

AQUA AMERICA INC
Form 10-Q
August 03, 2017
Table of Contents

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, 2017

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.)

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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, 2017: 177,651,543

Table of Contents

AQUA AMERICA, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

	Page
<u>Part I – Financial Information</u>	
<u>Item 1. Financial Statements:</u>	
<u>Consolidated Balance Sheets (unaudited) – June 30, 2017 and December 31, 2016</u>	2
<u>Consolidated Statements of Net Income (unaudited) – Three Months Ended June 30, 2017 and 2016</u>	3
<u>Consolidated Statements of Net Income (unaudited) – Six Months Ended June 30, 2017 and 2016</u>	4
<u>Consolidated Statements of Comprehensive Income (unaudited) – Three and Six Months Ended June 30, 2017 and 2016</u>	5
<u>Consolidated Statements of Capitalization (unaudited) – June 30, 2017 and December 31, 2016</u>	6
<u>Consolidated Statement of Equity (unaudited) – Six Months Ended June 30, 2017</u>	7
<u>Consolidated Statements of Cash Flow (unaudited) – Six Months Ended June 30, 2017 and 2016</u>	8
<u>Notes to Consolidated Financial Statements (unaudited)</u>	9
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	24
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	28
<u>Item 4. Controls and Procedures</u>	28
<u>Part II – Other Information</u>	
<u>Item 1. Legal Proceedings</u>	28
<u>Item 1A. Risk Factors</u>	28

<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	29
<u>Item 6. Exhibits</u>	29
<u>Signatures</u>	30
<u>Exhibit Index</u>	31

Table of Contents

AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands of dollars, except per share amounts)

(UNAUDITED)

	June 30, 2017	December 31, 2016
Assets		
Property, plant and equipment, at cost	\$ 6,717,832	\$ 6,509,117
Less: accumulated depreciation	1,558,681	1,507,502
Net property, plant and equipment	5,159,151	5,001,615
Current assets:		
Cash and cash equivalents	7,811	3,763
Accounts receivable and unbilled revenues, net	98,890	97,394
Inventory, materials and supplies	16,838	12,961
Prepayments and other current assets	13,009	12,804
Assets held for sale	1,543	1,728
Total current assets	138,091	128,650
Regulatory assets	1,003,808	948,647
Deferred charges and other assets	33,597	30,845
Investment in joint venture	6,786	7,026
Goodwill	42,266	42,208
Total assets	\$ 6,383,699	\$ 6,158,991
Liabilities and Equity		
Stockholders' equity:		
Common stock at \$.50 par value, authorized 300,000,000 shares, issued 180,635,368 and 180,311,345 as of June 30, 2017 and December 31, 2016	\$ 90,317	\$ 90,155
Capital in excess of par value	802,799	797,513
Retained earnings	1,075,856	1,032,844
Treasury stock, at cost, 2,984,264 and 2,916,969 shares as of June 30, 2017 and December 31, 2016	(73,206)	(71,113)
Accumulated other comprehensive income	764	669
Total stockholders' equity	1,896,530	1,850,068
Long-term debt, excluding current portion	1,844,342	1,759,962
Less: debt issuance costs	21,761	22,357
Long-term debt, excluding current portion, net of debt issuance costs	1,822,581	1,737,605
Commitments and contingencies (See Note 13)		

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Current liabilities:		
Current portion of long-term debt	143,567	150,671
Loans payable	67,456	6,535
Accounts payable	46,376	59,872
Accrued interest	17,007	18,367
Accrued taxes	18,858	25,607
Other accrued liabilities	39,283	40,484
Total current liabilities	332,547	301,536
Deferred credits and other liabilities:		
Deferred income taxes and investment tax credits	1,339,583	1,269,253
Customers' advances for construction	91,131	91,843
Regulatory liabilities	244,613	250,635
Other	105,051	115,583
Total deferred credits and other liabilities	1,780,378	1,727,314
Contributions in aid of construction	551,663	542,468
Total liabilities and equity	\$ 6,383,699	\$ 6,158,991

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

Table of Contents

AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF NET INCOME

(In thousands, except per share amounts)

(UNAUDITED)

	Three Months Ended June 30,	
	2017	2016
Operating revenues	\$ 203,418	\$ 203,876
Operating expenses:		
Operations and maintenance	70,853	73,994
Depreciation	33,407	31,619
Amortization	127	528
Taxes other than income taxes	14,419	14,242
Total operating expenses	118,806	120,383
Operating income	84,612	83,493
Other expense (income):		
Interest expense, net	21,387	20,115
Allowance for funds used during construction	(3,463)	(1,871)
Gain on sale of other assets	(10)	(121)
Equity loss in joint venture	161	229
Income before income taxes	66,537	65,141
Provision for income taxes	5,569	5,515
Net income	\$ 60,968	\$ 59,626
Net income per common share:		
Basic	\$ 0.34	\$ 0.34
Diluted	\$ 0.34	\$ 0.33
Average common shares outstanding during the period:		
Basic	177,609	177,288
Diluted	178,045	178,084
Cash dividends declared per common share	\$ 0.1913	\$ 0.178

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

Table of Contents

AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF NET INCOME

(In thousands, except per share amounts)

(UNAUDITED)

	Six Months Ended June 30,	
	2017	2016
Operating revenues	\$ 391,205	\$ 396,483
Operating expenses:		
Operations and maintenance	139,981	147,535
Depreciation	67,244	63,764
Amortization	316	978
Taxes other than income taxes	29,156	28,382
Total operating expenses	236,697	240,659
Operating income	154,508	155,824
Other expense (income):		
Interest expense, net	42,713	39,968
Allowance for funds used during construction	(6,656)	(4,179)
Gain on sale of other assets	(279)	(328)
Equity loss in joint venture	191	478
Income before income taxes	118,539	119,885
Provision for income taxes	8,499	8,522
Net income	\$ 110,040	\$ 111,363
Net income per common share:		
Basic	\$ 0.62	\$ 0.63
Diluted	\$ 0.62	\$ 0.63
Average common shares outstanding during the period:		
Basic	177,545	177,196
Diluted	178,042	177,920
Cash dividends declared per common share	\$ 0.3826	\$ 0.356

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

Table of Contents

AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands of dollars)

(UNAUDITED)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Net income	\$ 60,968	\$ 59,626	\$ 110,040	\$ 111,363
Other comprehensive income, net of tax:				
Unrealized holding gain on investments, net of tax expense of \$20 and \$7 for the three months, and \$51 and \$3 for the six months ended June 30, 2017 and 2016, respectively	37	12	95	6
Reclassification of gain on sale of investment to net income, net of tax of \$30 for the six months ended June 30, 2016 (1)	-	-	-	(57)
Comprehensive income	\$ 61,005	\$ 59,638	\$ 110,135	\$ 111,312

(1) Amount of pre-tax gain of \$87 reclassified from accumulated other comprehensive income to gain on sale of other assets on the consolidated statements of net income for the six months ended June 30, 2016.

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

Table of Contents

AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CAPITALIZATION

(In thousands of dollars, except per share amounts)

(UNAUDITED)

	June 30, 2017	December 31, 2016
Stockholders' equity:		
Common stock, \$.50 par value	\$ 90,317	\$ 90,155
Capital in excess of par value	802,799	797,513
Retained earnings	1,075,856	1,032,844
Treasury stock, at cost	(73,206)	(71,113)
Accumulated other comprehensive income	764	669
Total stockholders' equity	1,896,530	1,850,068
Long-term debt of subsidiaries (substantially collateralized by utility plant):		
Interest Rate Range	Maturity Date Range	
0.00% to 0.99%	2023 to 2033	4,339
1.00% to 1.99%	2019 to 2035	13,664
2.00% to 2.99%	2024 to 2033	20,120
3.00% to 3.99%	2019 to 2056	430,600
4.00% to 4.99%	2020 to 2054	422,896
5.00% to 5.99%	2019 to 2043	205,828
6.00% to 6.99%	2017 to 2036	52,995
7.00% to 7.99%	2022 to 2027	32,706
8.00% to 8.99%	2021 to 2025	6,334
9.00% to 9.99%	2018 to 2026	26,400
10.00% to 10.99%	2018	6,000
		1,221,882
Notes payable to bank under revolving credit agreement, variable rate, due 2021	135,000	25,000
Unsecured notes payable:		
Bank notes at 1.921% and 1.975% due 2017 and 2018	100,000	100,000
Notes ranging from 3.01% to 3.59% due 2027 through 2041	245,000	245,000

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Notes ranging from 4.62% to 4.87%, due 2017 through 2024	133,600	133,600
Notes ranging from 5.20% to 5.95%, due 2018 through 2037	152,427	159,809
Total long-term debt	1,987,909	1,910,633
Current portion of long-term debt	143,567	150,671
Long-term debt, excluding current portion	1,844,342	1,759,962
Less: debt issuance costs	21,761	22,357
Long-term debt, excluding current portion, net of debt issuance costs	1,822,581	1,737,605
Total capitalization	\$ 3,719,111	\$ 3,587,673

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

Table of Contents

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, 2016	\$ 90,155	\$ 797,513	\$ 1,032,844	\$ (71,113)	\$ 669	\$ 1,850,068
Net income	-	-	110,040	-	-	110,040
Other comprehensive income, net of income tax of \$51	-	-	-	-	95	95
Dividends	-	-	(67,920)	-	-	(67,920)
Sale of stock (23,194 shares)	12	703	-	-	-	715
Repurchase of stock (67,295 shares)	-	-	-	(2,093)	-	(2,093)
Equity compensation plan (160,279 shares)	80	(80)	-	-	-	-
Exercise of stock options (140,550 shares)	70	2,257	-	-	-	2,327
Stock-based compensation	-	2,810	(90)	-	-	2,720
Cumulative effect of change in accounting principle - windfall tax benefit	-	-	982	-	-	982
Other	-	(404)	-	-	-	(404)
Balance at June 30, 2017	\$ 90,317	\$ 802,799	\$ 1,075,856	\$ (73,206)	\$ 764	\$ 1,896,530

Refer to Note 15 - Recent Accounting Pronouncements for a discussion of the cumulative effect of change in accounting principle - windfall tax benefit

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

Table of Contents

AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOW

(In thousands of dollars)

(UNAUDITED)

	Six Months Ended	
	June 30,	
	2017	2016
Cash flows from operating activities:		
Net income	\$ 110,040	\$ 111,363
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	67,560	64,742
Deferred income taxes	6,299	5,051
Provision for doubtful accounts	2,052	2,101
Stock-based compensation	2,810	2,200
Loss (gain) on sale of utility system and market-based business unit	324	(1,782)
Gain on sale of other assets	(279)	(328)
Net change in receivables, inventory and prepayments	(7,417)	(4,130)
Net change in payables, accrued interest, accrued taxes and other accrued liabilities	(10,969)	(2,695)
Postretirement benefit contributions	(15,421)	(6,787)
Other	2,262	7,923
Net cash flows from operating activities	157,261	177,658
Cash flows from investing activities:		
Property, plant and equipment additions, including the debt component of allowance for funds used during construction of \$1,543 and \$1,097	(208,472)	(168,587)
Acquisitions of utility systems and other, net	(5,765)	(5,626)
Net proceeds from the sale of utility system and other assets	1,102	6,439
Other	(144)	(45)
Net cash flows used in investing activities	(213,279)	(167,819)
Cash flows from financing activities:		
Customers' advances and contributions in aid of construction	3,629	3,205
Repayments of customers' advances	(1,774)	(1,282)
Net proceeds of short-term debt	60,921	9,518
Proceeds from long-term debt	222,780	169,297
Repayments of long-term debt	(145,499)	(112,650)
Change in cash overdraft position	(12,616)	(15,338)
Proceeds from issuing common stock	715	670
Proceeds from exercised stock options	2,327	3,569
Stock-based compensation windfall tax benefits	-	1,198

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Repurchase of common stock	(2,093)	(2,859)
Dividends paid on common stock	(67,920)	(63,071)
Other	(404)	(402)
Net cash flows from (used in) financing activities	60,066	(8,145)
Net change in cash and cash equivalents	4,048	1,694
Cash and cash equivalents at beginning of period	3,763	3,229
Cash and cash equivalents at end of period	\$ 7,811	\$ 4,923
Non-cash investing activities:		
Property, plant and equipment additions purchased at the period end, but not yet paid for	\$ 32,770	\$ 20,863
Non-cash customer advances and contributions in aid of construction	11,488	11,199

Refer to Note 3 - Acquisitions for a description of non-cash activities

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

Table of Contents

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, 2017, the consolidated statements of net income and comprehensive income for the three and six months ended June 30, 2017 and 2016 the consolidated statements of cash flow for the six months ended June 30, 2017 and 2016, and the consolidated statement of equity for the six months ended June 30, 2017 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 our 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, 2016. 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, 2016 consolidated balance sheet data presented herein was derived from the Company’s December 31, 2016 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 of postretirement benefit contributions in the consolidated statements of cash flows.

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 our consolidated balance sheets, the revenues and expenses in our consolidated statements of net income, and the information that is contained in our 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 we include currently in our consolidated financial statements, summary of significant accounting policies, and notes.

There have been no changes to the summary of significant accounting policies previously identified in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016.

Note 2 – Goodwill

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

	Regulated Segment	Other	Consolidated
Balance at December 31, 2016	\$ 37,367	\$ 4,841	\$ 42,208
Goodwill acquired	72	-	72
Reclassification to utility plant acquisition adjustment	(14)	-	(14)
Balance at June 30, 2017	\$ 37,425	\$ 4,841	\$ 42,266

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

Table of Contents

AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

the recovery through customer rates, of goodwill associated with some acquisitions upon achieving specific objectives.

Note 3 – Acquisitions

During the first half of 2017, the Company completed three acquisitions of water and wastewater utility systems in various states adding 1,002 customers. The total purchase price of these utility systems consisted of \$5,765 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.

Pursuant to our strategy to grow through acquisitions, in January 2016, the Company acquired Superior Water Company, Inc., which provides public water service to approximately 3,900 customers in portions of Berks, Chester, and Montgomery counties in Pennsylvania. The total purchase price for the utility system was \$16,750, which consisted of the issuance of 439,943 shares of the Company's common stock and \$3,905 in cash. The purchase price allocation for this acquisition consisted primarily of acquired property, plant and equipment of \$25,167, contributions in aid of construction of \$16,565, and goodwill of \$8,622. Additionally, during 2016, the Company completed eighteen acquisitions of water and wastewater utility systems in various states adding 2,469 customers. The total purchase price of these utility systems consisted of \$5,518 in cash, which resulted in \$1,756 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 4 – Assets Held for Sale

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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.

In the second quarter of 2016, the Company decided to market for sale two business units that are reported within the Company's market-based subsidiary, Aqua Resources. One business unit installed and tested devices that prevent the contamination of potable water and repaired water and wastewater systems, for which the sale was completed in January 2017. The other business unit repairs and performs maintenance on water and wastewater systems, for which the sale was completed in June 2017.

]

10

Table of Contents

AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

Note 5 – Capitalization

In July 2017, Aqua Illinois issued \$100,000 of first mortgage bonds consisting of the following:

\	Amount	Interest Rate	Maturity
	\$25,000	3.64%	2032
	\$6,000	3.89%	2037
	\$15,000	3.90%	2038
	\$10,000	4.18%	2047
	\$22,000	4.22%	2049
	\$22,000	4.24%	2050

The proceeds from these bonds were used to repay existing indebtedness and for general corporate purposes.

In July 2017, Aqua Pennsylvania issued \$80,000 of first mortgage bonds, of which \$40,000 is due in 2055 and \$40,000 is due in 2057 with interest rates of 4.04% and 4.06%, respectively. The proceeds from these bonds were used to repay existing indebtedness and for general corporate purposes.

In January 2017, Aqua Pennsylvania issued \$50,000 of first mortgage bonds, of which \$10,000 is due in 2042 and \$40,000 is due in 2044 with interest rates of 3.65% and 3.69%, respectively. The proceeds from these bonds were used to repay existing indebtedness and for general corporate purposes.

Note 6 – Fair Value of Financial Instruments

The Company follows the Financial Accounting Standards Board's ("FASB") 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

Table of Contents

AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

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, 2017.

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.

The fair value of loans payable is determined based on its carrying amount and utilizing Level 1 methods and assumptions. As of June 30, 2017 and December 31, 2016, the carrying amount of the Company's loans payable was \$67,456 and \$6,535, respectively, which equates to their estimated fair value. The fair value of mutual funds to fund our deferred compensation plan liability is determined based on quoted market prices from active markets utilizing Level 1 methods and assumptions. As of June 30, 2017 and December 31, 2016, the carrying amount of these securities was \$18,000 and \$17,072, which equates to their fair value, and is reported in the consolidated balance sheet in deferred charges and other assets. The fair value of cash and cash equivalents, which is comprised of a money market fund, is determined based on the net asset value per unit utilizing Level 2 methods and assumptions. As of June 30, 2017 and December 31, 2016, the carrying amounts of the Company's cash and cash equivalents was \$7,811 and \$3,763, respectively, which equates to their fair value.

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

	June 30, 2017	December 31, 2016
Carrying Amount	\$ 1,987,909	\$ 1,910,633
Estimated Fair Value	2,049,090	2,018,933

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 \$91,131 as of June 30, 2017, and \$91,843 as of December 31, 2016. Their relative fair values cannot be accurately estimated because future refund payments depend on several variables, including new customer connections, customer consumption levels, and future rate increases. Portions of these non-interest bearing instruments are payable annually through 2027 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.

Note 7 – 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

Table of Contents

AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

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		Six Months Ended	
	Ended June 30, 2017	2016	June 30, 2017	2016
Average common shares outstanding during the period for basic computation	177,609	177,288	177,545	177,196
Dilutive effect of employee stock-based compensation	436	796	497	724
Average common shares outstanding during the period for diluted computation	178,045	178,084	178,042	177,920

For the three and six months ended June 30, 2017 and 2016, 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.

Note 8 – 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. 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 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, 2017, 3,741,035 shares were still available for issuance under the 2009 Plan. No further grants may be made under the 2004 Plan.

Table of Contents

AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

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		Six Months Ended	
	Ended June 30, 2017	2016	June 30, 2017	2016
Stock-based compensation within operations and maintenance expenses	\$ 971	\$ 967	\$ 1,841	\$ 1,492
Income tax benefit	394	392	747	601

The following table summarizes the PSU transactions for the six months ended June 30, 2017:

	Number of Share Units	Weighted Average Fair Value
Nonvested share units at beginning of period	476,896	\$ 27.96
Granted	125,202	30.79
Performance criteria adjustment	(64,034)	27.75
Forfeited	(12,915)	28.01
Share units vested in prior period and issued in current period	32,400	25.31
Share units issued	(125,999)	36.37
Nonvested share units at end of period	431,550	\$ 26.16

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, 2017 and 2016 was \$30.79 and \$28.89, 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 our 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 calculating the fair value of the PSUs. The recording of compensation expense for PSUs has no impact on net cash flows.

Table of Contents

AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

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,	
	2017	2016	2017	2016
Stock-based compensation within operations and maintenance expenses	\$ 322	\$ 296	\$ 603	\$ 464
Income tax benefit	133	122	249	191

The following table summarizes the RSU transactions for the six months ended June 30, 2017:

	Number of Stock Units	Weighted Average Fair Value
Nonvested stock units at beginning of period	109,273	\$ 28.48
Granted	41,293	30.37
Stock units vested and issued	(26,279)	26.12
Forfeited	(2,287)	30.52
Nonvested stock units at end of period	122,000	\$ 29.59

The per unit weighted-average fair value at the date of grant for RSUs granted during the six months ended June 30, 2017 and 2016 was \$30.37 and \$32.09, respectively.

Table of Contents

AQUA AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(In thousands of dollars, except per share amounts)

(UNAUDITED)

Stock Options – A stock option represents the option to purchase a number of shares of common stock of the Company as specified in the stock option grant agreement at the exercise price per share as determined by the closing market price of our common stock on the grant date. Stock options are exercisable in installments of 33% annually, starting one year from the grant date and expire 10 years from the grant date. The fair value of each stock option is amortized into compensation expense using the graded-vesting method, which results in the recognition of compensation costs over the requisite service period for each separately vesting tranche of the stock options as though the stock options were, in substance, multiple stock option grants. The following table provides the compensation cost and income tax benefit for stock-based compensation related to stock options:

Three	Six
Months	Months
Ended	Ended
	June
June 30,	30,