AQUA AMERICA INC
Form 10-Q
August 03, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON DC 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended June 30, 2018

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 1-6659

AQUA AMERICA, INC.

(Exact name of registrant as specified in its charter)

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

(Former Name, former address and former fiscal year, if changed since last report.)

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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12(b)-2 of the Exchange Act.:

Large accelerated filer	Accelerated filer
Non-accelerated filer (do not check if a smaller reporting company)	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

July 24, 2018: 177,913,909

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AQUA AMERICA, INC. AND SUBSIDIARIES

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AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands of dollars, except per share amounts)

(UNAUDITED)

Assets	June 30, 2018	December 31, 2017
Property, plant and equipment, at cost	$ 7,191,574	$ 7,003,993
Less: accumulated depreciation	1,649,601	1,604,133
Net property, plant and equipment	5,541,973	5,399,860
Current assets:		
Cash and cash equivalents	52,948	4,204
Accounts receivable and unbilled revenues, net	103,931	98,596
Inventory, materials and supplies	16,046	14,361
Prepayments and other current assets	14,891	12,542
Assets held for sale	1,558	1,543
Total current assets	189,374	131,246
Regulatory assets	750,826	713,971
Deferred charges and other assets, net	38,648	38,485
Investment in joint venture	7,474	6,671
Goodwill	42,050	42,230
Total assets	$ 6,570,345	$ 6,332,463
Liabilities and Equity		
Stockholders' equity:		
Common stock at $.50 par value, authorized 300,000,000 shares, issued 180,971,159 and 180,700,251 as of June 30, 2018 and December 31, 2017	$ 90,486	$ 90,350
Capital in excess of par value	811,763	807,135
Retained earnings	1,177,874	1,132,556
Treasury stock, at cost, 3,058,248 and 2,986,308 shares as of June 30, 2018 and December 31, 2017	(75,771)	(73,280)
Accumulated other comprehensive income	-	860
Total stockholders' equity	2,004,352	1,957,621
Long-term debt, excluding current portion	2,202,363	2,029,358
Less: debt issuance costs	21,002	21,605
Long-term debt, excluding current portion, net of debt issuance costs	2,181,361	2,007,753
Commitments and contingencies (See Note 14)		

Current liabilities:		
Current portion of long-term debt	118,540	113,769
Loans payable	-	3,650
Accounts payable	42,450	59,165
Book overdraft	15,567	21,629
Accrued interest	22,283	21,359
Accrued taxes	17,373	23,764
Other accrued liabilities	37,769	41,152
Total current liabilities	253,982	284,488
Deferred credits and other liabilities:		
Deferred income taxes and investment tax credits	808,711	769,073
Customers' advances for construction	93,342	93,186
Regulatory liabilities	542,525	541,910
Other	104,325	107,341
Total deferred credits and other liabilities	1,548,903	1,511,510
Contributions in aid of construction	581,747	571,091
Total liabilities and equity	$ 6,570,345	$ 6,332,463

See notes to consolidated financial statements beginning on page 9 of this report.

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AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF NET INCOME

(In thousands, except per share amounts)

(UNAUDITED)

	Three Months Ended June 30,	
	2018	2017
Operating revenues	$ 211,860	$ 203,418
Operating expenses:		
Operations and maintenance	73,515	69,615
Depreciation	36,613	33,407
Amortization	149	127
Taxes other than income taxes	14,829	14,419
Total operating expenses	125,106	117,568
Operating income	86,754	85,850
Other expense (income):		
Interest expense, net	23,723	21,387
Allowance for funds used during construction	(2,577)	(3,463)
Gain on sale of other assets	(141)	(10)
Equity (earnings) loss in joint venture	(911)	161
Other	437	1,238
Income before income taxes	66,223	66,537
Provision for income tax (benefit) expense	(367)	5,569
Net income	$ 66,590	$ 60,968
Net income per common share:		
Basic	$ 0.37	$ 0.34
Diluted	$ 0.37	$ 0.34
Average common shares outstanding during the period:		
Basic	177,901	177,609
Diluted	178,273	178,045
Cash dividends declared per common share	$ 0.2047	$ 0.1913

See notes to consolidated financial statements beginning on page 9 of this report.

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AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF NET INCOME

(In thousands, except per share amounts)

(UNAUDITED)

	Six Months Ended June 30,	
	2018	2017
Operating revenues	$ 406,207	$ 391,205
Operating expenses:		
Operations and maintenance	147,461	137,505
Depreciation	72,580	67,244
Amortization	279	316
Taxes other than income taxes	29,796	29,156
Total operating expenses	250,116	234,221
Operating income	156,091	156,984
Other expense (income):		
Interest expense, net	47,194	42,713
Allowance for funds used during construction	(5,444)	(6,656)
Gain on sale of other assets	(337)	(279)
Equity (earnings) loss in joint venture	(1,293)	191
Other	1,040	2,476
Income before income taxes	114,931	118,539
Provision for income tax (benefit) expense	(2,498)	8,499
Net income	$ 117,429	$ 110,040
Net income per common share:		
Basic	$ 0.66	$ 0.62
Diluted	$ 0.66	$ 0.62
Average common shares outstanding during the period:		
Basic	177,852	177,545
Diluted	178,299	178,042

Cash dividends declared per common share	$ 0.4094	$ 0.3826

See notes to consolidated financial statements beginning on page 9 of this report.

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AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands of dollars)

(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	$ 66,590	$ 60,968	$ 117,429	$ 110,040
Other comprehensive income, net of tax:				
Unrealized holding gain on investments, net of tax expense of $20 for the three months, and $51 for the six months ended June 30, 2017, respectively	-	37	-	95
Comprehensive income	$ 66,590	$ 61,005	$ 117,429	$ 110,135

See notes to consolidated financial statements beginning on page 9 of this report.

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AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CAPITALIZATION

(In thousands of dollars, except per share amounts)

(UNAUDITED)

		June 30, 2018	December 31, 2017
Stockholders' equity:			
Common stock, $.50 par value		$ 90,486	$ 90,350
Capital in excess of par value		811,763	807,135
Retained earnings		1,177,874	1,132,556
Treasury stock, at cost		(75,771)	(73,280)
Accumulated other comprehensive income		-	860
Total stockholders' equity		2,004,352	1,957,621
Long-term debt of subsidiaries (substantially collateralized by utility plant):			
Interest Rate Range	Maturity Date Range		
0.00% to 0.99%	2023 to 2033	3,876	4,196
1.00% to 1.99%	2019 to 2035	12,343	12,914
2.00% to 2.99%	2019 to 2033	18,377	19,254
3.00% to 3.99%	2019 to 2056	498,841	475,232
4.00% to 4.99%	2020 to 2057	706,431	631,599
5.00% to 5.99%	2019 to 2043	205,311	205,578
6.00% to 6.99%	2018 to 2036	44,000	44,000
7.00% to 7.99%	2022 to 2027	31,955	32,335
8.00% to 8.99%	2021 to 2025	5,842	6,092
9.00% to 9.99%	2018 to 2026	20,700	25,700
10.00% to 10.99%	2018	6,000	6,000
		1,553,676	1,462,900
Notes payable to bank under revolving credit agreement, variable rate, due 2021		157,000	60,000
Unsecured notes payable:			
Bank notes at 2.48% and 3.5% due 2019 and 2020		100,000	100,000
Notes at 3.01% and 3.59% due 2027 and 2041		245,000	245,000
		122,800	122,800

Notes ranging from 4.62% to 4.87%, due 2018 through 2024				
Notes ranging from 5.20% to 5.95%, due 2018 through 2037		142,427		152,427
Total long-term debt		2,320,903		2,143,127
Current portion of long-term debt		118,540		113,769
Long-term debt, excluding current portion		2,202,363		2,029,358
Less: debt issuance costs		21,002		21,605
Long-term debt, excluding current portion, net of debt issuance costs		2,181,361		2,007,753
Total capitalization	$	4,185,713	$	3,965,374

See notes to consolidated financial statements beginning on page 9 of this report.

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AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EQUITY

(In thousands of dollars)

(UNAUDITED)

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2017	$ 90,350	$ 807,135	$ 1,132,556	$ (73,280)	$ 860	$ 1,957,621
Net income	-	-	117,429	-	-	117,429
Dividends	-	-	(72,802)	-	-	(72,802)
Issuance of common stock under dividend reinvestment plan (22,170 shares)	11	709	-	-	-	720
Repurchase of stock (71,940 shares)	-	-	-	(2,491)	-	(2,491)
Equity compensation plan (185,639 shares)	93	(93)	-	-	-	-
Exercise of stock options (63,099 shares)	32	987	-	-	-	1,019
Stock-based compensation	-	3,428	(169)	-	-	3,259
Cumulative effect of change in accounting principle - financial instruments	-	-	860	-	(860)	-
Other	-	(403)	-	-	-	(403)
Balance at June 30, 2018	$ 90,486	$ 811,763	$ 1,177,874	$ (75,771)	$ -	$ 2,004,352

Refer to Note 16 - Recent Accounting Pronouncements for a discussion of the cumulative effect of change in accounting principle - financial instruments

See notes to consolidated financial statements beginning on page 9 of this report.

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AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOW

(In thousands of dollars)

(UNAUDITED)

	Six Months Ended June 30, 2018	2017
Cash flows from operating activities:		
Net income	$ 117,429	$ 110,040
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	72,859	67,560
Deferred income taxes	(4,602)	6,299
Provision for doubtful accounts	2,213	2,052
Stock-based compensation	3,432	2,810
Loss on sale of market-based business unit	-	324
Gain on sale of other assets	(337)	(279)
Net change in receivables, inventory and prepayments	(11,110)	(7,417)
Net change in payables, accrued interest, accrued taxes and other accrued liabilities	(6,165)	(10,969)
Pension and other postretirement benefits contributions	(8,692)	(15,421)
Other	4,658	2,262
Net cash flows from operating activities	169,685	157,261
Cash flows from investing activities:		
Property, plant and equipment additions, including the debt component of allowance for funds used during construction of $1,613 and $1,543	(216,614)	(208,472)
Acquisitions of utility systems and other, net	(190)	(5,765)
Net proceeds from the sale of market-based business unit and other assets	398	1,102
Other	(152)	(144)
Net cash flows used in investing activities	(216,558)	(213,279)
Cash flows from financing activities:		
Customers' advances and contributions in aid of construction	4,068	3,629
Repayments of customers' advances	(1,818)	(1,774)
Net (repayments) proceeds of short-term debt	(3,650)	60,921
Proceeds from long-term debt	218,037	222,780
Repayments of long-term debt	(41,001)	(145,499)
Change in cash overdraft position	(6,062)	(12,616)
Proceeds from issuing common stock	720	715
Proceeds from exercised stock options	1,019	2,327
Repurchase of common stock	(2,491)	(2,093)

Dividends paid on common stock	(72,802)	(67,920)
Other	(403)	(404)
Net cash flows from financing activities	95,617	60,066
Net change in cash and cash equivalents	48,744	4,048
Cash and cash equivalents at beginning of period	4,204	3,763
Cash and cash equivalents at end of period	$ 52,948	$ 7,811
Non-cash investing activities:		
Property, plant and equipment additions purchased at the period end, but not yet paid for	$ 26,010	$ 32,770
Non-cash customer advances and contributions in aid of construction	10,468	11,488

See notes to consolidated financial statements beginning on page 9 of this report.

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AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands of dollars, except per share amounts)

(UNAUDITED)

Note 1 – Basis of Presentation

The accompanying consolidated balance sheets and statements of capitalization of Aqua America, Inc. and subsidiaries (the "Company") at June 30, 2018, the consolidated statements of net income and comprehensive income for the three and six months ended June 30, 2018 and 2017 the consolidated statements of cash flow for the six months ended June 30, 2018 and 2017, and the consolidated statement of equity for the six months ended June 30, 2018 are unaudited, but reflect all adjustments, consisting of only normal recurring accruals, which are, in the opinion of management, necessary to present a fair statement of its consolidated financial position, consolidated changes in equity, consolidated results of operations, and consolidated cash flow for the periods presented. Because they cover interim periods, the statements and related notes to the 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 Annual Report on Form 10-K for the year ended December 31, 2017. The results of operations for interim periods may not be indicative of the results that may be expected for the entire year. The December 31, 2017 consolidated balance sheet data presented herein was derived from the Company's December 31, 2017 audited consolidated financial statements, but does not include all disclosures and notes normally provided in annual financial statements. Certain prior period amounts have been reclassified to conform to the current period presentation in the consolidated statements of net income as a result of the adoption, in the first quarter of 2018, of the Financial Accounting Standards Board's ("FASB") accounting guidance on the presentation of net periodic pension and postretirement benefit cost (refer to Note 16 – Recent Accounting Pronouncements).

The preparation of financial statements often requires the selection of specific accounting methods and policies. Further, significant estimates and judgments may be required in selecting and applying those methods and policies in the recognition of the assets and liabilities in its consolidated balance sheets, the revenues and expenses in its consolidated statements of net income, and the information that is contained in its summary of significant accounting policies and notes to consolidated financial statements. Making these estimates and judgments requires the analysis of information concerning events that may not yet be complete and of facts and circumstances that may change over time. Accordingly, actual amounts or future results can differ materially from those estimates that the Company includes currently in its consolidated financial statements, summary of significant accounting policies, and notes.

There have been no changes to the summary of significant accounting policies, other than as described in Note 2 – Revenue Recognition as a result of the adoption of a new accounting pronouncement adopted on January 1, 2018, previously identified in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

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AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

Note 2 – Revenue Recognition

The Company recognizes revenue as water and wastewater services are provided to our customers, which happens over time as the service is delivered and the performance obligation is satisfied. The Company's utility revenues recognized in an accounting period include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the last billing to the end of the accounting period. Unbilled amounts are calculated by deriving estimates based on average usage of the prior month. The Company's actual results could differ from these estimates, which would result in operating revenues being adjusted in the period that the revision to our estimates is determined. Unbilled amounts are included in accounts receivable and unbilled revenues, net on the consolidated balance sheet.

Generally, payment is due within 30 days once a bill is issued to a customer. Sales tax and other taxes we collect on behalf of government authorities, concurrent with our revenue-producing activities, are primarily excluded from revenue. The Company has determined that its revenue recognition is not materially different under the FASB's new accounting standard for revenue from contracts with customer, and has not made any changes to our accounting policy. The Company's revenues are being reported identical in the consolidated statements of net income to how they were reported under the FASB's former accounting standard for revenue recognition. The following table presents our revenues disaggregated by major source and customer class:

	Three Months Ended June 30,2018			Six Months Ended June 30,2018		
	Water Revenues	Wastewater Revenues	Other Revenues	Water Revenues	Wastewater Revenues	Other Revenues
Regulated:						
Residential	$ 122,530	$ 17,583	$ -	$ 236,367	$ 35,115	$ -
Commercial	33,456	2,975	-	63,798	5,863	-
Fire protection	7,970	-	-	15,908	-	-
Industrial	7,309	498	-	13,669	961	-
Other water	14,220	-	-	25,241	-	-
Other wastewater	-	1,920	-	-	2,711	-

Alternative revenue program	(120)	164	-	(120)	164	-
Other utility	-	-	2,319	-	-	4,654
Regulated segment total	185,365	23,140	2,319	354,863	44,814	4,654
Other and eliminations	-	-	1,036	-	-	1,876
Consolidated	$ 185,365	$ 23,140	$ 3,355	$ 354,863	$ 44,814	$ 6,530

Regulated Segment Revenues – These revenues are composed of three main categories: water, wastewater, and other. Water revenues represent revenues earned for supplying customers with water service. Wastewater revenues represent revenues earned for treating wastewater and releasing it into the water supply. Other revenues are associated fees that relate to the regulated business but are not water and wastewater revenues. See description below for a discussion on the performance obligation for each of these revenue streams.

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AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

Tariff Revenues – These revenues are categorized by customer class: residential, commercial, fire protection, industrial, and other water and other wastewater. The rates that generate these revenues are approved by the respective state utility commission, and revenues are billed cyclically and accrued for when unbilled. Other water and other wastewater revenues consist primarily of fines, penalties, surcharges, and availability lot fees. Our performance obligation for tariff revenues is to provide potable water or wastewater treatment service to customers. This performance obligation is satisfied over time as the services are rendered.

Alternative Revenue Program – These revenues represent the difference between the actual billed utility water and wastewater revenues for Aqua Illinois and the revenues set in the last Aqua Illinois rate case. We recognize revenues based on the target amount established in the last rate case, and then record either a regulatory asset or liability based on the cumulative difference between the target and actual, which results in either a refund due to customers or a payment from customers. This revenue program represents a contract between the utility and its regulators, not customers, and therefore is not within the scope of the FASB's accounting guidance for recognizing revenue from contracts with customers.

Other Utility Revenues – Other utility revenues represent revenues earned primarily from: antenna revenues, which represent fees received from telecommunication operators that have put cellular antennas on our water towers, operation and maintenance and billing contracts, which represent fees earned from municipalities for our operation of their water or wastewater treatment services or performing billing services, and fees earned from developers for accessing our water mains. The performance obligations vary for these revenues, but all are primarily recognized over time as the service is delivered.

Other and Eliminations – Other and eliminations consist of our market-based revenues, which comprises: Aqua Infrastructure and Aqua Resources (described below), and intercompany eliminations for revenue billed between our subsidiaries.

Aqua Infrastructure is the holding company for our 49% investment in a joint venture that operates a private pipeline system to supply raw water to natural gas well drilling operations in the Marcellus Shale of north central Pennsylvania. The joint venture earns revenues through providing non-utility raw water supply services to natural gas drilling companies which enter into water supply contracts. The performance obligation is to deliver non-potable water to the joint venture's customers. Aqua Infrastructure's share of the revenues recognized by the joint venture is reflected, net, in equity earnings in joint venture on our consolidated statements of net income.

Aqua Resources earns revenues by providing non-regulated water and wastewater services through operating and maintenance contracts, and third-party water and sewer service line repair. The performance obligations are performing agreed upon services in the contract, most commonly operation of third-party water or wastewater treatment services, or billing services, or allowing the use of our logo to a third-party water and sewer service line repair. Revenues are primarily recognized over time as service is delivered.

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AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

Note 3 – Goodwill

The following table summarizes the changes in the Company’s goodwill, by business segment:

	Regulated Segment	Other	Consolidated
Balance at December 31, 2017	$ 37,389	$ 4,841	$ 42,230
Goodwill acquired	25	-	25
Reclassification to utility plant acquisition adjustment	(25)	-	(25)
Other	(180)	-	(180)
Balance at June 30, 2018	$ 37,209	$ 4,841	$ 42,050

The reclassification of goodwill to utility plant acquisition adjustment results from a mechanism approved by the applicable utility commission. The mechanism provides for the transfer over time, and the recovery through customer rates, of goodwill associated with some acquisitions upon achieving specific objectives.

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AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

Note 4 – Acquisitions

During the first six months of 2018, the Company completed three acquisitions of water and wastewater utility systems in various states adding 448 customers. The total purchase price of these utility systems consisted of $190 in cash. The purchase price allocation for these acquisitions consisted primarily of acquired property, plant and equipment. The pro forma effect of the businesses acquired is not material either individually or collectively to the Company's results of operations.

In July 2018, the Company entered into a purchase agreement to acquire the wastewater utility system assets of Cheltenham Township, Pennsylvania, which serves approximately 10,500 customers for $50,250. The purchase price for this pending acquisition is subject to certain adjustments at closing, and is subject to regulatory approval, including the final determination of the fair value of the rate base acquired.

In addition to the Company's pending acquisition in Cheltenham Township, Pennsylvania, as part of the Company's growth-through-acquisition strategy, the Company entered into purchase agreements to acquire the water or wastewater utility system assets of seven municipalities for a total combined purchase price in cash of $152,800, which we plan to finance by the issuance of debt. The purchase price for these acquisitions is subject to certain adjustments at closing, and the acquisitions are subject to regulatory approvals, including the final determination of the fair value of the rate base acquired. In July 2018, we closed on the following acquisitions:

- Manteno, Illinois for $25,000 in cash, which serves approximately 3,800 wastewater customers, and
- Limerick, Pennsylvania for $75,100 in cash, which serves approximately 5,400 wastewater customers.

Closings for our remaining acquisitions are expected to occur by the end of 2019, subject to the timing of the regulatory approval process. In total, these acquisitions will add approximately 16,750 customers in two of the states in which the Company operates in.

During 2017, the Company completed four acquisitions of water and wastewater utility systems in various states adding 1,003 customers. The total purchase price of these utility systems consisted of $5,860 in cash, which resulted in $72 of goodwill being recorded. The pro forma effect of the businesses acquired is not material either individually or collectively to the Company's results of operations.

Note 5 – Assets Held for Sale

In the first quarter of 2017, the Company decided to market for sale a water system that serves approximately 265 customers. This water system is reported as assets held for sale in the Company's consolidated balance sheet. The Company has been in discussions with a potential buyer for the water system and is currently negotiating the terms of a sale, which will require regulatory approval.

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AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

Note 6 – Capitalization

In June 2018, the Company amended its unsecured revolving credit facility, to extend the expiration from February 2021 to June 2023, and to increase the facility from $250,000 to $500,000. Funds borrowed under this facility are classified as long-term debt and are used to provide working capital as well as support for letters of credit for insurance policies and other financing arrangements. Interest under this facility is based at the Company's option, on the prime rate, an adjusted Euro-Rate, an adjusted federal funds rate or at rates offered by the banks. A facility fee is charged on the total commitment amount of the agreement.

In June 2018, Aqua Pennsylvania issued $100,000 of first mortgage bonds, of which $25,000 is due in 2042, $10,000 is due in 2045, and $65,000 is due in 2048 with interest rates of 3.99%, 4.04%, and 4.09%, respectively. The proceeds from these bonds were used to repay existing indebtedness and for general corporate purposes.

In July 2018, Aqua Pennsylvania redeemed $49,660 of tax-exempt bonds at 5.25% that were originally maturing in 2042 and 2043, respectively.

Note 7 –Financial Instruments

The Company follows the FASB's accounting guidance for fair value measurements and disclosures, which defines fair value and establishes a framework for using fair value to measure assets and liabilities. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1: unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access;
- Level 2: inputs other than Level 1 that are observable, either directly or indirectly, such as quoted market prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in non-active markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; or
- Level 3: inputs that are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. There have been no changes in the valuation techniques used to measure fair value, or asset or liability transfers between the levels of the fair value hierarchy for the quarter ended June 30, 2018.

Financial instruments are recorded at carrying value in the financial statements and approximate fair value as of the dates presented. The fair value of these instruments is disclosed below in accordance with current accounting guidance related to financial instruments.

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The fair value of loans payable is determined based on its carrying amount and utilizing Level 1 methods and assumptions. As of December 31, 2017, the carrying amount of the Company's loans payable was $3,650, which equates to their estimated fair value. The fair value of cash and cash equivalents, which is comprised of uninvested cash, is determined based on the net asset value per unit utilizing Level 1 methods and assumptions. As of June 30, 2018 and December 31, 2017, the carrying amounts of the Company's cash and cash equivalents was $52,948 and $4,204, respectively, which equates to their fair value. The Company's assets underlying the deferred compensation and non-qualified pension plans are determined by the fair value of mutual funds, which are based on quoted market prices from active markets utilizing Level 1 methods and assumptions. As of June 30, 2018 and December 31, 2017, the carrying amount of these securities was $21,759 and $21,776, which equates to their fair value, and is reported in the consolidated balance sheet in deferred charges and other assets.

Unrealized gain and losses on equity securities held in conjunction with our non-qualified pension plan is as follows:

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018
Net gain (loss) recognized during the period on equity securities	$ 19	$ (2)
Less: net gain / loss recognized during the period on equity securities sold during the period	-	-
Unrealized gain (loss) recognized during the reporting period on equity securities still held at the reporting date	$ 19	$ (2)

The net gain (loss) recognized on equity securities is presented on the consolidated statements of net income on the line item "Other." Additionally, the unrealized gain (loss) recognized during the three and six months ended June 30, 2017, was reported on the consolidated statements of comprehensive income.

The carrying amounts and estimated fair values of the Company’s long-term debt is as follows:

	June 30, 2018	December 31, 2017
Carrying amount	$ 2,320,903	$ 2,143,127
Estimated fair value	2,322,759	2,262,785

The fair value of long-term debt has been determined by discounting the future cash flows using current market interest rates for similar financial instruments of the same duration utilizing Level 2 methods and assumptions.

The Company’s customers’ advances for construction have a carrying value of $93,342 as of June 30, 2018, and $93,186 as of December 31, 2017. Their relative fair values cannot be accurately estimated because future refund payments depend on several variables, including new customer connections, customer consumption levels, and future rates. Portions of these non-interest bearing instruments are payable annually through 2028 and amounts not paid by the respective contract expiration dates become non-refundable. The fair value of these amounts would, however, be less than their carrying value due to the non-interest bearing feature.

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Note 8 – Net Income per Common Share

Basic net income per common share is based on the weighted average number of common shares outstanding. Diluted net income per common share is based on the weighted average number of common shares outstanding and potentially dilutive shares. The dilutive effect of employee stock-based compensation is included in the computation of diluted net income per common share. The dilutive effect of stock-based compensation is calculated using the treasury stock method and expected proceeds upon exercise or issuance of the stock-based compensation. The treasury stock method assumes that the proceeds from stock-based compensation are used to purchase the Company's common stock at the average market price during the period. The following table summarizes the shares, in thousands, used in computing basic and diluted net income per common share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Average common shares outstanding during the period for basic computation	177,901	177,609	177,852	177,545
Dilutive effect of employee stock-based compensation	372	436	447	497
Average common shares outstanding during the period for diluted computation	178,273	178,045	178,299	178,042

For the three months ended June 30, 2017 and the six months ended June 30, 2018 and 2017, all of the Company's employee stock options were included in the calculations of diluted net income per share as the calculated cost to exercise the stock options was less than the average market price of the Company's common stock during these periods. For the three months ended June 30, 2018, employee stock options to purchase 159,244 shares of common stock were excluded from the calculation of diluted net income per share as the calculated cost to exercise the stock options was greater than the average market price of the Company's common stock during this period.

Note 9 – Stock-based Compensation

Under the Company's 2009 Omnibus Equity Compensation Plan, as amended as of February 27, 2014 (the "2009 Plan"), as approved by the Company's shareholders to replace the 2004 Equity Compensation Plan (the "2004 Plan"), stock options, stock units, stock awards, stock appreciation rights, dividend equivalents, and other stock-based awards may be granted to employees, non-employee directors, and consultants and advisors. No further grants may be made under the 2004 Plan. The 2009 Plan authorizes 6,250,000 shares for issuance under the plan. A maximum of 3,125,000 shares under the 2009 Plan may be issued pursuant to stock awards, stock units and other stock-based awards, subject to adjustment as provided in the 2009 Plan. During any calendar year, no individual may be granted (i) stock options and stock appreciation rights under the 2009 Plan for more than 500,000 shares of Company stock in the aggregate or (ii) stock awards, stock units or other stock-based awards under the 2009 Plan for more than 500,000 shares of Company stock in the aggregate, subject to adjustment as provided in the 2009 Plan. Awards to employees and consultants under the 2009 Plan are made by a committee of the Board of Directors of the Company, except that with respect to awards to the Chief Executive Officer, the

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committee recommends those awards for approval by the non-employee directors of the Board of Directors. In the case of awards to non-employee directors, the Board of Directors makes such awards. At June 30, 2018, 3,413,103 shares were still available for issuance under the 2009 Plan.

Performance Share Units – A performance share unit ("PSU") represents the right to receive a share of the Company's common stock if specified performance goals are met over the three-year performance period specified in the grant, subject to exceptions through the respective vesting period, generally three years. Each grantee is granted a target award of PSUs, and may earn between 0% and 200% of the target amount depending on the Company's performance against the performance goals. The following table provides compensation costs for stock-based compensation related to PSUs:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Stock-based compensation within operations and maintenance expenses	$ 1,339	$ 971	$ 2,198	$ 1,841
Income tax benefit	373	394	614	747

The following table summarizes the PSU transactions for the six months ended June 30, 2018:

	Number of Share Units	Weighted Average Fair Value
Nonvested share units at beginning of period	452,333	$ 26.16
Granted	87,593	37.65
Performance criteria adjustment	9,505	31.89
Forfeited	(7,780)	30.61
Share units vested in prior period and issued in current period	9,400	26.54

Share units issued	(136,081)	31.70
Nonvested share units at end of period	414,970	26.83

A portion of the fair value of PSUs was estimated at the grant date based on the probability of satisfying the market-based conditions using the Monte Carlo valuation method, which assesses probabilities of various outcomes of market conditions. The other portion of the fair value of the PSUs is based on the fair market value of the Company's stock at the grant date, regardless of whether the market-based condition is satisfied. The per unit weighted-average fair value at the date of grant for PSUs granted during the six months ended June 30, 2018 and 2017 was $37.65 and $30.79, respectively. The fair value of each PSU grant is amortized monthly into compensation expense on a straight-line basis over their respective vesting periods, generally 36 months. The accrual of compensation costs is based on the Company's estimate of the final expected value of the award, and is adjusted as required for the portion based on the performance-based condition. The Company assumes that forfeitures will be minimal, and recognizes forfeitures as they occur, which results in a reduction in compensation expense. As the payout of the PSUs includes dividend equivalents, no separate dividend yield assumption is required in

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calculating the fair value of the PSUs. The recording of compensation expense for PSUs has no impact on net cash flows.

Restricted Stock Units – A restricted stock unit ("RSU") represents the right to receive a share of the Company's common stock. RSUs are eligible to be earned at the end of a specified restricted period, generally three years, beginning on the date of grant. The Company assumes that forfeitures will be minimal, and recognizes forfeitures as they occur, which results in a reduction in compensation expense. As the payout of the RSUs includes dividend equivalents, no separate dividend yield assumption is required in calculating the fair value of the RSUs. The following table provides the compensation cost and income tax benefit for stock-based compensation related to RSUs:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Stock-based compensation within operations and maintenance expenses	$ 355	$ 322	$ 706	