities ratings of the entity that is accessing the capital markets. We primarily access the capital markets, including the commercial paper market, through AWCC. However, we also issue debt through our regulated subsidiaries, primarily in the form of tax exempt securities, to lower our overall cost of debt.

The following table shows the Company's securities ratings as of March 31, 2013:

| Securities            | Moody's Investors<br>Service | Standard & Poor's<br>Ratings Service |
|-----------------------|------------------------------|--------------------------------------|
| Senior unsecured debt | Baa2                         | BBB+                                 |
| Commercial paper      | P2                           | A2                                   |

A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating agency, and each rating should be evaluated independently of any other rating. Security ratings are highly dependent upon our ability to generate cash flows in an amount sufficient to service our debt and meet our investment plans. We can provide no assurances that our ability to generate cash flows is sufficient to maintain our existing ratings. None of our borrowings are subject to default or prepayment as a result of the downgrading of these security ratings, although such a downgrading could increase fees and interest charges under our credit facility.

As part of the normal course of business, we routinely enter into contracts for the purchase and sale of water, energy, fuels and other services. These contracts either contain express provisions or otherwise permit us and our counterparties to demand adequate assurance of future performance when there are reasonable grounds for doing so. In accordance with the contracts and applicable contract law, if we are downgraded by a credit rating agency, especially if such downgrade is to a level below investment grade, it is possible that a counterparty would attempt to rely on such a downgrade as a basis for making a demand for adequate assurance of future performance, which could include a

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demand that we provide collateral to secure our obligations. We do not expect that our posting of collateral would have a material adverse impact on our results of operations, financial position or cash flows.

### *Dividends*

Our board of directors practice has been to distribute to our shareholders a portion of our net cash provided by operating activities as regular quarterly dividends, rather than retaining that cash for other purposes. Since the dividends on our common stock will not be cumulative, only declared dividends will be paid.

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In order to take advantage of existing 2012 tax rates, the cash dividend payment that would have historically been paid in March 2013 was paid in December 2012. In March 2012, we made a cash dividend payment of \$0.23 per share to all shareholders of record as of February 3, 2012.

On May 6, 2013, our board of directors declared a quarterly cash dividend payment of \$0.28 per share payable on June 3, 2013 to all shareholders of record as of May 24, 2013.

### ***Market Risk***

There have been no significant changes to our market risk since December 31, 2012. For a discussion of our exposure to market risk, refer to Part II, Item 7A. Quantitative and Qualitative Disclosures about Market Risk, contained in our Annual Report on Form 10-K for the year ended December 31, 2012.

### ***Application of Critical Accounting Policies and Estimates***

Our financial condition, results of operations and cash flows are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. See Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates, in our Form 10-K for the year ended December 31, 2012 filed with the SEC for a discussion of our critical accounting policies.

### ***Recent Accounting Pronouncements***

See Part I, Item 1 Financial Statements (Unaudited) Note 2 New Accounting Pronouncements in this Quarterly Report on Form 10-Q for a discussion of new accounting standards recently adopted or pending adoption.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are subject to market risks in the normal course of business, including changes in interest rates and equity prices. For further discussion of market risks see *Market Risk* in Part I, Item 2 *Management's Discussion and Analysis of Financial Condition and Results of Operations*.

**ITEM 4. CONTROLS AND PROCEDURES**

***Evaluation of Disclosure Controls and Procedures***

American Water Works Company, Inc. maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in its reports filed or submitted under the Securities Exchange Act of 1934 (the Exchange Act) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

Our management, including the Chief Executive Officer and the Chief Financial Officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) of the Exchange Act) as of March 31, 2013 pursuant to 15d-15(e) under the Exchange Act.

Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of March 31, 2013, our disclosure controls and procedures were effective at a reasonable level of assurance. Our disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

***Changes in Internal Control over Financial Reporting***

There have been no changes in our internal control over financial reporting that occurred during the three months ended March 31, 2013, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

As noted under *Making Efficient Use of Capital* in Part I, Item 2- *Management's Discussion and Analysis of Financial Condition and Results of Operations* of this Form 10-Q, we have undertaken a project with the goals of increasing our operating efficiencies and effectiveness and controlling the costs associated with the operation of our business, all of which are important to providing quality service to our customers and communities we serve. Phase II of this project focuses on the implementation of an Enterprise Asset Management system, which will handle the management of asset lifecycles; and a Customer Information system which will contain all billing and data pertaining to our regulated customers. The implementation of these two systems, along with their integration with the Enterprise Resource Planning systems which went live in 2012, is reasonably likely to significantly change our internal control over financial reporting. Efforts have and will continue to be made to minimize any adverse impact on our controls, however, we cannot assure that all such impacts will be mitigated.

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**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

Previously reported under Part I, Item 3 Legal Proceedings in the Company's Form 10-K for the year ended December 31, 2012.

**ITEM 1A. RISK FACTORS**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in the Risk Factors in the Company's Form 10-K for the year ended December 31, 2012, and our other public filings, which could materially affect our business, financial condition or future results. There have been no material changes from risk factors previously disclosed in Risk Factors in the Company's Form 10-K for the year ended December 31, 2012.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4. MINE SAFETY DISCLOSURES**

None

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

**Exhibit**

| <b>Number</b> | <b>Exhibit Description</b>   |
|---------------|--|
| *10.1         | 2013 Annual Incentive Plan Highlights Brochure   |
| *10.2         | Agreement and General Release between Ellen C. Wolf and American Water Works Company, Inc., dated March 25, 2013                                 |
| *10.2A        | First Amendment to the Agreement and General Release between Ellen C. Wolf and American Water Works Company, Inc., dated March 28, 2013          |
| *10.3         | Employment Letter Agreement between Susan N. Story and American Water Works Company, Inc. dated February 6, 2013                                 |
| *10.4         | Credit Agreement, dated as of October 29, 2012, among American Water Capital Corp., the Lenders identified therein and JPMorgan Chase Bank, N.A. |
| *10.5         |  |

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American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Initial Restricted Stock Unit Grant Form for Susan N. Story.

- \*10.6 American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Restricted Stock Unit Grant Form for Jeffrey E. Sterba
- \*10.7 American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Performance Stock Unit Grant Form A for Jeffrey E. Sterba
- \*10.8 American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Performance Stock Unit Grant Form B for Jeffrey E. Sterba
- \*10.9 American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Nonqualified Stock Option Grant Form for Jeffrey E. Sterba
- \*10.10 American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Restricted Stock Unit Grant Form for ML2 - L5
- \*10.11 American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Performance Stock Unit Grant Form A for ML2 - L5
- \*10.12 American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Performance Stock Unit Grant Form B for ML2 - L5
- \*10.13 American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Nonqualified Stock Option Grant Form for ML2 - L5
- \*31.1 Certification of Jeffrey Sterba, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act
- \*31.2 Certification of Susan N. Story, Senior Vice President and Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act
- \*32.1 Certification of Jeffrey Sterba, President and Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act
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- 101 The following financial statements from American Water Works Company, Inc. s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2013, filed with the Securities and Exchange Commission on May 7, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations and Comprehensive Income; (iii) the Consolidated Statements of Cash Flows; (iv) the Consolidated Statements of Changes in Stockholders Equity; and (v) the Notes to Consolidated Financial Statements.

\* filed herewith.

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**Signatures**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 7th day of May, 2013.

AMERICAN WATER WORKS COMPANY, INC.

(REGISTRANT)

/S/ Jeffrey Sterba  
Jeffrey Sterba

President and Chief Executive Officer

Principal Executive Officer

/S/ Susan N. Story  
Susan N. Story

Senior Vice President and Chief Financial Officer

Principal Financial Officer

/S/ Mark Chesla  
Mark Chesla

Vice President and Controller

Principal Accounting Officer

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**EXHIBIT INDEX**

| <b>Exhibit</b> |  |
|----------------|--|
| <b>Number</b>  | <b>Exhibit Description</b>   |
| *10.1          | 2013 Annual Incentive Plan Highlights Brochure   |
| *10.2          | Agreement and General Release between Ellen C. Wolf and American Water Works Company, Inc., dated March 25, 2013                                 |
| *10.2A         | First Amendment to the Agreement and General Release between Ellen C. Wolf and American Water Works Company, Inc., dated March 28, 2013          |
| *10.3          | Employment Letter Agreement between Susan N. Story and American Water Works Company, Inc. dated February 6, 2013                                 |
| *10.4          | Credit Agreement, dated as of October 29, 2012, among American Water Capital Corp., the Lenders identified therein and JPMorgan Chase Bank, N.A. |
| *10.5          | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Initial Restricted Stock Unit Grant Form for Susan N. Story.       |
| *10.6          | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Restricted Stock Unit Grant Form for Jeffrey E. Sterba             |
| *10.7          | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Performance Stock Unit Grant Form A for Jeffrey E. Sterba          |
| *10.8          | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Performance Stock Unit Grant Form B for Jeffrey E. Sterba          |
| *10.9          | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Nonqualified Stock Option Grant Form for Jeffrey E. Sterba         |
| *10.10         | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Restricted Stock Unit Grant Form for ML2 L5                        |
| *10.11         | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Performance Stock Unit Grant Form A for ML2 L5                     |
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