

AQUA AMERICA INC
Form 10-K
February 26, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2018

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 1-6659

AQUA AMERICA, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania 23-1702594
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

762 W Lancaster Avenue, Bryn Mawr, Pennsylvania 19010-3489
(Address of principal executive offices) (Zip Code)

(610) 527-8000

(Registrant's telephone number, including area code)

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Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common stock, par value \$.50 per share	New York Stock Exchange, Inc.

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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Large accelerated filer Accelerated filer
Non-accelerated filer Small 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 Act). Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2018: \$6,243,784,324

The number of shares outstanding of the registrant's common stock as of February 12, 2019: 178,145,692

DOCUMENTS INCORPORATED BY REFERENCE

- (1) Portions of the definitive Proxy Statement, relating to the 2019 annual meeting of shareholders of registrant, to be filed within 120 days after the end of the fiscal year covered by this Form 10-K, have been incorporated by reference into Part III of this Form 10-K

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Annual Report on Form 10-K (the “Annual Report”) are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are made based upon, among other things, our current assumptions, expectations, plans, and beliefs concerning future events and their potential effect on us. These forward-looking statements involve risks, uncertainties and other factors, many of which are outside our control that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. In some cases you can identify forward-looking statements where statements are preceded by, followed by or include the words “believes,” “expects,” “anticipates,” “plans,” “future,” “potential,” “probably,” “predictions,” “intends,” “will,” “continue,” “in the event” or the negative of such terms or similar expressions. Forward-looking statements in this Annual Report include, but are not limited to, statements regarding:

- recovery of capital expenditures and expenses in rates;
- projected capital expenditures and related funding requirements;
- our capability to pursue timely rate increase requests;
- the availability and cost of capital financing;
- developments, trends and consolidation in the water and wastewater utility and infrastructure industries;
- dividend payment projections;
- opportunities for future acquisitions, both within and outside the water and wastewater industry, the success of pending acquisitions and the impact of future acquisitions;
- expectations regarding the proposed Peoples Gas Acquisition, including statements regarding regulatory approvals for the transaction, potential financing related to the transaction, closing of the transaction or the impact of the transaction on the Company;
- the capacity of our water supplies, water facilities and wastewater facilities;
- the impact of federal and/or state tax policies, including changes in tax laws and policies as a result of the Tax Cuts and Jobs Act of 2017, and the regulatory treatment of the effects of those policies;
- the impact of geographic diversity on our exposure to unusual weather;
- the impact of conservation awareness of customers and more efficient plumbing fixtures and appliances on water usage per customer;
- our authority to carry on our business without unduly burdensome restrictions;
- the continuation of investments in strategic ventures;
- our ability to obtain fair market value for condemned assets;
- the impact of fines and penalties;
- the impact of changes in and compliance with governmental laws, regulations and policies, including those dealing with taxation, the environment, health and water quality, and public utility regulation;
- the impact of decisions of governmental and regulatory bodies, including decisions to raise or lower rates and decisions regarding potential acquisitions;
- the development of new services and technologies by us or our competitors;
- the availability of qualified personnel;
- the condition of our assets;

- the impact of legal proceedings;
- general economic conditions;
- acquisition-related costs and synergies;
- the sale of water and wastewater divisions; and
- the amount of income tax deductions for qualifying utility asset improvements and the Internal Revenue Service's ultimate acceptance of the deduction methodology.

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Because forward-looking statements involve risks and uncertainties, there are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements, including but not limited to:

- our ability to integrate and otherwise realize all of the anticipated benefits of businesses, technologies or services which we may acquire;
- our ability to manage the expansion of our business, including our ability to manage our expanded operations following the closing of the Peoples Gas Acquisition;
- changes in general economic, business, credit and financial market conditions;
- changes in governmental laws, regulations and policies, including those dealing with taxation, the environment, health and water quality, and public utility regulation;
- our ability to treat and supply water or collect and treat wastewater;
- the profitability of future acquisitions;
- changes to the rules or our assumptions underlying our determination of what qualifies for an income tax deduction for qualifying utility asset improvements;
- conditions to the completion of the Peoples Gas Acquisition may not be satisfied or waived on a timely basis, or at all;
- the decisions of governmental and regulatory bodies, including decisions on rate increase requests and decisions regarding potential acquisitions;
- our ability to file rate cases on a timely basis to minimize regulatory lag;
- abnormal weather conditions, including those that result in water use restrictions;
- changes in, or unanticipated, capital requirements;
- changes in our credit rating or the market price of our common stock;
- changes in valuation of strategic ventures;
- the extent to which we are able to develop and market new and improved services;
- the effect of the loss of major customers;
- our ability to retain the services of key personnel and to hire qualified personnel as we expand;
- the diversion of our management's time and resources caused by the pendency of the Peoples Gas Acquisition;
- labor disputes;
- increasing difficulties in obtaining insurance and increased cost of insurance;
 - cost overruns relating to improvements to, or the expansion of, our operations;
- increases in the costs of goods and services;
- civil disturbance or terroristic threats or acts;
- the continuous and reliable operation of our information technology systems, including the impact of cyber security attacks or other cyber-related events;
- changes in accounting pronouncements;
- litigation and claims; and
- changes in environmental conditions, including the effects of climate change.

Given these risks and uncertainties, you should not place undue reliance on any forward-looking statements. You should read this Annual Report completely and with the understanding that our actual future results, performance and achievements may be materially different from what we expect. These forward-looking statements represent assumptions, expectations, plans, and beliefs only as of the date of this Annual Report. Except for our ongoing

obligations to disclose certain information under the federal securities laws, we are not obligated, and assume no obligation, to update these forward-looking statements, even though our situation may change in the future. For further information or other factors which could affect our financial results and such forward-looking statements, see Risk Factors. We qualify all of our forward-looking statements by these cautionary statements.

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PART I

Item 1. Business

The Company

Aqua America, Inc. (referred to as “Aqua America”, the “Company”, “we”, “us”, or “our”), a Pennsylvania corporation, is the holding company for regulated utilities providing water or wastewater services to an estimated three million people in Pennsylvania, Ohio, Texas, Illinois, North Carolina, New Jersey, Indiana, and Virginia. Our largest operating subsidiary is Aqua Pennsylvania, Inc., which accounted for approximately 53% of our operating revenues and approximately 71% of our Regulated segment’s income for 2018. As of December 31, 2018, Aqua Pennsylvania provided water or wastewater services to approximately one-half of the total number of people we serve. Aqua Pennsylvania’s service territory is located in the suburban areas in counties north and west of the City of Philadelphia and in 27 other counties in Pennsylvania. Our other regulated utility subsidiaries provide similar services in seven other states. In addition, the Company’s market-based activities are conducted through Aqua Infrastructure, LLC and Aqua Resources Inc. Aqua Infrastructure provides non-utility raw water supply services for firms in the natural gas drilling industry. Aqua Resources provides water service through operating and maintenance contracts with a municipal authority and another party close to our utility companies’ service territory; and offers, through a third-party, water and sewer line protection solutions and repair services to households. In 2017, we completed the sale of business units that were reported within Aqua Resources, one which installed and tested devices that prevent the contamination of potable water and another that constructed, maintained, and repaired water and wastewater systems. During 2016, we completed the sale of business units within Aqua Resources, which provided liquid waste hauling and disposal services and inspection, and cleaning and repair of storm and sanitary wastewater lines.

Aqua America, which prior to its name change in 2004 was known as Philadelphia Suburban Corporation, was formed in 1968 as a holding company for its primary subsidiary, Aqua Pennsylvania, formerly known as Philadelphia Suburban Water Company. In the early 1990s, we embarked on a growth through acquisition strategy focused on water and wastewater operations. Our most significant transactions to date have been the merger with Consumers Water Company in 1999, the acquisition of the regulated water and wastewater operations of AquaSource, Inc. in 2003, the acquisition of Heater Utilities, Inc. in 2004, and the acquisition of American Water Works Company, Inc.’s regulated water and wastewater operations in Ohio in 2012. Since the early 1990s, our business strategy has been primarily directed toward the regulated water and wastewater utility industry, where we have more than quadrupled the number of regulated customers we serve, and have extended our regulated operations from southeastern Pennsylvania to include our current regulated utility operations throughout Pennsylvania and in seven other states. During 2010 through 2013, we sold our utility operations in six states, pursuant to a portfolio rationalization strategy to focus our operations in areas where we have critical mass and economic growth potential. Currently, the Company seeks to acquire businesses in the U.S. regulated sector, which includes water and wastewater utilities and other regulated utilities, and to pursue growth ventures in market-based activities, such as infrastructure opportunities that are supplementary and complementary to our regulated businesses. On October 22, 2018, we entered into a

purchase agreement to acquire, from LDC Funding LLC, the parent company of PNG Companies, a natural gas distribution company consisting of Peoples Natural Gas Company LLC, Peoples Gas Company LLC, Peoples Gas West Virginia, Inc., Peoples Gas Kentucky, Inc., and Delta Natural Gas Company Inc. expanding the Company's regulated utility business to include natural gas distribution. This acquisition is referred to as the "Peoples Gas Acquisition," and collectively these businesses are referred to as "Peoples." Peoples serves approximately 740,000 gas utility customers in western Pennsylvania, West Virginia, and Kentucky. This acquisition is subject to regulatory approvals and is expected to close in mid-2019.

The descriptions of our business and operations, financial results, and operational data included in this Annual Report are historical and do not include Peoples or otherwise give effect to our pending acquisition of Peoples.

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The following table reports our operating revenues, by principal state, for the Regulated segment and Other and eliminations for the year ended December 31, 2018:

	Operating Revenues (000's)	Operating Revenues (%)
Pennsylvania	\$ 443,260	52.9%
Ohio	105,215	12.6%
Texas	71,581	8.5%
Illinois	71,352	8.5%
North Carolina	54,344	6.5%
Other states (1)	88,886	10.6%
Regulated segment total	834,638	99.6%
Other and eliminations	3,453	0.4%
Consolidated	\$ 838,091	100.0%

(1) Includes our operating subsidiaries in the following states: New Jersey, Indiana, and Virginia.

The Company has identified ten operating segments and has one reportable segment named the Regulated segment. The reportable segment is comprised of eight operating segments for our water and wastewater regulated utility companies which are organized by the states where we provide these services. These operating segments are aggregated into one reportable segment since each of the Company's operating segments has the following similarities: economic characteristics, nature of services, production processes, customers, water distribution or wastewater collection methods, and the nature of the regulatory environment. Further, Aqua Resources and Aqua Infrastructure are not quantitatively significant to be reportable and are included as a component of "Other," in addition to corporate costs that have not been allocated to the Regulated segment, because they would not be recoverable as a cost of utility service, and intersegment eliminations. Information concerning revenues, net income, identifiable assets and related financial information for the Regulated segment and Other and eliminations for 2018, 2017, and 2016 is set forth in Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 17 – Segment Information in the Notes to Consolidated Financial Statements which is contained in Item 8 of this Annual Report.

The following table summarizes our operating revenues, by utility customer class, for the Regulated segment and Other and eliminations for the year ended December 31, 2018:

	Operating Revenues (000's)	Operating Revenues (%)
Residential water	\$ 482,946	57.6%
Commercial water	133,753	16.0%
Fire protection	32,236	3.8%
Industrial water	28,848	3.5%
Other water	53,658	6.4%
Total water	731,441	87.3%
Wastewater	94,170	11.2%
Other utility	9,027	1.1%
Regulated segment total	834,638	99.6%
Other and eliminations	3,453	0.4%
Consolidated	\$ 838,091	100.0%

Our utility customer base is diversified among residential water, commercial water, fire protection, industrial water, other water, wastewater customers, and other utility customers (consisting of operating contracts that are closely associated with

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the utility operations). Residential water and wastewater customers make up the largest component of our utility customer base, with these customers representing approximately 67%, 70%, and 70% of our water and wastewater revenues for 2018, 2017, and 2016, respectively. Substantially all of our water customers are metered, which allows us to measure and bill for our customers' water consumption. Water consumption per customer is affected by local weather conditions during the year, especially during late spring, summer, and early fall. In general, during these seasons, an extended period of dry weather increases consumption, while above average rainfall decreases consumption. Also, an increase in the average temperature generally causes an increase in water consumption. On occasion, abnormally dry weather in our service areas can result in governmental authorities declaring drought warnings and imposing water use restrictions in the affected areas, which could reduce water consumption. See "Business – Water Utility Supplies, and Facilities and Wastewater Utility Facilities" for a discussion of water use restrictions that may impact water consumption during abnormally dry weather. The geographic diversity of our utility customer base reduces the effect of our exposure to extreme or unusual weather conditions in any one area of our service territory. Water usage is also affected by changing consumption patterns by our customers, resulting from such causes as increased water conservation and the installation of water saving devices and appliances that can result in decreased water usage. It is estimated that in the event we experience a 0.50% decrease in residential water consumption it would result in a decrease in annual residential water revenue of approximately \$2,400,000 and would likely be partially offset by a reduction in incremental water production expenses such as chemicals and power.

Our growth in revenues over the past five years is primarily a result of increases in water and wastewater rates and customer growth. See Economic Regulation for a discussion of water and wastewater rates. The increase in our utility customer base has been due to customers added through acquisitions, partnerships with developers, and organic growth (excluding dispositions) as shown below:

Year	Utility Customer Growth Rate
2018	2.3%
2017	1.1%
2016	1.6%
2015	1.9%
2014	1.3%

In 2018, our customer count increased by 22,741 customers, primarily due to utility systems that we acquired and organic growth. Overall, for the five-year period of 2014 through 2018, our utility customer base, adjusted to exclude customers associated with utility system dispositions, increased at an annual compound rate of 1.6%. During the five-year period ended December 31, 2018, our utility customer base including customers associated with utility system acquisitions and dispositions increased from 941,008 at January 1, 2014 to 1,005,590 at December 31, 2018. This five-year period includes the impact of the condemnation of our Fort Wayne, IN system in 2014, which resulted in the loss of approximately 13,000 connections.

Acquisitions and Other Growth Ventures

We believe that acquisitions will continue to be an important source of customer growth for us. We intend to continue to pursue acquisitions of government-owned and regulated water and wastewater systems that provide services in areas near our existing service territories or in new service areas. We engage in continuing activities with respect to potential acquisitions, including calling on prospective sellers, performing analyses of and due diligence on acquisition candidates, making preliminary acquisition proposals, and negotiating the terms of potential acquisitions. Further, we are also seeking other potential business opportunities, including but not limited to, partnering with public and regulated utilities to invest in infrastructure projects, growing our market-based activities by acquiring businesses that provide water and wastewater or other utility-related services, and investing in infrastructure projects.

According to the U.S. Environmental Protection Agency (“EPA”), based on the 2015 U.S. Census American Housing Survey, approximately 89% of the U.S. population obtains its water from community water systems, and 11% of the U.S. population obtains its water from private wells. With approximately 50,000 community water systems in the U.S. (81%

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of which serve less than 3,300 customers), the water industry is the most fragmented of the major utility industries (telephone, natural gas, electric, water and wastewater). The majority of these community water systems are government-owned, and the balance of the systems are regulated utilities. The nation's water systems range in size from large government-owned systems, such as the New York City water system, which serves approximately 8.6 million people, to small systems, where a few customers share a common well. In the states where we operate regulated utilities, we believe there are approximately 14,000 community water systems of widely-varying size, with the majority of the population being served by government-owned water systems.

Although not as fragmented as the water industry, the wastewater industry in the U.S. also presents opportunities for consolidation. According to the EPA's most recent survey of wastewater treatment facilities (which includes both government-owned facilities and regulated utility systems) in 2012, there were approximately 15,000 such facilities in the nation serving approximately 76% of the U.S. population. The remaining population represents individual homeowners with their own treatment facilities; for example, community on-lot disposal systems and septic tank systems. A majority of wastewater facilities are government-owned rather than regulated utilities. The EPA's survey also indicated that, in 2012, there were approximately 4,000 wastewater facilities in operation in the states where we operate regulated utilities.

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

- the benefits of economies of scale;
- the increasing cost and complexity of environmental regulations;
- the need for substantial capital investment;
- the need for technological and managerial expertise;
- the desire to improve water quality and service;
- limited access to cost-effective financing;
- the monetizing of public assets to support, in some cases, the declining financial condition of municipalities; and
- the use of system sale proceeds by a municipality to accomplish other public purposes.

We are actively exploring opportunities to expand our utility operations through acquisitions or other growth ventures. During the five-year period ended December 31, 2018, we expanded our utility operations by completing 64 acquisitions or other growth ventures. Additionally, in October 2018, the Company entered into an agreement to acquire Peoples, which will expand the Company's regulated utility business to include natural gas distribution. This acquisition is subject to regulatory approvals and is expected to close in mid-2019.

Water Utility Supplies and Facilities and Wastewater Utility Facilities

Our water utility operations obtain their water supplies from surface water sources, underground aquifers, and water purchased from other water suppliers. Our water supplies are primarily self-supplied and processed at twenty-one surface water treatment plants located in four states, and numerous well stations located in the states in which we conduct business. Approximately 5.8% of our water supplies are provided through water purchased from other water suppliers. It is our policy to obtain and maintain the permits necessary to obtain the water we distribute.

We believe that the capacities of our sources of supply, and our water treatment, pumping and distribution facilities, are generally sufficient to meet the present requirements of our customers under normal conditions. We plan system improvements and additions to capacity in response to normal replacement and renewal needs, changing regulatory standards, changing patterns of consumption, and increased demand from customer growth. The various state utility commissions have generally recognized the operating and capital costs associated with these improvements in setting water and wastewater rates.

On occasion, drought warnings and water use restrictions are issued by governmental authorities for portions of our service territories in response to extended periods of dry weather conditions. The timing and duration of the warnings and restrictions can have an impact on our water revenues and net income. In general, water consumption in the summer months is more affected by drought warnings and restrictions because discretionary and recreational use of water is at its

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highest during the summer months. At other times of the year, warnings and restrictions generally have less of an effect on water consumption. Currently, portions of our northern and central Texas service areas have conservation-based water restrictions. Drought warnings and watches result in the public being asked to voluntarily reduce water consumption.

We believe that our wastewater treatment facilities are generally adequate to meet the present requirements of our customers under normal conditions. Additionally, we own several wastewater collection systems that convey the wastewater to municipally-owned facilities for treatment. Changes in regulatory requirements can be reflected in revised permit limits and conditions when permits are renewed, typically on a five-year cycle, or when treatment capacity is expanded. Capital improvements are planned and budgeted to meet normal replacement and renewal needs, anticipated changes in regulations, needs for increased capacity related to projected growth, and to reduce inflow and infiltration to collection systems. The various state utility commissions have generally recognized the operating and capital costs associated with these improvements in setting wastewater rates for current and new customers. It is our policy to obtain and maintain the permits necessary for the treatment of the wastewater that we return to the environment.

Economic Regulation

Most of our water and wastewater utility operations are subject to regulation by their respective state utility commissions, which have broad administrative power and authority to regulate billing rates, determine franchise areas and conditions of service, approve acquisitions and authorize the issuance of securities. The utility commissions also establish uniform systems of accounts and approve the terms of contracts with affiliates and customers, business combinations with other utility systems, and loans and other financings. The policies of the utility commissions often differ from state to state, and may change over time. A small number of our operations are subject to rate regulation by county or city governments. The profitability of our utility operations is influenced to a great extent by the timeliness and adequacy of rate allowances we are granted by the respective utility commissions or authorities in the various states in which we operate.

Rate Case Management Capability – We maintain a rate case management capability, the objective of which is to provide that the tariffs of our utility operations reflect, to the extent practicable, the timely recovery of increases in costs of operations, capital expenditures, interest expense, taxes, energy, materials, and compliance with environmental regulations. We file rate increase requests to recover and earn a fair return on the infrastructure investments that we make in improving or replacing our facilities and to recover expense increases. In the states in which we operate, we are primarily subject to economic regulation by the following state utility commissions:

State	Utility Commission
Pennsylvania	Pennsylvania Public Utility Commission
Ohio	Public Utilities Commission of Ohio
Texas	Public Utility Commission of Texas
Illinois	Illinois Commerce Commission
North Carolina	North Carolina Utilities Commission
New Jersey	New Jersey Board of Public Utilities
Indiana	Indiana Utility Regulatory Commission
Virginia	Virginia State Corporation Commission

Our water and wastewater operations are comprised of 44 rate divisions, each of which requires a separate rate filing for the evaluation of the cost of service, including the recovery of investments, in connection with the establishment of rates for that rate division. When feasible and beneficial to our utility customers, we will seek approval from the applicable state regulatory commission to consolidate rate divisions to achieve a more even distribution of costs over a larger customer base. All of the states in which we operate permit us to file a revenue requirement for some form of consolidated rates for all, or some of the rate divisions in that state.

In Virginia, we may seek authorization to bill our utility customers in accordance with a rate filing that is pending before the respective regulatory commission. As of December 31, 2018, we have no billings under interim rate arrangements for rate case filings in progress. Furthermore, some utility commissions authorize the use of expense deferrals and amortization in order to provide for an impact on our operating income by an amount that approximates the requested amount in a rate request. In these states, the additional revenue billed and collected prior to the final regulatory

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commission ruling is subject to refund to customers based on the outcome of the ruling. The revenue recognized and the expenses deferred by us reflect an estimate as to the final outcome of the ruling. If the request is denied completely or in part, we could be required to refund to customers some or all of the revenue billed to date and write-off some or all of the deferred expenses.

Revenue Surcharges – Seven states in which we operate water utilities, and six states in which we operate wastewater utilities, permit us to add an infrastructure rehabilitation surcharge to their respective bills to offset the additional depreciation and capital costs associated with capital expenditures related to replacing and rehabilitating infrastructure systems. Without this surcharge, a water and wastewater utility absorbs all of the depreciation and capital costs of these projects between base rate increases. The gap between the time that a capital project is completed and the recovery of its costs in rates is known as regulatory lag. This surcharge is intended to substantially reduce regulatory lag, which often acted as a disincentive to water and wastewater utilities to rehabilitate their infrastructure. In addition, our subsidiaries in some states use a surcharge or credit on their bills to reflect changes in costs, such as changes in state tax rates, other taxes and purchased water costs, until such time as the new cost levels are incorporated into base rates.

Currently, New Jersey allows for an infrastructure rehabilitation surcharge for water utilities, while Pennsylvania, Illinois, Ohio, Indiana, and North Carolina allow for the use of an infrastructure rehabilitation surcharge for both water and wastewater utility systems, and Aqua Virginia is piloting an infrastructure rehabilitation surcharge for its water and wastewater utilities to be implemented in 2019, pursuant to the final order issued in Aqua Virginia's 2018 rate case. The infrastructure rehabilitation surcharge typically adjusts periodically based on additional qualified capital expenditures completed or anticipated in a future period, and is capped at a percentage of base rates, generally at 5% to 12.75%, and is reset to zero when new base rates that reflect the costs of those additions become effective or when a utility's earnings exceed a regulatory benchmark. This surcharge provided revenues of \$31,835,811 in 2018, \$10,255,284 in 2017, and \$7,379,000 in 2016.

Income Tax Accounting Change – In December 2012, Aqua Pennsylvania adopted an income tax accounting change, implemented on Aqua America's 2012 federal income tax return, which was filed in September 2013. This accounting change allows a tax deduction for qualifying utility asset improvements that were formerly capitalized for tax purposes, and was implemented in response to a June 2012 rate order issued by the Pennsylvania Public Utility Commission. The Pennsylvania rate order requires use of the flow-through method of income tax benefits which results in a reduction in current income tax expense as a result of the recognition of income tax benefits resulting from the accounting change. This tax accounting change and its treatment under the Pennsylvania rate order provided sufficient income tax benefits to permit the suspension of the Pennsylvania infrastructure rehabilitation surcharge from January 1, 2013 to September 30, 2017. Beginning on October 1, 2017, Aqua Pennsylvania initiated a water infrastructure rehabilitation surcharge for the capital invested since the last rate proceeding and filed a base rate case in August 2018. The base rate case is being reviewed by the Pennsylvania Public Utility Commission. In February 2019, the Company filed a settlement for this base rate case. Rates from this settlement for approximately \$47,000,000 are expected to go into effect in May 2019. The settlement agreement is subject to approval by the administrative law judge and the Pennsylvania Public Utilities Commission.

Fair Market Value Legislation – In April 2016, Pennsylvania enacted legislation allowing the public utility commission to utilize fair market value to set ratemaking rate base instead of the depreciated original cost of water or wastewater assets for certain qualifying municipal acquisitions. The legislation includes a process for engaging two independent utility valuation experts to perform appraisals that are filed with the public utility commission and then averaged and compared to the purchase price. The ratemaking rate base is the lower of the average of the appraisals or the purchase price and is subject to regulatory approval. Illinois, Indiana, New Jersey, North Carolina, and Ohio also have legislation that allows the use of fair market value under varying rules and circumstances, with Ohio’s legislation becoming effective on April 4, 2019. We believe that this legislation will encourage consolidation in the water and wastewater industry, providing municipalities with an option for exiting the business if they are dealing with challenges associated with their aging, deteriorating water and wastewater assets, do not have the expertise or technical capabilities to continue to comply with ever increasing environmental regulations or simply want to focus on other community priorities.

Revenue Stability Mechanisms – Revenue stability mechanisms separate the volume of water sold from our ability to meet our cost of service and infrastructure costs. These mechanisms allows us to recognize revenue based on a target

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amount established in the last rate case, and then record either a regulatory asset or liability based on the cumulative difference over time, which results in either a refund due to customers or a payment from customers. In Illinois, our operating subsidiary has adopted a revenue stability mechanism in its latest rate case.

Competition

In general, we believe that Aqua America and its subsidiaries have valid authority, free from unduly burdensome restrictions, to enable us to carry on our business as presently conducted in the franchised or contracted areas we now serve. The rights to provide water or wastewater service to customers in a particular franchised service territory are generally non-exclusive, although the applicable utility commissions usually allow only one regulated utility to provide service to customers in a given area. In some instances, another water utility provides service to a separate area within the same political subdivision served by one of our subsidiaries. Therefore, as a regulated utility, there is little or no competition for the daily water and wastewater service we provide to our customers. Water and wastewater utilities may compete for the acquisition of other water and wastewater utilities or for acquiring new customers in new service territories. Competition for these acquisitions generally comes from nearby utilities, either other regulated utilities or municipal-owned utilities, and sometimes from strategic or financial purchasers seeking to enter or expand in the water and wastewater industry. We compete for new service territories and the acquisition of other utilities on the following bases:

- economic value;
- economies of scale;
- our ability to provide quality water and wastewater service;
- our existing infrastructure network;
- our ability to perform infrastructure improvements;
- our ability to comply with environmental, health, and safety regulations;
- our technical, regulatory, and operational expertise;
- our ability to access capital markets; and
- our cost of capital.

The addition of new service territories and the acquisition of other utilities by regulated utilities such as by the Company are generally subject to review and approval by the applicable state utility commissions.

In a very few number of instances, in one of our southern states, where there are municipally-owned water or wastewater systems near our operating divisions, the municipally-owned system may either have water distribution or wastewater collection mains that are located adjacent to our division's mains or may construct new mains that parallel our mains. In these rare circumstances, the municipally-owned system may attempt to voluntarily offer service to customers who are connected to our mains, resulting in our mains becoming surplus or underutilized without compensation.

In the states where our subsidiaries operate, it is possible that portions of our subsidiaries' operations could be acquired by municipal governments by one or more of the following methods:

- eminent domain;
- the right of purchase given or reserved by a municipality or political subdivision when the original franchise was granted; and
- the right of purchase given or reserved under the law of the state in which the subsidiary was incorporated or from which it received its permit.

The price to be paid upon such an acquisition by the municipal government is usually determined in accordance with applicable law under eminent domain. In other instances, the price may be negotiated, fixed by appraisers selected by the parties or computed in accordance with a formula prescribed in the law of the state or in the particular franchise or charter. We believe that our operating subsidiaries would be entitled to fair market value for any assets that are condemned, and we believe the fair market value would be in excess of the book value for such assets.

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Despite maintaining a program to monitor condemnation interests and activities that may affect us over time, one of our primary strategies continues to be to acquire additional water and wastewater systems, to maintain our existing systems where there is a business or a strategic benefit, and to actively oppose unilateral efforts by municipal governments to acquire any of our operations, particularly for less than the fair market value of our operations or where the municipal government seeks to acquire more than it is entitled to under the applicable law or agreement. On occasion, we may voluntarily agree to sell systems or portions of systems in order to help focus our efforts in areas where we have more critical mass and economies of scale or for other strategic reasons.

Environmental, Health and Safety Regulation

Provision of water and wastewater services is subject to regulation under the federal Safe Drinking Water Act, the Clean Water Act, and related state laws, and under federal and state regulations issued under these laws. These laws and regulations establish criteria and standards for drinking water and for wastewater discharges. In addition, we are subject to federal and state laws and other regulations relating to solid waste disposal, dam safety and other aspects of our operations. Capital expenditures and operating costs required as a result of water quality standards and environmental requirements have been traditionally recognized by state utility commissions as appropriate for inclusion in establishing rates.

From time to time, Aqua America has acquired, and may acquire, systems that have environmental compliance issues. Environmental compliance issues also arise in the course of normal operations or as a result of regulatory changes. Aqua America attempts to align capital budgeting and expenditures to address these issues in due course. We believe that the capital expenditures required to address outstanding environmental compliance issues have been budgeted in our capital program and represent approximately \$74,200,000, or approximately 3.4% of our expected total capital expenditures over the next five years. We are parties to agreements with regulatory agencies in Pennsylvania, Texas, and North Carolina under which we have committed to make improvements for environmental compliance. These agreements are intended to provide the regulators with assurance that problems covered by these agreements will be addressed, and the agreements generally provide protection from fines, penalties and other actions while corrective measures are being implemented. We are actively working with state environmental officials in Pennsylvania, Texas, and North Carolina to implement or amend regulatory agreements as necessary.

Safe Drinking Water Act - The Safe Drinking Water Act establishes criteria and procedures for the EPA to develop national quality standards for drinking water. Regulations issued pursuant to the Safe Drinking Water Act set standards regarding the amount of microbial and chemical contaminants and radionuclides in drinking water. Current requirements under the Safe Drinking Water Act are not expected to have a material impact on our business, financial condition, or results of operations as we have made and are making investments to meet existing water quality standards. We may, in the future, be required to change our method of treating drinking water at some sources of supply and make additional capital investments if additional regulations become effective.

Clean Water Act - The Clean Water Act regulates discharges from drinking water and wastewater treatment facilities into lakes, rivers, streams, and groundwater. It is our policy to obtain and maintain all required permits and approvals for the discharges from our water and wastewater facilities, and to comply with all conditions of those permits and other regulatory requirements. A program is in place to monitor facilities for compliance with permitting, monitoring and reporting for wastewater discharges. From time to time, discharge violations may occur which may result in fines. These fines and penalties, if any, are not expected to have a material impact on our business, financial condition, or results of operations. We are also parties to agreements with regulatory agencies in several states where we operate while improvements are being made to address wastewater discharge issues.

Solid Waste Disposal - The handling and disposal of waste generated from water and wastewater treatment facilities is governed by federal and state laws and regulations. A program is in place to monitor our facilities for compliance with regulatory requirements, and we are not aware of any significant environmental remediation costs necessary from our handling and disposal of waste material from our water and wastewater operations.

Dam Safety - Our subsidiaries own thirty dams, of which fifteen are classified as high hazard dams that are subject to the requirements of the federal and state regulations related to dam safety, which undergo regular inspections and an annual engineering inspection. After a thorough review and inspection of our dams by professional outside engineering firms, we

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believe that all fifteen dams are structurally sound and well-maintained, except as described below. These inspections provide recommendations for ongoing rehabilitation which we include in our capital improvement program.

We performed studies of our dams that identified three dams in Pennsylvania and two dams in Ohio requiring capital improvements. These capital improvements result from the adoption by state regulatory agencies of revised formulas for calculating the magnitude of a possible maximum flood event. The most significant capital improvement remaining to be performed in our dam improvement program is on one dam in Pennsylvania at a total estimated cost of \$13,300,000. Design for this dam commenced in 2013 and construction is expected to be completed in 2021.

A 2017 dam inspection in Illinois found cracks on two control gate mechanisms, and as a result, temporary gates were installed to eliminate reliance on the cracked control gates. An inspection of the other control gates was conducted in the fourth quarter of 2017, and it was determined that the dam's control gates should be replaced. All gates were reinforced in 2018 and all 10 gates will be replaced in 2019 and 2020 at a total estimated cost of \$15,100,000. We believe these capital investments will be recoverable in ratemaking.

One of our Ohio dams needing capital improvements is no longer used for water supply and may be sold to a third party. Should that sale not be consummated, we will need to breach the dam or rehabilitate portions of the dam at a cost of up to approximately \$2,600,000.

Lead and Copper Rule – The events in Flint, Michigan, which commenced in 2014, and other communities have brought attention to the issue of lead in drinking water from home plumbing. Lead in drinking water can come from lead that leaches from service lines, home plumbing solder, and fixtures or faucets. Since the Lead and Copper Rule in 1992, we have been working to prevent lead leaching from home plumbing sources by reducing water corrosivity and adding chemicals that can prevent leaching of lead in pipes and homes. We also focus on identifying and removing lead service lines and encouraging customers to replace the customer-owned portion of the service line if it is lead as they are identified during our main replacement program or during other maintenance activities. We are currently developing a lead service line inventory. We support the recommendations of The Lead Service Line Replacement Collaborative, a collaborative of leading water industry organizations that has recommended full replacement of lead service lines as a “best practice” to reduce lead in drinking water, but we only have control over the company-owned portion of each service line. In cases where we are replacing a company-owned lead service line, our standard approach is to replace the company-owned portion and advise and encourage the customer to replace the customer-owned portion of the service line, all the way to the customer's home. In Pennsylvania, we may have the legal and regulatory authority to replace the customer-owned portion of the service line and will attempt to obtain customer permission to do so. We also advise customers of the potential health impacts of lead in drinking water, and conduct lead testing at homes following replacement of a lead service line. We do not plan on replacing customer-owned lead service lines at locations where our portion of the service line does not contain lead, but if we become aware of such situations we will notify the customer. It is anticipated that the EPA will propose updated regulations for the Lead and Copper Rule in 2019.

Partnership for Safe Water Program – Aqua America is a proud participant in the American Water Works Association’s (AWWA) Partnership for Safe Water Program. This voluntary program is a commitment to excellence within the drinking water community above and beyond EPA’s stringent treatment goals. All of our active surface water treatment plants (within Pennsylvania, Ohio, Illinois, and Virginia) maintain good standing in the program which includes many awards of achievement. The honors include the “Director’s Award” (achieved at 5 systems) which recognizes plants that have: 1) completed a comprehensive self-assessment report, 2) created an action plan for continuous improvement, and 3) provided several evaluations of performance demonstrating operational excellence. Several of our systems have met these criteria annually and have received 5, 10, 15, and 20 year subscriber awards. Furthermore, our Roaring Creek Pennsylvania treatment plant has received the Phase IV Excellence Award, the highest honor achieved in the Partnership Program.

Safety Standards - Our facilities and operations may be subject to inspections by representatives of the Occupational Safety and Health Administration from time to time. We maintain safety policies and procedures to comply with the Occupational Safety and Health Administration’s rules and regulations, but violations may occur from time to time, which may result in fines and penalties, which are not expected to have a material impact on our business, financial condition, or results of operations. We endeavor to correct such violations promptly when they come to our attention.

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Security

We maintain security measures at our facilities, and collaborate with federal, state and local authorities and industry trade associations regarding information on possible threats and security measures for water and wastewater utility operations. The costs incurred are expected to be recoverable in water and wastewater rates and are not expected to have a material impact on our business, financial condition, or results of operations.

We also maintain cyber security protection measures with respect to our information technology, including our customer data, and, in some cases, the monitoring and operation of our treatment, storage and pumping facilities.

Employee Relations

As of December 31, 2018, we employed a total of 1,570 full-time employees. Our subsidiaries are parties to 15 labor agreements with labor unions covering 516 employees. The labor agreements expire at various times between April 2019 and December 2023, except for one labor agreement, which expired in October 2018, representing 4 employees. The employees under this expired agreement continue to work under the agreement, and negotiations with the labor union representing these employees are ongoing and we expect to reach a new agreement.

Available Information

We file annual, quarterly, current reports, proxy statements, and other information with the Securities and Exchange Commission (“SEC”). You may obtain our SEC filings from the SEC’s web site at www.sec.gov.

Our internet web site address is www.aquaamerica.com. We make available free of charge through our web site’s Investor Relations page all of our filings with the SEC, including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and other information. These reports and information are available as soon as reasonably practicable after such material is electronically filed with the SEC.

In addition, you may request a copy of the foregoing filings, at no cost by writing or telephoning us at the following address or telephone number:

Investor Relations Department

Aqua America, Inc.

762 W. Lancaster Avenue

Bryn Mawr, PA 19010-3489

Telephone: 610-527-8000

Our Board of Directors has various committees including an audit committee, an executive compensation committee, a corporate governance committee, and a risk mitigation and investment policy committee. Each of these committees has a formal charter. We also have Corporate Governance Guidelines and a Code of Ethical Business Conduct. Copies of these charters, guidelines, and codes can be obtained free of charge from our Investor Relations page on our web site, www.aquaamerica.com. In the event we change or waive any portion of the Code of Ethical Business Conduct that applies to any of our directors, executive officers, or senior financial officers, we will post that information on our web site.

The references to our web site and the SEC's web site are intended to be inactive textual references only, and the contents of those web sites are not incorporated by reference herein and should not be considered part of this or any other report that we file with or furnish to the SEC.

Item 1A. Risk Factors

In addition to the other information included in this Annual Report, the following factors should be considered in evaluating our business and future prospects. Any of the following risks, either alone or taken together, could materially harm our business, financial condition, and results of operations. If one or more of these or other risks or uncertainties

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materialize, or if our underlying assumptions prove to be incorrect, our business, financial condition, and results of operations could be materially harmed.

Our water supply, including water provided to our customers, is subject to various contaminants which may result in disruption in our services, additional costs, fines, laws and/or regulations, and litigation which could harm our business, reputation, financial condition, and results of operations.

Our water supplies, including water provided to our customers, are subject to possible contaminants, including those from:

- naturally occurring compounds or man-made substances;
- chemicals and other hazardous materials;
- lead and other materials;
- pharmaceuticals and personal care products; and
- possible deliberate or terrorist attacks.

Depending on the nature of the water contamination, we may have to interrupt the use of that water supply until we are able to substitute, where feasible, the flow of water from an uncontaminated water source, including if practicable, the purchase of water from other suppliers, or continue the water supply under restrictions on use for drinking or broader restrictions against all use except for basic sanitation and essential fire protection. We may incur significant costs, including, but not limited to, costs for water quality testing and monitoring, treatment of the contaminated source through modification of our current treatment facilities or development of new treatment methods, or the purchase of alternative water supplies. In addition, the costs we could incur to decontaminate a water source or our water distribution system and dispose of waste could also be significant. The costs resulting from the contamination may not be recoverable in rates we charge our customer, or may not be recoverable in a timely manner. If we are unable to adequately treat the contaminated water supply or substitute a water supply from an uncontaminated water source in a timely or cost effective manner, there may be an adverse effect on our business, financial condition, and results of operations. We could also be subject to:

- claims for consequences arising out of human exposure to contamination and/or hazardous substances in our water supplies, including toxic torts;
- claims for other environmental damage;
 - claims for customers' business interruption as a result of an interruption in water service;
- claims for breach of contract;
- criminal enforcement actions;
- regulatory fines; or
- other claims.

We incur substantial costs on an ongoing basis to comply with all laws and regulations. New or stricter laws and/or regulations could increase our costs. Although we may seek to recover these costs through customer rates, there is no guarantee that the various state regulators would approve the increase in costs.

The events in Flint, Michigan, which commenced in 2014, and other communities have brought attention to the issue of lead in drinking water from home plumbing. We have been working to prevent lead leaching from home plumbing sources by reducing water corrosivity and adding chemicals that can prevent leaching of lead in pipes and homes. We also focus on identifying and removing lead service lines and encouraging customers to replace the customer-owned portion of the service line if it is lead as they are identified during our main replacement program or during other maintenance activities.

We are devoting our attention to various emerging contaminants, including the Per- and Polyfluoroalkyl Substances (PFAS) family of chemicals and other chemicals and substances that do not have any regulatory standard in drinking water. We rely on governmental agencies to establish the standard of protection from these unregulated contaminants and we meet or exceed these standards, when established. There is no guarantee that the various state regulators would approve the costs associated with the treatment in our system of the emerging contaminants without the establishment of treatment standards by the appropriate governmental entities.

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We may incur costs to defend our position and/or incur reputational damage even if we are not liable for consequences arising out of human exposure to contamination and/or hazardous substances in our water supplies or other environmental damage. Our insurance policies may not be sufficient to cover the costs of these claims, and losses incurred may make it difficult for us to secure insurance in the future at acceptable rates. Such claims or actions could harm our business, financial condition, and results of operations.

The rates we charge our customers are subject to regulation. If we are unable to obtain government approval of our requests for rate increases or if approved rate increases are untimely or inadequate to recover and earn a return on our capital investments, to recover expenses or taxes, or to take into account changes in water usage, our profitability may suffer.

The rates we charge our customers are subject to approval by utility commissions in the states in which we operate. We file rate increase requests, from time to time, to recover our investments in utility plant and expenses. Our ability to maintain and meet our financial objectives is dependent upon the recovery of, and return on, our capital investments and expenses through the rates we charge our customers. Once a rate increase petition is filed with a utility commission, the ensuing administrative and hearing process may be lengthy and costly, and our costs may not always be fully recoverable. The timing of our rate increase requests are therefore partially dependent upon the estimated cost of the administrative process in relation to the investments and expenses that we hope to recover through the rate increase. In addition, the amount or frequency of rate increases may be decreased or lengthened as a result of many factors including changes in regulatory oversight in the states in which we operate utilities and income tax laws, including regulations regarding tax-basis depreciation as it applies to our capital expenditures or qualifying utility asset improvements. We can provide no assurances that any future rate increase request will be approved by the appropriate utility commission; and, if approved, we cannot guarantee that these rate increases will be granted in a timely or sufficient manner.

In Virginia, we may seek authorization to bill our utility customers in accordance with a rate filing that is pending before the respective regulatory commission. Furthermore, some utility commissions authorize the use of expense deferrals and amortization in order to provide for an impact on our operating income by an amount that approximates the requested amount in a rate request. The additional revenue billed and collected prior to the final ruling is subject to refund to customers based on the outcome of the ruling. The revenue recognized and the expenses deferred by us reflect an estimate as to the final outcome of the ruling. If the request is denied completely or in part, we could be required to refund to customers some or all of the revenue billed to date, and write-off some or all of the deferred expenses.

Any failure of our water and wastewater treatment plants, network of water and wastewater pipes, or water reservoirs could result in damages that may harm our business, financial condition, and results of operations.

Our operating subsidiaries treat water and wastewater, distribute water and collect wastewater through an extensive network of pipes, and store water in reservoirs. A failure of a major treatment plant, pipe, or reservoir could result in claims for injuries or property damage. The failure of a major treatment plant, pipe, or reservoir may also result in the need to shut down some facilities or parts of our network in order to conduct repairs. Such failures and shutdowns may limit our ability to supply water in sufficient quality and quantities to our customers or collect and treat wastewater in accordance with standards prescribed by governmental regulators, including state utility commissions, and may harm our business, financial condition, and results of operations. Any business interruption or other losses might not be covered by insurance policies or be recoverable in rates, and such losses may make it difficult for us to secure insurance in the future at acceptable rates.

Our business requires significant capital expenditures that are partially dependent on our ability to secure appropriate funding. Disruptions in the capital markets may limit our access to capital and may impact the Peoples Gas Acquisition. If we are unable to obtain sufficient capital, or if the cost of borrowing increases, it may harm our business, financial condition, results of operations, and our ability to pay dividends, and could make it more difficult and more expensive for us to complete the Peoples Gas Acquisition.

Our business is capital intensive. In addition to the capital required to fund customer growth through our acquisition strategy, on an annual basis, and particularly the acquisition of Peoples, we spend significant sums for additions to or replacement of property, plant and equipment. We obtain funds for our capital expenditures from operations, contributions and advances by developers and others, debt issuances, and equity issuances. We have paid dividends consecutively for 74 years and our Board of Directors recognizes the value that our common shareholders place on both

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our historical payment record and on our future dividend payments. Our ability to continue our growth through acquisition, including the Peoples Gas Acquisition, and to maintain and meet our financial objectives is dependent upon the availability of adequate capital, and we may not be able to access the capital markets on favorable terms or at all. Further, while we have obtained a commitment (the “Bridge Commitment”) from certain banks to provide senior unsecured bridge loans (the “Bridge Loan”), which backstops the Peoples Gas Acquisition purchase price and the refinancing of certain debt of the Company, we expect to obtain long-term financing in the capital markets to fund these transactions in lieu of utilizing the funds available under the Bridge Commitment. If such long-term financing is not available on terms acceptable to us, we would draw upon the Bridge Commitment to complete these transactions and would incur significantly higher borrowing costs than the contemplated long-term financing, which would increase the overall cost of the Peoples Gas Acquisition and could harm our business, financial condition, results of operations, and cash flows. The Bridge Loan would mature 364 days after the closing of the Peoples Gas Acquisition, and any debt incurred to refinance the Bridge Loan may be on unfavorable terms. Additionally, if in the future, our credit facilities are not renewed or our short-term borrowings are called for repayment, we would need to seek alternative financing sources; however, there can be no assurance that these alternative financing sources would be available on terms acceptable to us. In the event we are unable to obtain sufficient capital, we may need to take steps to conserve cash by reducing our capital expenditures or dividend payments and our ability to pursue acquisitions may be limited. The reduction in capital expenditures may result in reduced potential earnings growth, affect our ability to meet environmental laws and regulations, and limit our ability to improve or expand our utility systems to the level we believe appropriate. There is no guarantee that we will be able to obtain sufficient capital in the future on reasonable terms and conditions for expansion, construction and maintenance. In addition, delays in completing major capital projects could delay the recovery of the capital expenditures associated with such projects through rates.

If the cost of borrowing increases, we might not be able to recover increases in our cost of capital through rates. The inability to recover higher borrowing costs through rates, or the regulatory lag associated with the time that it takes to begin recovery, may harm our business, financial condition, results of operations and cash flows.

In an effort to manage our exposure to interest rate risk associated with our planned issuance of long-term debt to fund a portion of the Peoples Gas Acquisition, we have entered into, and in the future, may enter into, financial derivative instruments such as interest rate swap agreements. However, these efforts may not be effective to fully mitigate interest rate risk, and may expose us to other risks and uncertainties, including quarterly mark-to-market valuation risk associated with these instruments, that could negatively and materially affect our business, financial condition, results of operations and cash flows.

Our inability to comply with debt covenants under our loan and debt agreements could result in prepayment obligations.

We are obligated to comply with debt covenants under some of our loan and debt agreements. In addition, we intend to incur additional indebtedness in connection with the Peoples Gas Acquisition, including by assuming certain

outstanding indebtedness of Peoples, and will be obligated to comply with the debt covenants under the agreements governing such indebtedness. Failure to comply with covenants under our loan and debt agreements could result in an event of default, which if not cured or waived, could result in us being required to repay or finance these borrowings before their due date, limit future borrowings, cause us to default on other obligations, and increase borrowing costs. If we are forced to repay or refinance (on less favorable terms) these borrowings, our business, financial condition, and results of operations could be harmed by reduced access to capital and increased costs and rates.

One of the important elements of our growth strategy is the acquisition of regulated utility systems. Any acquisition we decide to undertake may involve risks. Further, competition for acquisition opportunities from other regulated utilities, governmental entities, and strategic and financial buyers may hinder our ability to grow our business.

One important element of our growth strategy is the acquisition and integration of regulated utility systems in order to broaden our service areas. In addition, the acquisition of Peoples is an opportunity to broaden our services to include natural gas distribution and additional states of operation. We will not be able to acquire other businesses if we cannot identify suitable acquisition opportunities or reach mutually agreeable terms with acquisition candidates. It is our intent, when practical, to integrate any businesses we acquire with our existing operations. Investing in and integrating acquisitions could require us to incur significant costs and cause diversion of our management's time and resources, and

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we may be unable to successfully integrate our business with acquired businesses or to realize anticipate benefits of acquisitions. Acquisitions by us could also result in:

- dilutive issuances of our equity securities;
- incurrence of debt, contingent liabilities, and environmental liabilities;
- unanticipated capital expenditures;
- failure to maintain effective internal control over financial reporting;
- recording goodwill and other intangible assets for which we may never realize their full value and may result in an asset impairment that may negatively affect our results of operations;
- fluctuations in quarterly results;
- other acquisition related expenses; and
- exposure to unknown or unexpected risks and liabilities.

For example, we expect to finance the Peoples Gas Acquisition purchase price and to refinance certain of our debt with a mix of common equity, equity-linked securities, and debt financing. Any such common equity or equity-linked securities financing could reduce the market price of our shares of common stock, dilute ownership interests of holders of our common stock, or otherwise adversely affect holders of our common stock. Any such debt financing would cause us to have outstanding indebtedness greater than our current outstanding indebtedness, which could require us to use a larger portion of our cash flows for debt service (reducing funds available for other purposes), reduce our ability to make investments and acquisitions, limit our ability to obtain additional financing on acceptable terms, and increase our vulnerability to adverse economic and industry conditions. In addition, we have incurred and expect to incur additional substantial expenses related to the completion of the Peoples Gas Acquisition and the integration of our business with Peoples.

Some or all of these items could harm our business, financial condition, results of operations, and cash flows, and our ability to finance our business and to comply with regulatory requirements. Additionally, the Peoples acquisition is subject to obtaining regulatory approvals, which approvals may be denied or subject to burdensome conditions. The businesses we acquire, including Peoples, may not achieve sales and profitability that would justify our investment, and any difficulties we encounter in the integration process, including in the integration of processes necessary for internal control and financial reporting, could interfere with our operations, reduce our operating margins and harm our internal controls.

Some states in which we operate allow the respective public utility commissions to use fair market value to set ratemaking rate base instead of the traditional depreciated original cost of water or wastewater assets for certain qualifying municipal acquisitions. Depending on the state, there are varying rules and circumstances in which fair value is determined. A number of states' regulations allow ratemaking rate base to equal the lower of the average of the appraisals or the purchase price, subject to regulatory approval. There may be situations where we may pay more than the ultimate fair value of the utility assets as set by the regulatory commission, despite the fair value legislation suggesting its full recovery. In these situations, goodwill may be recognized to the extent there is an excess purchase price over the fair value of net tangible and identifiable intangible assets acquired through acquisition. Our financial

condition and results of operations can be harmed by an inability to earn a return on, and recover our purchase price as a component of rate base.

We compete with governmental entities, other regulated utilities, and strategic and financial buyers, for acquisition opportunities. As consolidation becomes more prevalent in the utility industry and competition for acquisitions increases, the prices for suitable acquisition candidates may increase to unacceptable levels and limit our ability to grow through acquisitions. In addition, our competitors may impede our growth by purchasing utilities near our existing operations, thereby preventing us from acquiring them. Governmental entities or environmental / social activist groups have challenged, and may in the future challenge our efforts to acquire new service territories, particularly from municipalities or municipal authorities. Higher purchase prices and resulting rates may limit our ability to invest additional capital for system maintenance and upgrades in an optimal manner. Our growth could be hindered if we are not able to compete effectively for new companies and/or service territories with other companies or strategic and financial buyers that have lower costs of operations or capital, or that submit more attractive bids. Any of these risks may harm our business, financial condition, and results of operations.

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The Peoples Gas Acquisition is subject to conditions, some or all of which may not be satisfied or waived on a timely basis, if at all. Failure to close the Peoples Gas Acquisition could negatively and materially affect our business, financial condition and results of operations.

The closing of the Peoples Gas Acquisition is subject to a number of conditions, including, among others, the receipt of regulatory approvals (including by the public utility commissions in Pennsylvania, Kentucky, and West Virginia). These regulatory approvals may be denied or may be subject to our agreeing to certain actions, undertakings, terms, or other measures. These conditions make the closing and timing of the closing of the Peoples Gas Acquisition uncertain. In addition, either we or Seller can terminate the acquisition agreement at any time prior to the closing of the Peoples Gas Acquisition in the event the Acquisition is not completed by October 22, 2019 (subject to extension to April 22, 2020 to obtain necessary regulatory approvals) and in other customary circumstances. In the event that the Peoples Gas Acquisition is terminated due to certain breaches by the Company, a fee of \$120,000,000 would be payable to the Seller as liquidated damages. In addition, if the Peoples Gas Acquisition is not completed, we could be subject to litigation related to any failure to complete the Peoples Gas Acquisition or related to any enforcement proceeding commenced against us to perform our obligations under the acquisition agreement. Failure to close the Peoples Gas Acquisition may cause the market price of our common stock to decline, and could otherwise negatively and materially affect our business, financial condition and results of operations.

Similarly, delays in the closing of the Peoples Gas Acquisition could, among other things, result in additional transaction costs, loss of revenue or other negative effects associated with uncertainty about the closing of the Peoples Gas Acquisition, and could cause us not to realize a portion of the benefits that we expect to achieve if the Peoples Gas Acquisition is successfully completed within its expected timeframe. We cannot assure you that the conditions to the closing of the Peoples Gas Acquisition will be satisfied or waived or that the Peoples Gas Acquisition will be completed.

Integrating the Peoples Gas Acquisition may disrupt or have a negative impact on our business.

We anticipate that the Peoples Gas Acquisition will close in mid-2019, following receipt of all regulatory approvals. We could have difficulty integrating the acquired assets, personnel and operations with our own. The Peoples Gas Acquisition is complex and we will devote significant time and resources to integrating the businesses. Risks that could impact us negatively include:

- the difficulty of integrating the acquired companies, and their concepts and operations;
- the potential disruption of the ongoing businesses and distraction of our management and the management of the acquired companies;
- changes in our business focus and/or management;
- risks related to the natural gas distribution business;

- difficulties in maintaining uniform standards, controls, procedures and policies;
- the potential impairment of relationships with employees and partners as a result of any integration of new management personnel;
- the potential inability to manage an increased number of locations and employees;
- our ability to successfully manage Peoples; or
- the effect of any government regulations which relate to the business acquired.

If we are not successful in addressing these risks effectively, our business could be severely impaired.

Our operations are geographically concentrated in Pennsylvania, which make us susceptible to risks affecting Pennsylvania.

Although we operate water and wastewater facilities in a number of states, our operations are concentrated in Pennsylvania. As a result, our financial results are largely subject to political, water supply, labor, utility cost and regulatory risks, economic conditions, natural disasters and other risks affecting Pennsylvania.

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We are increasingly dependent on the continuous and reliable operation of our information technology systems, and a disruption of these systems, resulting from cyber security attacks or other events, could harm our business.

We rely on our information technology systems in connection with the operation of our business, especially with respect to customer service and billing, accounting and, in some cases, the monitoring and operation of our treatment, storage and pumping facilities. In addition, we rely on our systems to track our utility assets and to manage maintenance and construction projects, materials and supplies, and our human resource functions. The addition of the Peoples information technology systems, and the integration of such systems with ours adds additional complexity. A loss of these systems, or major problems with the operation of these systems, could harm our business, financial condition, and results of operations. Our information technology systems may be vulnerable to damage or interruption from the following types of cyber security attacks or other events:

- power loss, computer systems failures, and internet, telecommunications or data network failures;
- operator negligence or improper operation by, or supervision of, employees;
- physical and electronic loss of data;
- computer viruses, cyber security attacks, intentional security breaches, hacking, denial of service actions, misappropriation of data and similar events;
- difficulties in the implementation of upgrades or modification to our information technology systems; and
- hurricanes, fires, floods, earthquakes and other natural disasters.

Although we do not believe that our systems are at a materially greater risk of cyber security attacks than other similar organizations, our information technology systems may be vulnerable to damage or interruption from the types of cyber security attacks or other events listed above or other similar actions, and such incidents may go undetected for a period of time. Such cyber security attacks or other events may result in:

- the loss or compromise of customer, financial, employee, or operational data;
- disruption of billing, collections or normal field service activities;
- disruption of electronic monitoring and control of operational systems; and
- delays in financial reporting and other normal management functions.

Possible impacts associated with a cyber security attack or other events may include: remediation costs related to lost, stolen, or compromised data; repairs to data processing systems; increased cyber security protection costs; adverse effects on our compliance with regulatory and environmental laws and regulation, including standards for drinking water; litigation; and reputational damage. We maintain insurance to help defray costs associated with cyber security attacks or other events, but we cannot provide assurance that such insurance will provide coverage for any particular type of incident or event or that such insurance will be adequate, and losses incurred may make it difficult for us to secure insurance in the future at acceptable rates.

We have a cyber-security controls framework in place. We monitor our control effectiveness in an increasing threat landscape and continuously take action to improve our security posture. We cannot assure you that, despite such measures, a form of system failure or data security breach will not have a material adverse effect on our financial condition and results of operations.

Our facilities could be the target of a possible terrorist or other deliberate attack which could harm our business, financial condition and results of operations.

In addition to the potential contamination of our water supply as described in a separate risk factor herein, we maintain security measures at our facilities and have heightened employee and public safety official awareness of potential threats to our utility systems. We have and will continue to bear increases in costs for security precautions to protect our facilities, operations, and supplies, most of which have been recoverable under state regulatory policies. While the costs of increases in security, including capital expenditures, may be significant, we expect these costs to continue to be recoverable in utility rates. Despite our security measures, we may not be in a position to control the outcome of terrorist events, or other attacks on our utility systems, should they occur. Such an event could harm our business, financial condition, and results of operations.

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Our business is impacted by weather conditions and is subject to seasonal fluctuations, which could harm demand for our water service and our revenues and earnings.

Demand for our water during the warmer months is generally greater than during cooler months due primarily to additional requirements for water in connection with irrigation systems, swimming pools, cooling systems, and other outside water use. Throughout the year, and particularly during typically warmer months, demand will vary with temperature, rainfall levels and rainfall frequency. In the event that temperatures during the typically warmer months are cooler than normal, if there is more rainfall than normal, or rainfall is more frequent than normal, the demand for our water may decrease and harm our business, financial condition, and results of operations. In Illinois, our operating subsidiary has adopted a revenue stability mechanism which allows us to recognize state PUC authorized revenue for a period which is not based upon the volume of water sold during that period, and effectively lessens the impact of weather and consumption variability.

Decreased residential customer water consumption as a result of water conservation efforts may harm demand for our water service and may reduce our revenues and earnings.

There has been a general decline in water usage per residential customer as a result of an increase in conservation awareness, and the impact of an increased use of more efficient plumbing fixtures and appliances. These gradual, long-term changes are normally taken into account by the utility commissions in setting rates, whereas short-term changes in water usage, if significant, may not be fully reflected in the rates we charge. We are dependent upon the revenue generated from rates charged to our residential customers for the volume of water used. If we are unable to obtain future rate increases to offset decreased residential customer water consumption to cover our investments, expenses, and return for which we initially sought the rate increase, our business, financial condition, and results of operations may be harmed.

Drought conditions and government imposed water use restrictions may impact our ability to serve our current and future customers, and may impact our customers' use of our water, which may harm our business, financial condition, and results of operations.

We depend on an adequate water supply to meet the present and future demands of our customers. Drought conditions could interfere with our sources of water supply and could harm our ability to supply water in sufficient quantities to our existing and future customers. An interruption in our water supply could harm our business, financial condition, and results of operations. Moreover, governmental restrictions on water usage during drought conditions may result in a decreased demand for our water, even if our water supplies are sufficient to serve our customers during these drought conditions, which may harm our business, financial condition, and results of operations.

The failure of, or the requirement to repair, upgrade or dismantle any of our dams or reservoirs may harm our business, financial condition, and results of operations.

Several of our water systems include impounding dams and reservoirs of various sizes. Although we believe our dam review program, which includes regular inspections and other engineering studies, will ensure our dams are structurally sound and well-maintained, the failure of a dam could result in significant downstream damage and could result in claims for property damage or for injuries or fatalities. We periodically inspect our dams and purchase liability insurance to cover such risks, but depending on the nature of the downstream damage and cause of the failure, the policy limits of insurance coverage may not be sufficient, and losses incurred may make it difficult for us to secure insurance in the future at acceptable rates. A dam failure could also result in damage to, or disruption of, our water treatment and pumping facilities that are often located downstream from our dams and reservoirs. Significant damage to these facilities, or a significant decline in the storage of the raw water impoundment, could affect our ability to provide water to our customers until the facilities and a sufficient raw water impoundment can be restored. The estimated costs to maintain our dams are included in our capital budget projections and, although such costs to date have been recoverable in rates, there can be no assurance that rate increases will be granted in a timely or sufficient manner to recover such costs in the future, if at all.

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General economic conditions may affect our financial condition and results of operations.

A general economic downturn may lead to a number of impacts on our business and may affect our financial condition and results of operations. Such impacts may include: