

ARTESIAN RESOURCES CORP

Form 10-K

March 10, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2016

OR

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

Commission file number 000-18516

ARTESIAN RESOURCES CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

51-0002090

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

664 Churchmans Road, Newark, Delaware 19702

Address of principal executive offices

(302) 453 – 6900

Registrant's telephone number, including area code

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

Title of each class

Class A Non-Voting Common Stock

Name of each exchange on which registered The NASDAQ Global Select Market

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

Yes No

The aggregate market value of the Class A Non-Voting Common Stock and Class B Common Stock held by non-affiliates of the registrant at June 30, 2016 was \$269,178,000 and \$8,328,000, respectively. The aggregate market value of Class A Non-Voting Common Stock was computed by reference to the closing price of such class as reported on the Nasdaq Global Market on June 30, 2016, which trade date was June 30, 2016. The aggregate market value of Class B Common Stock was computed by reference to the last reported trade of such class as reported on the OTC Bulletin Board as of June 30, 2016, which trade date was June 27, 2016.

As of March 6, 2017, 8,251,271 shares of Class A Non-Voting Common Stock and 881,452 shares of Class B Common Stock were outstanding.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Statements in this Annual Report on Form 10-K which express our "belief," "anticipation" or "expectation," as well as other statements which are not historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act, Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act and the Private Securities Litigation Reform Act of 1995. Statements regarding our goals, priorities, growth and expansion plans and expectation for our water and wastewater subsidiaries and non-regulated subsidiaries, customer base growth opportunities in Delaware and Cecil County, Maryland, our belief regarding our capacity to provide water services for the foreseeable future to our customers, our belief relating to our compliance and the cost to achieve compliance with relevant governmental regulations, our expectation of the timing of decisions by regulatory authorities, the impact of weather on our operations and the execution of our strategic initiatives, our expectation of the timing for construction on new projects, our expectation relating to the adoption of recent accounting pronouncements, contract operations opportunities, legal proceedings, our properties, deferred tax assets, adequacy of our available sources of financing, the expected recovery of expenses related to our long-term debt, our expectation to be in compliance with financial covenants in our debt instruments, our ability to refinance our debt as it comes due, our ability to adjust our debt level, interest rate, maturity schedule and structure, the timing and terms of renewals of our lines of credit, plans to increase our wastewater treatment operations, engineering services and other revenue streams less affected by weather, expected future contributions to our postretirement benefit plan, anticipated growth in our non-regulated division, the impact of recent acquisitions on our ability to expand and foster relationships, anticipated investments in certain of our facilities and systems and the sources of funding for such investments, sufficiency of internally generated funds and credit facilities to provide working capital and our liquidity needs are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and involve risks and uncertainties that could cause actual results to differ materially from those projected. Words such as "expects", "anticipates", "intends", "plans", "believes", "seeks", "estimates", "projects", "forecasts", "may", "should", variations of such words and similar expressions are intended to identify such forward-looking statements. Certain factors as discussed under Item 1A -Risk Factors, such as changes in weather, changes in our contractual obligations, changes in government policies, the timing and results of our rate requests, changes in economic and market conditions generally, and other matters could cause results to differ materially from those in the forward-looking statements. While the Company may elect to update forward-looking statements, we specifically disclaim any obligation to do so and you should not rely on any forward-looking statement as representation of the Company's views as of any date subsequent to the date of the filing of this Annual Report on Form 10-K.

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PART I

ITEM 1. BUSINESS

General Information

Artesian Resources Corporation, a Delaware Corporation incorporated in 1927, operates as the holding company of eight wholly-owned subsidiaries offering water, wastewater and other services on the Delmarva Peninsula. The Company's principal executive offices are located at 664 Churchmans Road, Newark, Delaware 19702. Our principal subsidiary, Artesian Water Company, Inc., is the oldest and largest investor-owned public water utility on the Delmarva Peninsula, and has been providing superior water service since 1905. We distribute and sell water, including water for public and private fire protection, to residential, commercial, industrial, municipal and utility customers in the states of Delaware, Maryland and Pennsylvania. We provide wastewater services to customers in Delaware. In addition, we provide contract water and wastewater operations, and water, sewer and internal Service Line Protection Plans. Our Class A Non-Voting Common Stock is listed on the NASDAQ Global Select Market and trades under the symbol "ARTNA."

Artesian Resources Corporation, or Artesian Resources, operates as the parent holding company of five regulated public utilities: Artesian Water Company, Inc., or Artesian Water, Artesian Water Pennsylvania, Inc., or Artesian Water Pennsylvania, Artesian Water Maryland, Inc., or Artesian Water Maryland, Artesian Wastewater Management, Inc., or Artesian Wastewater, Artesian Wastewater Maryland, Inc., or Artesian Wastewater Maryland, and three non-regulated subsidiaries: Artesian Utility Development, Inc., or Artesian Utility, Artesian Development Corporation, or Artesian Development, and Artesian Consulting Engineers, Inc., or Artesian Consulting Engineers. The terms "we," "our" and the "Company" as used herein refer to Artesian Resources and its subsidiaries. The business activity conducted by each of our subsidiaries is discussed below under separate headings.

Our Market

Our current market area is the Delmarva Peninsula. Our largest service area is in the State of Delaware, which had an estimated population of approximately 952,000 at July 1, 2016. According to the US Census Bureau, Delaware's population increased an estimated 6.0% from 2011 to 2016, as compared to the nationwide growth rate of approximately 4.7%. Substantial portions of Delaware, particularly outside of New Castle County, are not served by a public water or wastewater system and represent potential opportunities for Artesian Water and Artesian Wastewater to obtain new exclusive franchised service areas. We continue to focus resources on developing and serving existing service territories and obtaining new territories throughout the State.

We have interconnection agreements for the sale of water with the towns of Elkton and Chesapeake City, Maryland. The Town of Elkton is required to take a minimum of 250,000 gallons per day of water through the interconnection and may take a maximum of 1.5 million gallons per day, or mgd. Our interconnection with Chesapeake City is currently the town's sole source of water with an average daily take of 75,000 gallons.

We hold Certificates of Public Convenience and Necessity, or CPCNs, for approximately 283 square miles of exclusive water service territory and approximately 25 square miles of wastewater service territory, most of which is in Delaware and some in Maryland and Pennsylvania. Our largest connected regional water system, consisting of approximately 141 square miles and 74,000 metered customers, is located in northern New Castle County and portions of southern New Castle County, Delaware. A significant portion of our exclusive service territory is in Delaware and remains undeveloped, and if and when development occurs and there is population growth in these areas, we will increase our customer base by providing water and/or wastewater service to the newly developed areas and new customers.

Subsidiaries

Artesian Water

Artesian Water, our principal subsidiary, is the oldest and largest public water utility in the State of Delaware and has been providing water service within the state since 1905. Artesian Water distributes and sells water to residential, commercial, industrial, governmental, municipal and utility customers throughout the State of Delaware. In addition, Artesian Water provides services to other water utilities, including operations and billing functions, and also has contract operation agreements with private and municipal water providers. We also provide water for public and private fire protection to customers in our service territories.

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Artesian Water Maryland

Artesian Water Maryland began operations in August 2007. Artesian Water Maryland distributes and sells water to residential, commercial, industrial and municipal customers in Cecil County, Maryland.

Artesian Water Pennsylvania

Artesian Water Pennsylvania began operations upon receiving recognition as a regulated public water utility by the Pennsylvania Public Utility Commission, or PAPUC, in 2002. It provides water service to a residential community in Chester County.

Artesian Wastewater

Artesian Wastewater is a regulated entity that owns wastewater collection and treatment infrastructure and provides wastewater services to customers in Delaware as a regulated public wastewater service company. As of December 31, 2016, Artesian Wastewater owned and operated four wastewater treatment facilities, which are permitted to treat approximately 500,000 gallons per day. In August 2016, Artesian Wastewater and Sussex County, a political subdivision of Delaware, entered into an agreement to provide wastewater treatment and disposal services for each other in order to address the periodic need of additional wastewater treatment and disposal capacities and facilities in Sussex County, beyond those under their own ownership and control, to assure the timely, efficient and cost effective transmission and management of wastewater. There are numerous locations in Sussex County where Artesian Wastewater's and Sussex County's facilities are capable of being connected or integrated to allow for the movement and disposal of wastewater generated by one or the other's system.

On September 27, 2016, Artesian Wastewater entered into a wastewater services agreement with Allen Harim Foods, LLC, or Allen Harim, for Artesian Wastewater to provide treatment and disposal services for sanitary wastewater discharged from Allen Harim's properties located in Sussex County, Delaware upon completion of a pipeline to transfer the sanitary wastewater. The completion of the pipeline should occur during the second quarter of 2017. On January 27, 2017, Artesian Wastewater entered into a second wastewater agreement with Allen Harim for Artesian Wastewater to provide disposal services for approximately 1.5 million gallons per day of treated industrial and/or process wastewater upon completion of an approximately eight mile pipeline that will transfer the wastewater from Allen Harim's properties to a 67 million gallon storage lagoon at Artesian's Northern Sussex Water Recycling Facility. Artesian will use the reclaimed wastewater for spray irrigation on agricultural land in the area. The completion of the industrial and/or process wastewater pipeline and storage lagoon should occur during the first quarter of 2018.

Artesian Wastewater Maryland

Artesian Wastewater Maryland is a regulated wastewater entity in the State of Maryland and was incorporated on June 3, 2008. Artesian Wastewater Maryland is able to provide public wastewater services to customers in the State of Maryland. It is currently not providing wastewater services in Maryland.

Artesian Utility

Artesian Utility was formed in 1996. It designs and builds water and wastewater infrastructure and provides contract water and wastewater services on the Delmarva Peninsula. Artesian Utility also evaluates land parcels, provides recommendations to developers on the size of water or wastewater facilities and the type of technology that should be used for treatment at such facilities, and operates water and wastewater facilities in Delaware for municipal and governmental organizations. Artesian Utility also may contract with developers for design and construction of wastewater facilities within the Delmarva Peninsula, using a number of different technologies for treatment of

wastewater at each facility. In addition, as further discussed below, effective April 2012, Artesian Utility operates the Water Service Line Protection Plan, or WSLP Plan, and the Sewer Service Line Protection Plan, or SSLP Plan. In November 2015, a third plan was added, the Internal Service Line Protection Plan, or ISLP Plan.

We currently operate wastewater treatment facilities for the town of Middletown, Delaware, in southern New Castle County, or Middletown, under a 20-year contract that expires in July 2022. The facilities include two wastewater treatment stations with capacities of up to approximately 2.5 mgd and 250,000 gallons per day, respectively. We also operate a wastewater disposal facility in Middletown in order to support the 2.5 mgd wastewater facility. One of the wastewater treatment facilities in Middletown now provides reclaimed wastewater for use in spray irrigation on public and agricultural lands in the area.

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Artesian Utility has operated the WSLP Plan and the SSLP Plan since 2012. Artesian Resources initiated the WSLP Plan in March 2005. The WSLP Plan covers all parts, material and labor required to repair or replace participating customers' leaking water service lines up to an annual limit. The SSLP Plan was initiated in the second quarter of 2008. The SSLP Plan covers all parts, material and labor required to repair or replace participating customers' leaking or clogged sewer lines up to an annual limit. In the second quarter of 2010, the WSLP Plan and SSLP Plan were extended to include non-utility customers of Artesian Resources. The ISLP Plan was introduced in November 2015 to further enhance available coverage to include water and wastewater lines within the residence. As of December 31, 2016, approximately 19,500, or 25.0%, of our eligible water customers signed up for the WSLP Plan, approximately 15,200, or 19.5%, of our eligible customers signed up for the SSLP Plan, and approximately 3,600 signed up for the ISLP Plan. Approximately 1,400 non-customer participants signed up for either the WSLP Plan, the SSLP Plan, or the ISLP Plan.

Artesian Development

Artesian Development is a real estate holding company that owns properties, including land zoned for office buildings, a water treatment plant and wastewater facility, as well as property for current operations, including an office facility in Sussex County, Delaware. The facility consists of approximately 10,000 square feet of office space along with nearly 10,000 square feet of warehouse space. This facility is leased to Artesian Water and Artesian Wastewater and allows all of our Sussex County, Delaware operations to be housed in one central location.

Artesian Consulting Engineers

Artesian Consulting Engineers no longer offers development and architectural services to outside third parties. Artesian will continue to provide design and engineering contract services through our Artesian Utility subsidiary.

Regulatory Matters

Overview

Our water and wastewater utility operations are subject to regulation by their respective state regulatory commissions, which have broad administrative power and authority to regulate rates charged for service, determine franchise areas and conditions of service, approve acquisitions, authorize the issuance of securities and other matters. The profitability of our utility operations is influenced, to a great extent, by the timeliness and adequacy of regulatory relief we are granted by the respective regulatory commissions or authorities in the states in which we operate.

We are subject to regulation by the following state regulatory commissions:

- The Delaware Public Service Commission, or DEPSC, regulates both Artesian Water and Artesian Wastewater.
- The Maryland Public Service Commission, or MDPSC, regulates both Artesian Water Maryland and Artesian Wastewater Maryland.
- The Pennsylvania Public Utility Commission, or PAPUC, regulates Artesian Water Pennsylvania.

Our water and wastewater utility operations are also subject to regulation under the federal Safe Drinking Water Act of 1974, or Safe Drinking Water Act, the Clean Water Act of 1972, or 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. Capital expenditures and operating costs required as a result of water quality standards and environmental requirements have been traditionally recognized by state regulatory commissions as appropriate for inclusion in establishing rates.

Water and Wastewater Rates

Our regulated utilities periodically seek rate increases to cover the cost of increased operating expenses, increased financing expenses due to additional investments in utility plant and other costs of doing business. In Delaware, utilities are permitted by law to place rates into effect, under bond, on a temporary basis pending completion of a rate increase proceeding. The first temporary increase may be up to the lesser of \$2.5 million on an annual basis or 15% of gross water sales. Should the rate case not be completed within seven months, by law, the utility may put the entire requested rate relief, up to 15% of gross water sales, in effect under bond until a final resolution is ordered and placed into effect. If any such rates are found to be in excess of rates the DEPSC finds to be appropriate, the utility must refund customers the portion found to be in excess with interest. The timing of our rate increase requests are therefore 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. We can provide no assurances that rate increase requests will be approved by applicable regulatory agencies and, if approved, we cannot guarantee that these rate increases will be granted in a timely or sufficient manner to cover the investments and expenses for which we initially sought the rate increase.

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On August 18, 2015, the DEPSC made a preliminary ruling in response to Artesian Water's April 2014 application to implement new rates to meet a requested increase in revenue of 15.90%, or approximately \$10.0 million, on an annualized basis. The preliminary ruling recommended a permanent rate increase in revenue of approximately \$6.0 million, or 9.50%, on an annualized basis, which was an incremental increase for customers of approximately 6.20% above the Distribution System Improvement Charge, or DSIC, rate previously in effect. On October 6, 2015, a DEPSC order was issued concurring with the preliminary ruling issued on August 18, 2015. On January 19, 2016, a final DEPSC order was issued related to the permanent rate increase and concurred with the October 6, 2015 order. Because the permanent rate increase was less than amounts collected under previously approved temporary increases in rates, Artesian Water was required to refund a portion of the temporary rate increases to its customers. The refund, plus interest, at the average prime rate, for the overpayment from customers was applied to current and future customer bills in October 2015. Because the final rate award was at a level not less than the amount previously reported as income, there was no material impact upon previously reported water sales revenue. The new rates are designed to allow recovery of capital investments made by Artesian Water and to cover increased costs of operations, including water quality testing, chemicals and electricity for water treatment, taxes, labor and benefits.

Service Territory Expansion

In Delaware, a Certificate of Public Convenience and Necessity, or CPCN, grants a water or wastewater company the exclusive right to serve all existing and new customers within a designated area. The DEPSC has the authority to issue and revoke these CPCNs. In this Form 10-K, we may refer to CPCNs as "franchises" or "service territories."

For a water company, the DEPSC may grant a CPCN under circumstances where there has been a determination that the water in the proposed service area does not meet the regulations governing drinking water standards of the State Division of Public Health for human consumption or where the supply is insufficient to meet the projected demand. For a wastewater company, the DEPSC has jurisdiction over non-governmental wastewater utilities having fifty or more customers in the aggregate. A CPCN for water and wastewater utilities shall be granted by the DEPSC to applicants in possession of one of the following:

Ø a signed service agreement with the developer of a proposed subdivision or development, which subdivision or development has been duly approved by the respective county government;

Ø a petition requesting such service signed by a majority of the landowners of the proposed territory to be served; or

Ø a duly certified copy of a resolution from the governing body of a county or municipality requesting the applicant to provide service to the proposed territory to be served.

CPCNs are not transferable. A water or wastewater utility that has a CPCN must obtain the approval of the DEPSC to abandon a service territory. Once a CPCN is granted to a water or wastewater utility, it may not be suspended or terminated unless the DEPSC determines in accordance with its rules and regulations that good cause exists for any such suspension or termination. Although Artesian has been granted an exclusive franchise for each of its existing water and wastewater systems, its ability to expand service areas can be affected by the DEPSC awarding franchises to other regulated water or wastewater utilities with whom we compete for such franchises.

In Maryland, the Company must obtain approval from the appropriate local government authority for the ability to serve a particular area and also ensure that the acquired area is in the county's master water and sewer plan. The authority to exercise a franchise must then be obtained from the MDPSC. Utilities that seek to develop a franchise by constructing new facilities must obtain appropriate approvals from the Maryland Department of the Environment, the local government and the MDPSC. The utility must also obtain approval for soil and erosion plans and easement agreements from appropriate parties.

Other Regulatory Matters

Delaware law permits water utilities to put into effect, on a semi-annual basis, increases related to specific types of distribution system improvements through DSIC. This charge may be implemented by water utilities between general rate increase applications that normally recognize changes in a water utility's overall financial position. The DSIC approval process is less costly when compared to the approval process for general rate increase requests. The DSIC rate applied between base rate filings is capped at 7.5% of the amount billed to customers under otherwise applicable rates and charges, and the DSIC rate increase applied cannot exceed 5% within any 12-month period. The following table summarizes Artesian Water's applications with the DEPSC to collect DSIC rates and the eligible plant improvements the rates are based on:

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Application Date	11/26/2014	05/28/2015	11/24/2015	05/31/2016	11/29/2016
DEPSC Approval Date	12/16/2014	06/16/2015	12/15/2015	06/28/2016	12/20/2016
Effective Date	01/01/2015	07/01/2015	01/01/2016	07/01/2016	01/01/2017
Cumulative DSIC Rate	0.34 %	1.15 %	1.57 %	2.30 %	4.71 %
Eligible Plant Improvements – Cumulative Dollars (in millions)	\$ 1.3	\$ 4.6	\$ 7.0	\$ 10.3	\$ 16.6
Eligible Plant Improvements – Installed Beginning Date	10/01/2014	10/01/2014	10/01/2014	10/01/2014	10/01/2014
Eligible Plant Improvements – Installed Ending Date	10/31/2014	04/30/2015	10/31/2015	4/30/2016	10/31/2016

All DEPSC approvals noted in the table above are subject to audit at a later date. For the years ended December 31, 2016, December 31, 2015 and December 31, 2014, we earned approximately \$1,306,000, \$520,000 and \$788,000 in DSIC revenue, respectively.

Environmental Regulation

Our water and wastewater operations are subject to federal, state, and local requirements relating to environmental protection. The United States Environmental Protection Agency, or the EPA, the Delaware Department of Natural Resources and Environmental Control, or DNREC, and the Delaware Division of Public Health, or DPH, regulate the water quality of our treatment and distribution systems in Delaware, as do the EPA and the Maryland Department of the Environment, or MDE, with respect to our operations in Maryland. Chester Water Authority, which supplies water to Artesian Water through an interconnection in northern New Castle County, is regulated by the Pennsylvania Department of Environmental Protection, as well as the EPA. We believe that we are in material compliance with all current federal, state and local water quality standards, including regulations under the federal Safe Drinking Water Act. However, if new water quality regulations are too costly, or if we fail to comply with such regulations, it could have a material adverse effect on our financial condition and results of operations.

The water industry is capital intensive, with the highest capital investment in plant and equipment per dollar of revenue among all utilities. Increasingly stringent drinking water regulations to meet the requirements of the Safe Drinking Water Act have required the water industry to invest in more advanced treatment systems and processes, which require a heightened level of expertise. Significant enhancements were made to existing facilities to effectively treat and remove compounds as required by government agencies, such as ultra violet oxidation treatment, ceramic membrane filtration and carbon filtration. We are currently in full compliance with the requirements of the Safe Drinking Water Act. Even though our water utility was founded in 1905, the majority of our investment in infrastructure occurred in the last 40 years.

Under Delaware state laws and regulations, we are required to file applications with DNREC for water allocation permits for each of our operating wells pumping greater than 50,000 gallons per day. For any wells in the Delaware River Basin, we must also file allocation permits with the Delaware River Basin Commission, or DRBC. We have 119 operating and 60 observation and monitoring wells in our Delaware systems. At December 31, 2016, we had allocation permits for 103 wells, and 16 wells that do not require a permit.

Our access to aquifers within our service territory is not exclusive. Water allocation permits control the amount of water that can be drawn from water resources and are granted with specific restrictions on water level draw down limits, annual, monthly and daily pumpage limits, and well field allocation pumpage limits. We are also subject to water allocation regulations that control the amount of water that we can draw from water sources. As a result, if new or more restrictive water allocation regulations are imposed, they could have an adverse effect on our ability to supply the demands of our customers, and in turn, our water supply revenues and results of operations. Our ability to supply the demands of our customers historically has not been affected by private usage of the aquifers by landowners or the limits imposed by the state of Delaware. Because of the extensive regulatory requirements relating to the withdrawal

of any significant amounts of water from the aquifers, we believe that third party usage of the aquifers within our service territory will not interfere with our ability to meet the present and future demands of our customers.

As required by the Safe Drinking Water Act, the EPA has established maximum contaminant levels for various substances found in drinking water to ensure that the water is safe for human consumption. These limits are known as Maximum Contaminant Levels and Maximum Residual Disinfection Levels. The EPA also regulates how often public water systems monitor their water for contaminants and report the monitoring results to the individual state agencies or the EPA. Generally, the larger the population served by a water system, the more frequent the monitoring and reporting requirements. The Safe Drinking Water Act applies to all 50 states.

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DPH has set maximum contaminant levels for certain substances that are more restrictive than the maximum contaminant levels set by the EPA. The DPH is the EPA's agent for enforcing the Safe Drinking Water Act in Delaware and, in that capacity, monitors the activities of Artesian Water and reviews the results of water quality tests performed by Artesian Water for adherence to applicable regulations. Artesian Water is also subject to other laws regulating substances and contaminants in water, including rules for volatile organic compounds and the Total Coliform Rule.

A normal by-product of our iron removal treatment facilities is a solid consisting of the iron removed from untreated groundwater plus residue from chemicals used in the treatment process. The solids produced at our facilities are either disposed directly into approved wastewater facilities or removed from our facilities by a licensed third party vendor. A normal by-product of our carbon absorption filtration process is exhausted carbon media, which is disposed of by the contractor providing the media replacement. Management believes that compliance with existing federal, state or local laws and regulations regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, has no material effect upon the business and affairs of the Company, but there is no assurance that such compliance will continue to not have a material effect in the future.

The MDE ensures that water quality and quantity at all public water systems in Maryland meet the needs of the public and are in compliance with federal and state regulations. The MDE also ensures that public drinking water systems provide safe and adequate water to all current and future users in Maryland, and that appropriate usage, planning, and conservation policies are implemented for Maryland's water resources. The MDE oversees the development of Source Water Assessments for water supplies, and issues water appropriation permits for public drinking water systems. In order to appropriate water for municipal, commercial, industrial or other non-domestic uses, a Water Appropriation Permit must be obtained. Issuance of the permit involves evaluating the needs of the user and the potential impact of the withdrawal on neighboring users and the water source in order to maximize beneficial use of the water of the State of Maryland. Permits for large appropriations often involve conducting pump tests to measure adequacy of an aquifer and safe yield of a well, or reviewing stream flow records to determine the adequacy of a surface water source. Regulations were finalized in 1999 that require all new community water systems to have sufficient technical, managerial and financial capacity to provide safe drinking water to their consumers prior to being issued a Construction Permit. Also, in 2007, capacity management guidance was finalized. Capacity limiting factors can include, source capacity, treatment capacity and appropriation permit quantity. The quantity of water withdrawn from the Port Deposit surface water intake is allocated by the Susquehanna River Basin Commission, or SRBC, and MDE. We have 12 operating wells and one surface water in-take in our Maryland systems.

The Clean Water Act has established the foundation for wastewater discharge control in the United States. The Clean Water Act established a control program for ensuring that communities have clean water by regulating the release of contaminants into waterways. Permits that limit the amounts of pollutants discharged are required of all wastewater dischargers under the National Pollutant Discharge Elimination System, or the NPDES permit program. In accordance with the NPDES permit program, the implementing states set maximum discharge limits for wastewater effluents and overflows from wastewater collection systems. Discharges that exceed the limits specified under the NPDES permit program can lead to the imposition of penalties. The Clean Water Act also requires that wastewater treatment plant discharges meet a minimum of secondary treatment. The secondary treatment process can remove up to 90% of the organic matter in wastewater.

Under the Delaware state laws and regulations, we are required to hold a permit from DNREC for the construction, operation, maintenance or repair of any on-site wastewater treatment and disposal systems with daily design flow rates of greater than or equal to 2,500 gallons. A classification on the facility is performed in accordance with Regulations Licensing Operators of Wastewater Facilities. The class of operator required for the facility is determined by the Board of Certification for Licensed Wastewater Operations in accordance with Regulations Licensing Operators of Wastewater Facilities. We operate environmentally friendly wastewater systems that meet all requirements of Federal, State and local standards.

Sources of Water

We derive about 95% of our self-supplied groundwater from wells that pump groundwater from aquifers and other formations located in the Atlantic Coastal Plain. The remaining 5% of our groundwater supply comes from wells in the Piedmont Province. We use a variety of treatment methods, including aeration, pH adjustment, chlorination, fluoridation, ultra violet oxidation, arsenic removal, nitrate removal, radium removal, iron removal, and carbon absorption to meet federal, state and local water quality standards. Additionally, a corrosion inhibitor is added to all of our self-supplied groundwater and most of the supply from interconnections. We have 56 different water treatment facilities in our Delaware systems. We have 8 separate water treatment facilities in our Maryland systems. All water supplies that we purchase from neighboring utilities are potable.

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To supplement our groundwater supply, we purchase treated surface water through interconnections only in the northern service area of our New Castle County, Delaware system. The treated surface water is blended with our groundwater supply for distribution to our customers. Nearly 84% of the overall 7.6 billion gallons of water we distributed in all of our Delaware systems during 2016 came from our groundwater wells, while the remaining 15% came from interconnections with other utilities and municipalities. The majority of the 0.1 billion gallons of water we distributed in all of our Maryland systems during 2016 came from our groundwater wells, while a portion came from treated surface water. In Delaware in 2016, we pumped an average of 17.8 mgd from our groundwater wells and obtained an average of approximately 3.1 mgd from interconnections. We have one water treatment facility that treats surface water from the Susquehanna River, located in Cecil County, Maryland. Our peak water supply capacity currently is approximately 55.0 mgd in Delaware and approximately 2.0 mgd in Maryland. We believe that we have in place sufficient capacity to provide water service for the foreseeable future to all existing and new customers in all of our service territories.

Interconnections and Storage

Most of our New Castle County, Delaware water system is interconnected. In the remainder of the State of Delaware, we have several satellite systems that have not yet been connected by transmission and distribution facilities. We intend to join these systems into larger integrated regional systems through the construction of a transmission and distribution network as development continues and our expansion efforts provide us with contiguous exclusive service territories.

In Delaware, we have 23 interconnections with 2 neighboring water utilities and 7 municipalities that provide us with the ability to purchase or sell water. An interconnection agreement with the Chester Water Authority has a "take or pay" clause requiring us to purchase 1.095 billion gallons annually. During the fiscal year ended December 31, 2016, we used the minimum draw under this agreement. The Chester Water Authority agreement, which expires December 31, 2021, provides for the right to extend the term of this agreement through and including December 31, 2047, at our option, subject to the approval of the Susquehanna River Basin Commission. All of the interconnections provide Artesian Water the ability to sell water to neighboring water utilities or municipalities. In Maryland, we have one interconnection that connects the Artesian Water system in Delaware to the Meadowview System, one interconnection with a neighboring utility, and three interconnections with the Town of Elkton. The interconnection with the Artesian Water Delaware system is capable of providing up to 3.0 mgd of water to our Maryland systems, of which 1.5 mgd is available to the Town of Elkton per our agreement with the Town. In March 2013, the interconnection to the Town of Chesapeake City was completed. The Town of Chesapeake City placed in service an interconnection and 1.57 miles of new water main to provide water to the Town of Chesapeake City from the Artesian Water Delaware system. The interconnection is currently the town's sole source of water supply, averaging approximately 75,000 gallons per day.

As of December 31, 2016, we were serving customers through approximately 1,260 miles of transmission and distribution mains. Mains range in diameter from two inches to twenty-four inches, and most of the mains are made of ductile iron or cast iron.

We have 29 storage tanks in Delaware, most of which are elevated, providing total system storage of 42 million gallons. We have developed and are using an Aquifer Storage and Recovery, or ASR, system in New Castle County, Delaware. Our ASR system provides approximately 130 million gallons of storage capacity, which can be withdrawn at an average rate of approximately 1 mgd. At some locations, we rely on hydropneumatic tanks to maintain adequate system pressures. Where possible, we combine our smaller satellite systems with systems having elevated storage facilities. In Cecil County, Maryland we have 7 storage tanks capable of storing approximately 2.4 million gallons.

Additional General Information

Seasonality

Substantially all of our water customers are metered, which allows us to measure and bill for our customers' water consumption. Demand for water during the warmer months is generally greater than during cooler months primarily due to additional customer requirements for water in connection with cooling systems, swimming pools, irrigation systems and other outside water use. Throughout the year, and particularly during typically warmer months, demand for water will vary with temperature and rainfall. In the event that temperatures during the typically warmer months are cooler than expected, or there is more rainfall than expected, the demand for water may decrease and our revenues may be adversely affected.

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Competition

Our business in our franchised service areas is substantially free from direct competition with other public utilities, municipalities and other entities. However, our ability to provide additional water and wastewater services is subject to competition from other public utilities, municipalities and other entities. Even though our regulated utilities have been granted an exclusive franchise for each of our existing community water and wastewater systems, our ability to expand service areas can be affected by the DEPSC, the MDPSC or the PAPUC, awarding franchises to other regulated water or wastewater utilities with whom we compete for such franchises.

Employees

The Company has no collective bargaining agreements with any of its employees, and its work force is not union organized or union represented. As of December 31, 2016, we employed 225 full-time employees. Of these employees, 50 were officers and managers; 116 were employed as operations personnel, including engineers, technicians, draftsman, maintenance and repair persons, meter readers and utility personnel; and 35 were employed in accounting, budgeting, information systems, human resources, customer relations and public relations. The remaining 24 employees were administrative personnel. We believe that our employee relations are good.

Available Information

We are a Delaware corporation with our principal executive offices located at 664 Churchmans Road, Newark, Delaware, 19702. Our telephone number is (302) 453-6900 and our website address is www.artesianresources.com. We make available free of charge through our website our Code of Ethics, Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, current reports on Form 8-K our Corporate Governance Guidelines, our Board Committee Charter and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission, or the SEC. We include our website address in this Annual Report on Form 10-K only as an inactive textual reference and do not intend it to be an active link to our website. Information contained on our website shall not be deemed incorporated into, or to be a part of, this report.

We file our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K pursuant to Section 13(a) or 15(d) of the Exchange Act electronically with the SEC. The public may read or copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC, 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site, www.sec.gov, that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

ITEM 1A. RISK FACTORS

We are exposed to a variety of risks and uncertainties. Most are general risks and uncertainties applicable to all water and wastewater utility companies. We describe below some of the specific known risk factors that could negatively affect our business, financial condition or results of operations. If one or more of these risks or uncertainties materialize, actual results may vary materially from our projections. All forward-looking statements made by us in this Annual Report to the SEC on Form 10-K, in our Annual Report to Shareholders and in our subsequently filed quarterly and current reports to the SEC, as well as in our press releases and other public communications, are qualified by the risks described below.

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Our operating revenue is primarily from water sales. The rates that we charge our customers are subject to the regulations of the Public Service Commissions in the states in which we operate. Additionally, our business requires significant capital expenditures on an annual basis and these expenditures are made for additions and replacement of property. If a Public Service Commission disapproves or is unable to timely approve our requests for rate increases or approves rate increases that are inadequate to cover our investments or increased costs, our profitability may suffer.

We file rate increase requests, from time to time, to recover our investments in utility plant and expenses. Once a rate increase petition is filed with a Public Service Commission, the ensuing administrative and hearing process may be lengthy and costly. We can provide no assurances that any future rate increase request will be approved by the DEPSC, MDPSC or PAPUC, and if approved, we cannot guarantee that these rate increases will be granted in a timely manner and/or will be sufficient in amount to cover the investments and expenses for which we initially sought the rate increase. To the extent we are able to pass through such costs to customers and a state public service commission subsequently determines that such costs should not have been paid by customers, we may be required to refund such costs, with interest, to customers. Any such costs not recovered through rates, or any such refund, could adversely affect our results of operations, financial position or cash flows.

We rely on governmental approvals in the States of Delaware, Maryland and Pennsylvania for applicable water allocation, water appropriation and water capacity permits related to additional systems that will assist in the operation of our water business. In addition, we rely on governmental approvals in the States of Delaware and Maryland for applicable wastewater collection, treatment and disposal permits that will assist in the operation of our wastewater business.

Our water and wastewater services are governed by various federal and state governmental agencies. Pursuant to these regulations, we are required to obtain various permits for any additional systems to assist in our operations. If any of those permit approvals are not received timely or at all, the Company may risk the loss of economic opportunity and its ability to create additional systems for the effective operation of our water business in the States of Delaware, Maryland and Pennsylvania or our wastewater business in the States of Delaware and Maryland. We can provide no assurances that we will receive all necessary permits to create additional systems to assist in the operation of our water or wastewater business.

Our business is subject to seasonal fluctuations, which could affect demand for our water service and our revenues.

Demand for water during warmer months is generally greater than during cooler months primarily due to additional customer requirements in irrigation systems, swimming pools, cooling systems and other outside water use. In the event that temperatures during typically warmer months are cooler than normal, or rainfall is more than normal, the demand for our water may decrease and adversely affect our revenues.

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 adversely affect our financial condition and results of operations.

We believe that we have in place sufficient capacity to provide water service for the foreseeable future to all existing and new customers in all of our service territories. However, severe drought conditions could interfere with our sources of water supply and could adversely affect our ability to supply water in sufficient quantities to our existing and future customers. This may adversely affect our revenues and earnings. Moreover, governmental restrictions on water usage during drought conditions may result in a decreased demand for water, which may adversely affect our revenue and earnings.

Our operating costs could be significantly increased if new or stricter regulatory standards are imposed by federal and state environmental agencies.

Our water and wastewater services are governed by various federal and state environmental protection and health and safety laws and regulations, including the federal Safe Drinking Water Act, the Clean Water Act and similar state laws. These federal and state regulations are issued by the United States Environmental Protection Agency and state environmental regulatory agencies. Pursuant to these laws, we are required to obtain various water allocation permits and environmental permits for our operations. The water allocation permits control the amount of water that can be drawn from water resources. New or stricter water allocation regulations can adversely affect our ability to meet the demands of our customers. While we have budgeted for future capital and operating expenditures to maintain compliance with these laws and our permits, it is possible that new or stricter standards would be imposed that will raise our operating costs. Thus, we can provide no assurances that our costs of complying with, or discharging liability under current and future environmental and health and safety laws will not adversely affect our business, results of operations or financial condition.

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We are subject to risks associated with the collection, treatment and disposal of wastewater.

Wastewater collection, treatment and disposal involve various unique risks. If collection or treatment systems fail, overflow, or do not operate properly, untreated wastewater or other contaminants could spill onto nearby properties or into nearby streams and rivers, causing damage to persons or property, injury to aquatic life and economic damages, which may not be recoverable in fees. This risk is most acute during periods of substantial rainfall or flooding, which are common causes of sewer overflow and system failure. Liabilities resulting from such damages and injuries could materially and adversely affect the Company's results of operations and financial condition.

Turnover in our management team could have an adverse impact on our business or the financial market's perception of our ability to continue to grow.

Our success depends significantly on the continued contribution of our management team both individually and collectively. The loss of the services of any member of our management team or the inability to hire and retain experienced management personnel could harm our operating results.

We face competition from other water and wastewater utilities for the acquisition of new exclusive service territories.

Water and wastewater utilities competitively pursue the right to exclusively serve territories in Delaware and Maryland by entering into agreements with landowners, developers or municipalities and, under current law, then applying to the DEPSC or the MDPSC for a CPCN, which grants a water or wastewater utility the exclusive right to serve all existing and new customers of a water or wastewater utility within a designated area. Typically, water and wastewater utilities enter into agreements with developers who have approval from county governments with respect to proposed subdivisions or developments. Once a CPCN is granted to a water or wastewater utility, generally it may not be suspended or terminated unless the DEPSC or MDPSC determines in accordance with its rules and regulations that good cause exists for any such suspension or termination. Therefore, we face competition from other water and wastewater utilities as we pursue the right to exclusively serve territories. If we are unable to enter into agreements with landowners, developers or municipalities and secure CPCNs for the right to exclusively serve territories in Delaware or Maryland, our ability to expand may be significantly impeded.

We depend on the availability of capital for expansion, construction and maintenance. Weaknesses in capital and credit markets may limit our access to capital.

Our ability to continue our expansion efforts and fund our utility construction and maintenance program depends on the availability of adequate capital. There is no guarantee that we will be able to obtain sufficient capital in the future on favorable terms and conditions for expansion, construction and maintenance. In the event our lines of credit are not extended or we are unable to refinance our first mortgage bonds when due and the borrowings are called for payment, we will have to seek alternative financing sources, although there can be no assurance that these alternative financing sources will be available on terms acceptable to us. In the event we are unable to obtain sufficient capital, our expansion efforts could be curtailed, which may affect our growth and may affect our future results of operations.

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

The effects of adverse U.S. economic conditions may lead to a number of impacts on our business that may materially and adversely affect our financial condition and results of operations. Such impacts may include a reduction in discretionary and recreational water use by our residential water customers, particularly during the summer months; a decline in usage by industrial and commercial customers as a result of decreased business activity and commerce in our customers' businesses; an increased incidence of customers' inability, bankruptcy or delay in paying their bills which may lead to higher bad debt expense and reduced cash flow; and a lower natural customer growth rate may result as compared to what had been experienced before the economic downturn due to a decline in new housing starts

and a possible slight decline in the number of active customers due to housing vacancies or abandonments.

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Any future acquisitions we undertake or other actions to further grow our water and wastewater business may involve risks.

An element of our growth strategy is the acquisition and integration of water and wastewater systems in order to broaden our current service areas, and move into new ones. It is our intent, when practical, to integrate any businesses we acquire with our existing operations. The negotiation of potential acquisitions as well as the integration of acquired businesses could require us to incur significant costs and cause diversion of our management's time and resources. We may not be successful in the future in identifying businesses that meet our acquisition criteria. The failure to identify such businesses may limit the rate of our growth. In addition, future acquisitions or expansion of our service areas by us could result in:

- ØDilutive issuance of our equity securities;
- ØIncurrence of debt and contingent liabilities;
- ØDifficulties in integrating the operations and personnel of the acquired businesses;
- ØDiversion of our management's attention from ongoing business concerns;
- ØFailure to have effective internal control over financial reporting;
- ØOverload of human resources; and
- ØOther acquisition-related expense

Some or all of these items could have a material adverse effect on our business and our ability to finance our business and comply with regulatory requirements. The businesses we acquire in the future may not achieve sales and profitability that would justify our investment.

We also may experience risks relating to the challenges and costs of closing a transaction and the risk that an announced transaction may not close. Completion of certain acquisition transactions are conditioned upon, among other things, the receipt of approvals, including from the certain state public utilities commissions. Failure to complete a pending transaction would prevent us from realizing the anticipated benefits. We would also remain liable for significant transaction costs, including legal and accounting fees, whether or not the transaction is completed.

We are subject to, and could be further subject to, governmental investigations or actions by other third parties.

We are subject to various federal and state laws, including environmental laws, violations of which can involve civil or criminal sanctions.

Our operations from time to time could be parties to or targets of lawsuits, claims, investigations and proceedings, including system failure, injury, contract, environmental, health and safety and employment matters, which are handled and defended in the ordinary course of business. The results of any future litigation or settlement of such lawsuits and claims are inherently unpredictable, but such outcomes could also materially and adversely affect our business, financial position and results of operations.

We are dependent on the continuous and reliable operation of our information technology systems.

We rely on our information technology systems to manage our operation of our business. Specifically with respect to customer service and billing, managing construction projects, managing our financial records, tracking assets, remotely monitoring some of our treatment, storage and pumping facilities and managing human resources, inventory and accounts receivable collections. Such systems require periodic modifications, upgrades and or replacement that

subject us to inherent costs and risks, including substantial capital expenditures, additional administration and operating expenses, and other risks and costs of delays in transitioning to new systems or of integrating new systems into our current systems. Our computer and communications systems and operations could be damaged or interrupted by natural disasters, telecommunications failures or acts of war or terrorism or similar events or disruptions. A loss of these systems or major problems with the operation of these systems could affect our operations and have a material adverse effect on our results of operations.

There have been an increasing number of cyber-attacks on companies around the world, which have caused operational failures or compromised sensitive corporate or customer data. These attacks have occurred over the internet, through malware, viruses or attachments to e-mails or through persons inside the organization or with access to systems inside the organization. We have implemented security measures and will continue to devote resources to address any security vulnerabilities in an effort to prevent cyber-attacks. Despite our efforts, a cyber-attack, if it occurred, could cause water or wastewater system problems, disrupt service to our customers, compromise important data or systems or result in an unintended release of customer information. We feel we have adequate cyber-security insurance coverage to mitigate the cost of any such cyber-attack, however, a possible cyber-attack could affect our operations and have a material adverse effect on our results of operations.

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Contamination of our water supply may result in disruption in our services and could lead to litigation that may adversely affect our business, operating results and financial condition.

Our water supplies are subject to contamination from naturally-occurring compounds as well as pollution resulting from man-made sources. Even though we monitor the quality of water on an on-going basis, any possible contamination due to factors beyond our control could interrupt the use of our water supply until we are able to substitute it from an uncontaminated water source. Additionally, treating the contaminated water source could involve significant costs and could adversely affect our business. We could also be held liable for consequences arising out of human or environmental exposure to hazardous substances, if found, in our water supply. This could adversely affect our business, results of operations and financial condition.

Potential terrorist attacks may disrupt our operations and adversely affect our business, operating results and financial condition.

We have taken steps to increase security measures at our facilities and heighten employee awareness of threats to our water supply. We also have tightened our security measures regarding delivery and handling of certain chemicals used in our business. We have and will continue to bear any increase in costs, most of which have been recoverable under state regulatory policies, for security precautions to protect our facilities, operations and supplies. While the costs of increases in security, including capital expenditures, may be significant, we expect these costs to continue to be recoverable in water and wastewater rates. Despite our security measures, we may not be in a position to control the outcome of terrorist events, or other attacks on our water systems, should they occur.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our corporate headquarters are located at 664 Churchmans Road, Newark, Delaware and are owned by Artesian Water.

Artesian Development owns approximately 6 acres of land in New Castle County, Delaware zoned for office development and two nine-acre parcels of land in Sussex County, Delaware for water and wastewater treatment facilities and elevated water storage. Artesian Development also owns an office facility located in Sussex County, Delaware. The facility consists of approximately 10,000 square feet of office space along with approximately 10,000 square feet of warehouse space.

Artesian Water owns land, rights-of-way, easements, transmission and distribution mains, pump facilities, treatment plants, storage tanks, meters, vehicles and related equipment and facilities throughout Delaware, of which the majority are used for utility operations. Artesian Water Pennsylvania owns transmission and distribution mains. Artesian Water Maryland owns land, transmission and distribution mains, pump facilities and storage tanks. Artesian Wastewater owns land, rights-of-way, easements, treatment and disposal plants, collection mains and lift stations. Artesian Wastewater owns a 75-acre parcel of land in Sussex County, Delaware for the operation of the wastewater facility known as the Northern Sussex Regional Water Recharge Complex. The following table indicates our utility plant as of December 31, 2016.

Utility plant comprises:

In thousands

	Estimated Useful Life (In Years)	December 31, 2016
Utility plant at original cost		
Utility plant in service-Water		
Intangible plant	---	\$ 140
Source of supply plant	45-85	19,627
Pumping and water treatment plant	8-62	78,542
Transmission and distribution plant		
Mains	81	236,261
Services	39	38,803
Storage tanks	76	24,108
Meters	26	24,710
Hydrants	60	12,870
General plant	3-31	53,417
Utility plant in service-Wastewater		
Treatment and disposal plant	35-62	15,613
Collection mains and lift stations	81	8,675

General plant	3-31	931
Property held for future use	---	14,815
Construction work in progress	---	6,674
		535,186
Less – accumulated depreciation		109,684
		\$425,502

Substantially all of Artesian Water's utility plant, except the utility plant in the town of Townsend, Delaware, is pledged as security for First Mortgage Securities. As of December 31, 2016, no other utility plant has been pledged as security for loans.

We believe that our properties are generally maintained in good condition and in accordance with current standards of good water and wastewater works industry practice. We believe that all of our existing facilities adequately meet current necessary production capacities and current levels of utilization.

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ITEM 3. LEGAL PROCEEDINGS

Periodically, we are involved in other proceedings or litigation arising in the ordinary course of business. We do not believe that the ultimate resolution of these matters will materially affect our business, financial position or results of operations. However, we cannot assure that we will prevail in any litigation and, regardless of the outcome, may incur significant litigation expense and may have significant diversion of management attention.

ITEM 4. MINE SAFETY DISCLOSURES

The information concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 104 of Regulation S-K (17 CFR 229.104) is not applicable to our Company.

PART II

ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND
5. ISSUER PURCHASES OF EQUITY SECURITIESMarket Information for the Company's Common Equity

Artesian Resources' Class A Non-Voting Common Stock, or Class A Stock, is listed on NASDAQ Global Select Market and trades under the symbol "ARTNA." On March 6, 2017, the last closing sale price as reported by the NASDAQ Global Select Market was \$32.27 per share. On March 6, 2017 there were 702 holders of record of the Class A Stock. The following table sets forth, for the periods indicated, the high and low closing sale prices for the Class A Stock as reported by NASDAQ Global Select Market and the cash dividends declared per share.

CLASS A NON-VOTING COMMON STOCK

	High	Low	Dividend Per Share
2016			
First Quarter	\$31.31	\$25.52	\$0.2216
Second Quarter	33.92	26.26	0.2249
Third Quarter	34.87	26.32	0.2249
Fourth Quarter	33.00	26.78	0.2283
2015			
First Quarter	\$22.72	\$20.00	\$0.2151
Second Quarter	22.16	20.70	0.2183
Third Quarter	24.14	21.32	0.2183
Fourth Quarter	29.11	24.14	0.2216

Our Class B Voting Stock, or Class B Stock, is quoted on the OTC Bulletin Board under the symbol "ARTNB." There has been a limited and sporadic public trading market for the Class B Stock. As of March 6, 2017, the last reported trade of the Class B Stock on the OTC Bulletin Board was at a price of \$32.77 per share on January 13, 2017. As of March 6, 2017, we had 159 holders of record of the Class B Stock. The Class B shares are paid the same dividend as the Class A shares noted in the table above.

Recent Sales of Unregistered Securities

During the year ended December 31, 2016, we did not issue any unregistered shares of our Class A or Class B Stock.

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Equity Compensation Plan Information

The following table provides information on the shares of our Class A Stock that may be issued upon exercise of outstanding stock options and vesting of awards as of December 31, 2016 under the Company's stockholder approved stock plans.

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options (a)	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	236,755	\$ 18.91	321,500
Equity compensation plans not approved by security holders	---	---	---
Total	236,755		321,500

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The following graph compares the percentage change in cumulative shareholder return on the Company's Class A Stock with the Standard & Poor's 500 Stock Index and a Peer Group of water utility companies having similar market capitalizations. The graph covers the period from December 2011 (assuming a \$100 investment on December 31, 2011, and the reinvestment of any dividends) through December 2016:

Company Name / Index	INDEXED RETURNS					
	Base Period 2011	Years Ending December 31				
	2011	2012	2013	2014	2015	2016
Artesian Resources Corporation	100	123.88	131.46	134.53	171.41	203.90
S&P 500 Index	100	116.00	153.57	174.60	177.01	198.18
Peer Group	100	119.11	140.89	173.01	195.08	239.56

The Peer Group includes American States Water Company, American Water Works Company, Inc., Aqua America, Inc., California Water Service Group, Connecticut Water Service, Inc., Middlesex Water Company, SJW Corporation and York Water Company.

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ITEM 6. SELECTED FINANCIAL DATA

The selected statement of operations and balance sheet data shown below were derived from our consolidated financial statements. The consolidated statement of operations data for the years ended December 31, 2016, 2015 and 2014 and the consolidated balance sheet data as of December 31, 2016 and 2015 have been derived from our audited financial statements included elsewhere in this Annual Report on Form 10-K. The consolidated statement of operations data for the years ended December 31, 2013 and 2012 and the consolidated balance sheet data as of December 31, 2014, 2013 and 2012 have been derived from audited consolidated financial statements which are not included in this Annual Report on Form 10-K. You should read this selected financial data together with our consolidated financial statements and related notes, as well as the discussion under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations."

In thousands, except per share and operating data	2016	2015	2014	2013	2012	
STATEMENT OF OPERATIONS DATA						
Operating revenues						
Water sales	\$70,587	\$68,932	\$64,667	\$61,846	\$63,607	
Other utility operating revenue	3,816	3,694	3,648	3,253	3,169	
Non-utility operating revenue	4,686	4,398	4,150	3,974	3,787	
Total operating revenues	\$79,089	\$77,024	\$72,465	\$69,073	\$70,563	
Operating expenses						
Operating and maintenance	\$38,260	\$38,453	\$37,086	\$36,630	\$36,217	
Depreciation and amortization	9,188	8,837	8,673	8,251	7,930	
State and federal income taxes	8,331	7,784	6,375	5,588	6,616	
Property and other taxes	4,491	4,368	4,285	4,120	3,945	
Total operating expenses	\$60,270	\$59,442	\$56,419	\$54,589	\$54,708	
Operating income	\$18,819	\$17,582	\$16,046	\$14,484	\$15,855	
Other income, net	779	721	853	872	1,036	
Total income before interest charges	\$19,598	\$18,303	\$16,899	\$15,356	\$16,891	
Interest charges	\$6,644	\$6,998	\$7,393	\$7,055	\$7,045	
Net income	\$12,954	\$11,305	\$9,506	\$8,301	\$9,846	
Dividends on preferred stock						
Net income applicable to common stock	\$12,954	\$11,305	\$9,506	\$8,301	\$9,846	
Net income per share of common stock:						
Basic	\$1.42	\$1.26	\$1.07	\$0.95	\$1.14	
Diluted	\$1.41	\$1.26	\$1.07	\$0.94	\$1.13	
Average shares of common stock outstanding:						
Basic	9,098	8,960	8,884	8,774	8,666	
Diluted	9,161	9,005	8,926	8,836	8,717	
Cash dividends per share of common stock	\$0.90	\$0.87	\$0.85	\$0.82	\$0.79	
In thousands, except for operating data		2016	2015	2014	2013	2012

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BALANCE SHEET DATA

Utility plant, at original cost less accumulated depreciation	\$425,502	\$405,606	\$393,793	\$378,960	\$366,563
Total assets	\$450,976	\$431,626	\$422,213	\$403,832	\$391,714
Lines of credit	\$7,130	\$10,487	\$18,491	\$10,332	\$10,717
Long-term obligations and redeemable preferred stock, including current portions	\$103,647	\$104,936	\$106,199	\$106,642	\$107,368
Stockholders' equity	\$139,023	\$132,331	\$125,605	\$121,836	\$118,180
Total capitalization	\$241,354	\$235,978	\$230,559	\$227,346	\$224,437

OPERATING DATA

Average water sales per customer	\$830	\$824	\$780	\$755	\$783
Water pumped (millions of gallons)	7,626	7,646	7,592	7,286	7,407
Number of metered customers	85,000	83,700	82,900	81,900	81,200
Miles of water main	1,260	1,218	1,201	1,182	1,162

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Our profitability is primarily attributable to the sale of water. Gross water sales comprise 89.3% of total operating revenues for the year ended December 31, 2016. Our profitability is also attributed to the various contract operations, water, sewer and internal Service Line Protection Plans and other services we provide. Water sales are subject to seasonal fluctuations, particularly during summer when water demand may vary with rainfall and temperature. In the event temperatures during the typically warmer months are cooler than expected, or rainfall is greater than expected, the demand for water may decrease and our revenues may be adversely affected. We believe the effects of weather are short term and do not materially affect the execution of our strategic initiatives. Our contract operations, Service Line Protection Plans and other services provide a revenue stream that is not affected by changes in weather patterns.

While water sales are our primary source of revenues, we continue to seek growth opportunities to provide wastewater service in Delaware and the surrounding areas. We also continue to explore and develop relationships with developers and municipalities in order to increase revenues from contract water and wastewater operations, wastewater management services, design, construction and engineering services. We plan to continue developing and expanding our contract operations and other services in a manner that complements our growth in water service to new customers. Our anticipated growth in these areas is subject to changes in residential and commercial construction, which may be affected by interest rates, inflation and general housing and economic market conditions. We anticipate continued growth in our non-regulated division due to our water, sewer and internal Service Line Protection Plans.

Water Division

Overview

Artesian Water, Artesian Water Maryland and Artesian Water Pennsylvania provide water service to residential, commercial, industrial, governmental, municipal and utility customers. Increases in the number of customers contribute to increases, or help to offset any intermittent decreases in our operating revenue. The Town of Middletown, which is one of our municipal customers and is located in southern New Castle County, Delaware, has more than tripled in population since 2001, and population growth in this area is expected to continue for some time as a result of ongoing and future residential, commercial and industrial construction. As population growth continues in Middletown and other areas in Delaware, we believe that the demand for water will increase, thereby contributing to an increase in our operating revenues. As of December 31, 2016, we had approximately 82,700 metered water customers in Delaware, an increase of approximately 1,300 compared to December 31, 2015. The number of metered water customers in Maryland totaled 2,300 as of December 31, 2016, which remained consistent with 2015. The number of metered water customers in Pennsylvania totaled 40, which remained consistent with 2015. For the year ended December 31, 2016, approximately 7.6 billion gallons of water were distributed in our Delaware systems and approximately 158 million gallons of water were distributed in our Maryland systems.

Wastewater Division

Overview

Artesian Wastewater owns wastewater infrastructure and began providing wastewater services in Delaware in July 2005. Artesian Wastewater Maryland, which was incorporated on June 3, 2008, is able to provide regulated wastewater services in Maryland. Our wastewater customers are billed a flat monthly fee, which contributes to providing a revenue stream unaffected by weather. Artesian Wastewater entered into agreements with an industrial

customer and Sussex County for wastewater services that will expand our service area and provide growth opportunities.

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Non-Regulated Division

Overview

Artesian Utility provides contract water and wastewater operation services to private, municipal and governmental institutions. Artesian Utility currently operates wastewater treatment facilities for the town of Middletown, in southern New Castle County, or Middletown, under a 20-year contract that expires in July 2022. The facilities include two wastewater treatment stations with capacities of up to approximately 2.5 mgd and 250,000 gallons per day, respectively. We also operate a wastewater disposal facility in Middletown in order to support the 2.5 mgd wastewater facility.

Artesian Utility has operated the WSLP Plan and the SSLP Plan since 2012. Artesian Resources initiated the WSLP Plan in March 2005. In November 2015, a third plan was added, the ISLP Plan. The WSLP Plan covers all parts, material and labor required to repair or replace participating customers' leaking water service lines up to an annual limit. The SSLP Plan was initiated in the second quarter of 2008. The SSLP Plan covers all parts, material and labor required to repair or replace participating customers' leaking or clogged sewer lines up to an annual limit. In the second quarter of 2010, the WSLP Plan and SSLP Plan were extended to include non-utility customers of Artesian Resources. The ISLP Plan was introduced in November 2015 to further enhance available coverage to include water and wastewater lines within the residence. As of December 31, 2016, approximately 19,500, or 25.0%, of our eligible water customers signed up for the WSLP Plan, approximately 15,200, or 19.5%, of our eligible customers signed up for the SSLP Plan, and approximately 3,600 customers signed up under the ISLP Plan. Approximately 1,400 non-customer participants signed up for either the WSLP Plan, the SSLP Plan, or the ISLP Plan.

Artesian Development is a real estate holding company that owns properties, including land zoned for office buildings, a water treatment plant and wastewater facility, as well as property for current operations, including an office facility in Sussex County, Delaware. The facility consists of approximately 10,000 square feet of office space along with nearly 10,000 square feet of warehouse space. This facility allows all of our Sussex County, Delaware operations to be housed in one central location.

Artesian Consulting Engineers no longer offers development and architectural services to outside third parties. Artesian will continue to provide design and engineering contract services through our Artesian Utility subsidiary.

Strategic Direction

Our strategy is to significantly increase customer growth, revenues, earnings and dividends by expanding our water, wastewater and Service Line Protection Plan services across the Delmarva Peninsula. We remain focused on providing superior service to our customers and continuously seeking ways to improve our efficiency and performance. By providing water and wastewater services, we believe we are positioned as the primary resource for developers and communities throughout the Delmarva Peninsula seeking to fill both needs simultaneously. We have a proven ability to acquire and integrate high growth, reputable entities, through which we have captured additional service territories that will serve as a base for future revenue. We believe this experience presents a strong platform for further expansion and that our success to date also produces positive relationships and credibility with regulators, municipalities, developers and customers in both existing and prospective service areas.

In our regulated water division, our strategy is to focus on a wide spectrum of activities, which include identifying new and dependable sources of supply, developing the wells, treatment plants and delivery systems to supply water to customers and educating customers on the wise use of water. Our strategy includes focused efforts to expand in new regions added to our Delaware service territory over the last 10 years. In addition, we believe growth will occur in the Maryland counties on the Delmarva Peninsula. We plan to expand our regulated water service area in the Cecil County designated growth corridor and to expand our business through the design, construction, operation,

management and acquisition of additional water systems. The expansion of our exclusive franchise areas elsewhere in Maryland and the award of contracts will similarly enhance our operations within the state.

On February 23, 2017, Artesian Water entered into an agreement with Fort DuPont Redevelopment and Preservation Corporation, or FDRPC, for the purchase of existing water assets and for the provision of potable water and fire suppression services. The Fort DuPont National Historic District, or Fort DuPont, consists of 325-acres and lies between the Delaware River on the east, the Chesapeake and Delaware Canal on the south and the Delaware City Branch Canal. The total price for the purchase of the water assets is \$1.0 million. The water assets include a water treatment plant, storage tank, mains, and other equipment used to provide potable water and fire suppression services to portions of Fort DuPont and the surrounding properties. In connection with the planned future development of Fort DuPont, the parties intend to design, build and operate a state of the art, cost effective, safe and reliable water system that will include both new water assets as well as improvements and upgrades to the existing water assets. The water system can be expanded to meet the needs of the planned 600 residential unit as well as new commercial customers, in addition to water service currently provided to the Governor Bacon Health Center and National Guard facilities. The agreement may be terminated at any time prior to closing by mutual written consent of Artesian and FDRPC.

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We believe that Delaware's generally lower cost of living in the region, availability of development sites in relatively close proximity to the Atlantic Ocean in Sussex County, and attractive financing rates for construction and mortgages have resulted, and will continue to result, in increases to our customer base. Delaware's lower property and income tax rate make it an attractive region for new home development and retirement communities. Substantial portions of Delaware are currently not served by a public water system, which could also assist in an increase to our customer base as systems are added.

In our regulated wastewater division, we foresee significant growth opportunities and will continue to seek strategic partnerships and relationships with developers and municipalities to complement existing agreements for the provision of wastewater service on the Delmarva Peninsula. Artesian Wastewater plans to utilize our larger regional wastewater facilities to expand service areas to new customers while transitioning our smaller treatment facilities into regional pump stations in order to gain additional efficiencies in the treatment and disposal of wastewater. We feel this will reduce operational costs at the smaller treatment facilities in the future since they will be converted from treatment and disposal plants to pump stations to assist with transitioning the flow of wastewater from one regional facility to another.

Artesian Wastewater entered into agreements that will provide growth opportunities and will utilize our larger regional wastewater facilities. In August 2016, Artesian Wastewater and Sussex County, a political subdivision of Delaware, entered into an agreement to provide wastewater treatment and disposal services for each other in order to address the periodic need of additional wastewater treatment and disposal capacities and facilities in Sussex County, beyond those under their own ownership and control, to assure the timely, efficient and cost effective transmission and management of wastewater. There are numerous locations in Sussex County where Artesian Wastewater's and Sussex County's facilities are capable of being connected or integrated to allow for the movement and disposal of wastewater generated by one or the other's system. On September 27, 2016, Artesian Wastewater entered into a wastewater services agreement with Allen Harim Foods, LLC, or Allen Harim, for Artesian Wastewater to provide treatment and disposal services for sanitary wastewater discharged from Allen Harim's properties located in Sussex County, Delaware upon completion of a pipeline to transfer the sanitary wastewater. The completion of the pipeline should occur during the second quarter of 2017. On January 27, 2017, Artesian Wastewater entered into a second wastewater agreement with Allen Harim for Artesian Wastewater to provide disposal services for approximately 1.5 million gallons per day of treated industrial and/or process wastewater upon completion of an approximately eight mile pipeline that will transfer the wastewater from Allen Harim's properties to a 67 million gallon storage lagoon at Artesian's Northern Sussex Water Recycling Facility. Artesian will use the reclaimed wastewater for spray irrigation on agricultural land in the area. The completion of the industrial and/or process wastewater pipeline and storage lagoon should occur during the first quarter of 2018.

The general need for increased capital investment in our water and wastewater systems is due to a combination of population growth, more protective water quality standards and aging infrastructure. Our capital investment plan for the next three years includes projects for water treatment plant improvements and additions in both Delaware and Maryland and wastewater treatment plant improvements and additions in Delaware. Capital improvements are planned and budgeted to meet anticipated changes in regulations and needs for increased capacity related to projected growth. The Delaware Public Service Commission and Maryland Public Service Commission have generally recognized the operating and capital costs associated with these improvements in setting water and wastewater rates for current customers and capacity charges for new customers.

In our non-regulated division, we continue pursuing opportunities to expand our contract operations. Through Artesian Utility, we will seek to expand our contract design, engineering and construction services of water and wastewater facilities for developers, municipalities and other utilities. Artesian Development owns two nine-acre parcels of land, located in Sussex County, Delaware, which will allow for construction of a water treatment facility and wastewater treatment facility.

Inflation

We are affected by inflation, most notably by the continually increasing costs required to maintain, improve and expand our service capability. The cumulative effect of inflation results in significantly higher facility costs compared to investments made 20 to 40 years ago, which must be recovered from future cash flows.

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CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Critical accounting policies and estimates are those we believe are most important to portraying the financial condition and results of operations and also require significant estimates, assumptions or other judgments by management. The following provides an overview of the accounting policies that are particularly important to the results of operations and financial condition of the Company. Changes in the estimates, assumptions or other judgments included within these accounting policies could result in a significant change to the financial statements in any quarterly or annual period. We consider the following policies to be the most critical in understanding the judgment that is involved in preparing our Consolidated Financial Statements. Senior management has discussed the selection and development of our critical accounting policies and estimates with the Audit Committee of the Board of Directors.

All additions to plant are recorded at cost. Cost includes direct labor, materials, and indirect charges for such items as transportation, supervision, pension, medical, and other fringe benefits related to employees engaged in construction activities. When depreciable units of utility plant are retired, any cost associated with retirement, less any salvage value or proceeds received, is charged to a regulated retirement liability. Maintenance, repairs, and replacement of minor items of plant are charged to expense as incurred.

We record water service revenue, including amounts billed to customers on a cycle basis and unbilled amounts, based upon estimated usage from the date of the last meter reading to the end of the accounting period. As actual usage amounts are received, adjustments are made to the unbilled estimates in the next billing cycle based on the actual results. Estimates are made on an individual customer basis, based on one of three methods (the previous year's consumption in the same period, the previous billing period's consumption, or averaging) and are adjusted to reflect current changes in water demand on a system-wide basis. While actual usage for individual customers may differ materially from the estimate, we believe the overall total estimate of consumption and revenue for the fiscal period will not differ materially from actual billed consumption.

We record accounts receivable at the invoiced amounts. The reserve for bad debts is adjusted based on the provision for bad debts, which is calculated as a percentage of total water sales. The Company reviews the bad debt provision expense and the reserve for bad debts on a quarterly basis. Account balances are written off against the reserve when it is probable the receivable will not be recovered.

Our regulated utilities record deferred regulatory assets under Financial Accounting Standards Board, or FASB, Accounting Standards Codification, or ASC, Topic 980, which are costs that may be recovered over various lengths of time as prescribed by the DEPSC, MDPSC and PAPUC. As the utility incurs certain costs, such as expenses related to rate case applications, a deferred regulatory asset is created. Adjustments to these deferred regulatory assets are made when the DEPSC, MDPSC or PAPUC determines whether the expense is recoverable in rates, the length of time over which an expense is recoverable, or, because of changes in circumstances, whether a remaining balance of deferred expense is recoverable in rates charged to customers. Adjustments to reflect changes in recoverability of certain deferred regulatory assets may have a significant effect on our financial results.

Our long-lived assets consist primarily of utility plant in service and regulatory assets. We review for impairment of our long-lived assets, including utility plant in service, in accordance with the requirements of FASB ASC Topic 360. We review regulatory assets for the continued application of FASB ASC Topic 980. Our review determines whether there have been changes in circumstances or events that have occurred that require adjustments to the carrying value of these assets. Adjustments to the carrying value of these assets would be made in instances where changes in circumstances or events indicate the carrying value of the asset may not be recoverable. The Company believes there are no impairments in the carrying amounts of its long-lived assets or regulatory assets at December 31, 2016.

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Results of Operations

2016 Compared to 2015

Operating Revenues

Revenues totaled \$79.1 million for the year ended December 31, 2016, \$2.1 million, or 2.7%, above revenues for the year ended December 31, 2015 of \$77.0 million. Water sales revenues increased \$1.7 million, or 2.4%, for the year ended December 31, 2016 compared to 2015. The increase in water sales revenue is primarily due to an increase in DSIC revenue of approximately \$0.8 million and an increase in overall water consumption and the number of water customers. We realized 89.3% of our total operating revenue for the year ended December 31, 2016 from the sale of water as compared to 89.5% for the year ended December 31, 2015.

Other utility operating revenue increased approximately \$0.1 million, or 3.3%, for the year ended December 31, 2016 compared to the year ended December 31, 2015. The increase is primarily due to an increase in wastewater revenue related to customer growth and new development inspections, partially offset by a decrease in operating subsidies due to developers satisfying their wastewater connection payments for all lots within certain communities.

Non-utility operating revenue increased approximately \$0.3 million, or 6.5%, for the year ended December 31, 2016 compared to 2015. The increase is primarily due to an approximately \$229,000 increase in Service Line Protection Plans, or SLP Plans, revenue and contract service revenue.

Percentage of Operating Revenues

	2016	2015	2014
Water Sales			
Residential	53.5 %	54.7 %	53.6 %
Commercial	21.6	21.1	21.3
Industrial	0.1	0.1	0.1
Government and Other	14.1	13.8	14.2
Other utility operating revenues	4.8	4.7	5.0
Non-utility operating revenues	5.9	5.6	5.8
Total	100.0 %	100.0 %	100.0 %

Residential

Residential water service revenues in 2016 amounted to \$42.3 million, an increase of \$1.1 million, or 2.6% above the \$41.2 million recorded in 2015, primarily due to an increase in DSIC revenue and an increase in overall water consumption and the number of customers. The volume of water sold to residential customers increased to 3,741 million gallons in 2016 compared to 3,737 million gallons in 2015, a 0.1% increase. The number of residential customers served increased by approximately 1,300, or 1.6%, in 2016.

Commercial

Water service revenues from commercial customers in 2016 increased by 2.4%, from \$16.7 million in 2015 to \$17.1 million in 2016, primarily due to an increase in DSIC revenue and an increase overall water consumption. The volume of water sold to commercial customers increased to 2,178 million gallons in 2016 compared to 2,150 million gallons sold in 2015, an increase of 1.3%.

Industrial

Water service revenues from industrial customers decreased 22.2% from \$99,000 in 2015 to \$77,000 in 2016. The volume of water sold to industrial customers decreased to 8,000 gallons in 2016 from 11,000 gallons in 2015, a decrease of 25.7%.

Government and Other

Government and other water service revenues in 2016 increased by 2.8%, from \$10.9 million in 2015 to \$11.2 million in 2016, primarily due to an increase in DSIC revenue. The volume of water sold to government and other customers was 810,000 gallons in 2016 and 2015, respectively.

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Other Utility Operating Revenue

Other utility operating revenue, derived from contract operations, antenna leases on water tanks, finance/service charges and wastewater customer service revenues increased 3.3%, from \$3.7 million in 2015 to \$3.8 million in 2016. The increase is primarily due to an increase in revenue from wastewater customers compared to 2015 and an increase in inspection fee revenue related to new development, partially offset by a decrease in operating subsidies due to developers satisfying their wastewater connection payments for all lots within certain communities.

Non-Utility Operating Revenue

Non-utility operating revenue, derived from non-regulated water and wastewater operations, increased 6.5%, from \$4.4 million in 2015 to \$4.7 million in 2016. The increase is primarily due to an approximately \$0.3 million increase in SLP Plan revenue and contract service revenue.

Operating Expenses

Operating expenses, excluding depreciation and income taxes, decreased \$70,000, or 0.2%, for the year ended December 31, 2016 compared to the year ended December 31, 2015. The components of the change in operating expenses primarily include a decrease in utility operating expenses of \$0.5 million, an increase in non-utility operating expenses of \$0.3 million and an increase in property and other taxes of \$0.1 million.

Utility operating expenses decreased \$0.5 million, or 1.4%, for the year ended December 31, 2016 compared to the year ended December 31, 2015. The net decrease is primarily related to the following.

Payroll and employee benefit costs decreased \$0.4 million, or 1.9%, primarily as a result of a discretionary profit sharing contribution to the employee deferred contribution retirement plan of 1% that was made in 2015 and not in 2016, unfilled employee position vacancies throughout 2016 and greater capitalized pay in 2016 related to a meter replacement project. These decreases were partially offset by 2015 and 2016 merit based pay increases.

Purchased power expense decreased \$0.1 million, or 5.2%, primarily due to the execution of a lower rate three-year supply contract effective May 2016.

Administration expenses decreased \$0.1 million, or 1.6%, primarily due to a decrease in consulting fees related to an accounting software update in 2015 and a decrease in rate case costs due to the timing of expenses related to Artesian Water's rate applications. These decreases are partially offset by increased legal costs associated with litigation before the DEPSC pertaining to a developer dispute over Contributions in Aid of Construction. Artesian submitted a petition to the DEPSC on October 20, 2016 requesting deferred accounting treatment related to this litigation, however the request was denied by the DEPSC on December 20, 2016.

Repair and maintenance costs increased \$0.1 million, or 2.1%, primarily due to increased tank painting expenses due to the painting of more tanks in 2016 compared to 2015, partially offset by a decrease in water treatment expenses related to the installation of a new ultra violet oxidation treatment facility in 2015.

Non-utility expenses increased approximately \$0.3 million, or 12.9%, primarily due to an increase in payroll and benefits costs as well as an increase in plumbing services related to the Service Line Protection Plans.

Percentage of Operating and Maintenance Expenses

	2016	2015	2014
Payroll and Associated Expenses	49.7 %	50.4 %	51.8 %
Administrative	15.6	15.8	13.4
Purchased Water	10.6	10.5	10.9
Repair and Maintenance	8.1	7.9	8.6
Purchased Power	6.0	6.2	6.0
Water Treatment	3.2	3.2	3.4
Non-utility Operating	6.8	6.0	5.9
Total	100.0 %	100.0 %	100.0 %

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Property and other taxes increased by \$0.1 million, or 2.8%, compared to the same period in 2015, reflecting increases in tax rates charged for public schools in various areas where Artesian holds property and an increase in utility plant subject to taxation. Property taxes are assessed on land, buildings and certain utility plant, which include the footage and size of pipe, hydrants and wells primarily owned by Artesian Water.

The ratio of operating expense, excluding depreciation and income taxes, to total operating revenues was 54.1% for the year ended December 31, 2016, compared to 55.6% for the year ended December 31, 2015.

Depreciation and amortization expense increased \$0.4 million, or 4.0%, primarily due to continued investment in utility plant in service providing supply, treatment, storage and distribution of water.

Federal and state income tax expense increased \$0.5 million, primarily due to higher pre-tax income for the year ended December 31, 2016, compared to the year ended December 31, 2015. Our total effective income tax rate, or ETR, for 2016 and 2015 was 39.1% and 40.8%, respectively.

Other Income, Net

Allowance for funds used during construction, or AFUDC, decreased \$27,000 due to decreased long-term construction activity subject to AFUDC. Miscellaneous income increased \$85,000, primarily due to the timing of charitable contributions this period compared to the same period last year.

Interest Charges

Interest expense decreased \$0.4 million, primarily due to a decrease in the Series S First Mortgage Bond interest rate from 6.73% to 4.45% effective March 1, 2016 and a decrease in short-term debt outstanding.

Net Income

For the year ended December 31, 2016, our net income applicable to common stock increased \$1.6 million compared to 2015. This increase in net income was primarily due to higher operating income margins in our water utility business as a result of increased water sales revenue and decreased utility operating expenses, as well as decreased interest expense.

2015 Compared to 2014

Operating Revenues

Revenues totaled \$77.0 million for the year ended December 31, 2015, \$4.6 million, or 6.3%, above revenues for the year ended December 31, 2014 of \$72.5 million. Water sales revenues increased \$4.3 million, or 6.6%, for the year ended December 31, 2015 compared to 2014, primarily as a result of temporary rate increases that were placed into effect on June 10, 2014 and November 13, 2014. Pursuant to the order issued by the DEPSC on October 6, 2015, the permanent rate increase was less than the amounts collected under previously approved temporary increases in rates. The excess amounts collected resulted in refunds to customers in the amount of \$878,000 including interest. The amount was refunded in October 2015. Since the final rate award was at a level not less than the amount previously reported as income, there was no material impact upon previously reported water sales revenue. The increase in water sales revenue was partially offset by a decrease in DSIC revenue of approximately \$0.3 million, as the DSIC was reset to zero upon the implementation of the first step of temporary rate increases on June 10, 2014. We realized 89.5% of our total operating revenue for the year ended December 31, 2015 from the sale of water as compared to 89.2% for the year ended December 31, 2014.

Other utility operating revenue increased approximately \$46,000, or 1.3%, for the year ended December 31, 2015 compared to the year ended December 31, 2014. The increase was primarily due to an increase in wastewater rates that was fully implemented in September 2014 and an increase in the number of wastewater customers, partially offset by a decrease in operating subsidies due to developers satisfying their wastewater connection payments for all lots within certain communities.

Non-utility operating revenue increased approximately \$248,000, or 6.0%, for the year ended December 31, 2015 compared to 2014. The increase was primarily due to an approximately \$320,000 increase in water and wastewater Service Line Protection Plan, or SLP Plans, revenue. The SLP Plans provide coverage for all material and labor required to repair or replace participants' leaking water service or clogged sewer lines up to an annual limit. The increase in non-utility operating revenue is partially offset by a decrease in contract revenue, primarily due to a decrease in wastewater contract services.

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Residential

Residential water service revenues in 2015 amounted to \$43.3 million, an increase of \$4.5 million, or 11.5% above the \$38.8 million recorded in 2014, primarily due to a result of temporary rate increases placed in effect on June 10, 2014 and November 13, 2014. The volume of water sold to residential customers increased to 3,852 million gallons in 2015 compared to 3,702 million gallons in 2014, a 4.0% increase. The number of residential customers served increased by approximately 900, or 1.2%, in 2015.

Commercial

Water service revenues from commercial customers in 2015 increased by 7.9%, from \$15.4 million in 2014 to \$16.7 million in 2015, primarily due to temporary rate increases placed in effect on June 10, 2014 and November 13, 2014. The volume of water sold to commercial customers decreased to 2,034 million gallons in 2015 compared to 2,120 million gallons sold in 2014, a decrease of 4.1%.

Industrial

Water service revenues from industrial customers decreased 4.4% from \$104,000 in 2014 to \$99,000 in 2015. The volume of water sold to industrial customers decreased to 11.0 million gallons in 2015 from 12.5 million gallons in 2014, a decrease of 11.6%.

Government and Other

Government and other water service revenues in 2015 increased by 6.6%, from \$10.3 million in 2014 to \$10.9 million in 2015, primarily due to temporary rate increases placed in effect on June 10, 2014 and November 13, 2014. The volume of water sold to government and other customers decreased to 810 million gallons in 2015 from 857 million gallons in 2014, a decrease of 5.4%.

Other Utility Operating Revenue

Other utility operating revenue, derived from contract operations, antenna leases on water tanks, finance/service charges and wastewater customer service revenues increased 1.3%, from \$3.6 million in 2014 to \$3.7 million in 2015. The increase was primarily due to an increase in revenue from wastewater customers, partially offset by a decrease in contract service revenue and repair and miscellaneous income.

Non-Utility Operating Revenue

Non-utility operating revenue, derived from non-regulated water and wastewater operations, increased 6.0%, from \$4.1 million in 2014 to \$4.4 million in 2015. The increase was primarily due to an approximately \$0.3 million increase in water and wastewater SLP Plans revenue. The SLP Plans provide coverage for all material and labor required to repair or replace participants' leaking water service or clogged sewer lines up to an annual limit. The increase in non-utility operating revenue was partially offset by a decrease in wastewater contract services.

Operating Expenses

Operating expenses, excluding depreciation and income taxes, increased \$1.4 million, or 3.5%, from \$41.4 million in 2014 to \$42.8 million in 2015. The components of the change in operating expenses primarily include an increase in utility operating expenses of \$1.3 million and an increase in non-utility operating expenses of \$0.1 million.

The increase in utility operating expenses of \$1.3 million, or 3.6%, in 2015 as compared to 2014, was primarily comprised of an increase in administration expenses, an increase in purchased power expense and an increase in payroll and employee benefit expenses.

Administration expenses increased \$0.7 million, or 15.6%, primarily due to rate case expenses being amortized when the temporary rates were first put into effect, in addition to an increase in consulting fees related to an accounting software update, an increase in telephone expenses due to service upgrades, an increase in auditing expenses primarily due to the timing of services performed by the auditors this year compared to last, an increase in legal fees and an increase in employee recruitment expenses.

Payroll and employee benefit costs increased \$0.5 million, or 2.8%, primarily as a result of an increase in wages and an increase in discretionary profit sharing of 1% over last year.

Purchased power expense increased \$0.2 million, or 8.2%, primarily due to increased water pumpage and installation of a new ultra violet oxidation treatment facility.

Repair and maintenance costs decreased \$0.2 million, or 5.0%, primarily due to decreased fuel costs related to lower gas prices.

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Non-utility expenses increased approximately \$0.1 million, or 5.1%, primarily the result of an increase in SLP Plan repairs. The increased repair costs were a result of increased SLP Plan participation.

Property and other taxes increased by \$0.1 million, or 1.9%, compared to the same period in 2014, reflecting increases in tax rates charged for public schools in various areas where Artesian holds property and an increase in utility plant subject to taxation. Property taxes are assessed on land, buildings and certain utility plant, which include the footage and size of pipe, hydrants and wells primarily owned by Artesian Water.

The ratio of operating expense, excluding depreciation and income taxes, to total operating revenues was 55.6% for the year ended December 31, 2015, compared to 57.1% for the year ended December 31, 2014.

Depreciation and amortization expense increased \$0.2 million, or 1.9%, primarily due to continued investment in utility plant in service providing supply, treatment, storage and distribution of water.

Federal and state income tax expense increased \$1.4 million, primarily due to higher pre-tax income for the year ended December 31, 2015, compared to the year ended December 31, 2014. Our total effective income tax rate, or ETR, for 2015 and 2014 was 40.8% and 40.1%, respectively.

Other Income, Net

Allowance for funds used during construction, or AFUDC, decreased \$80,000 due to decreased long-term construction activity subject to AFUDC. Miscellaneous income decreased \$52,000, primarily due to an increase in charitable contributions in 2015 compared to 2014.

Interest Charges

Interest expense decreased \$0.4 million, primarily due to accrual of prejudgment interest expense in the year ended December 31, 2014, related to the litigation against Chester Water Authority in regard to the proper determination of the rate charged for water purchased under contract from Chester Water Authority.

Net Income

For the year ended December 31, 2015, our net income applicable to common stock increased \$1.8 million compared to the same period a year ago. This increase in net income was primarily due to higher operating income margins in our water utility business, as a result of rate increases placed in effect during 2014, an increase in service line protection plan revenue and a decrease in interest expense. The decrease of \$0.4 million in interest expense was primarily due to the accrual of interest expense in the third quarter of 2014 related to the litigation against Chester Water Authority in regard to the proper determination of the rate Chester Water Authority charged for water purchased under contract.

Liquidity and Capital Resources

Overview

The Company's sources of liquidity for the year ended December 31, 2016 were \$29.8 million provided by cash flow from operating activities, \$9.9 million in net contributions and advances from developers and \$1.8 million in net proceeds from the issuance of common stock. These funds were used to invest \$28.2 million in capital expenditures, to pay dividends of approximately \$8.1 million, and to repay \$3.4 million of the Company's line of credit.

We depend on the availability of capital for expansion, construction and maintenance. We rely on our sources of liquidity for investments in our utility plant and to meet our various payment obligations. We expect that our net investments in our utility plant and systems in 2017 will be approximately \$40.7 million. Our total obligations related to interest and principal payments on indebtedness, rental payments and water service interconnection agreements for 2017 are anticipated to be approximately \$11.3 million. We expect to fund our activities for the next year using our available cash balances, bank credit lines and projected cash generated from operations. We believe that internally generated funds along with existing credit facilities will be adequate to provide sufficient working capital to maintain normal operations and to meet our financing requirements. However, since part of our business strategy is to expand through strategic acquisitions, we may seek additional debt financing or issue additional equity securities to finance future acquisitions or for other purposes. There is no assurance that we will be able to secure funding on terms acceptable to us, or at all.

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Operating Activities

Our primary source of liquidity for the year ended December 31, 2016 was \$29.8 million provided by cash flow from operating activities. Cash flow from operating activities is primarily provided by our utility operations, and is impacted by the timeliness and adequacy of rate increases and changes in water consumption as a result of year-to-year variations in weather conditions, particularly during the summer. A significant part of our ability to maintain and meet our financial objectives is to ensure that our investments in utility plant and equipment are recovered in the rates charged to customers. As such, from time to time, we file rate increase requests to recover increases in operating expenses and investments in utility plant and equipment. In addition, the Company has a long history of paying regular quarterly dividends as approved by our Board of Directors using net cash from operating activities.

The primary focus of Artesian's investment in 2016 was to continue to provide high quality reliable service to our growing service territory. We invested \$28.2 million in capital expenditures during 2016 compared to \$20.7 million invested during the same period in 2015. During 2016, we invested \$2.3 million to enhance or improve existing treatment facilities and sources of supply and for the rehabilitation of pumping equipment to better serve our customers. We invested \$5.0 million to upgrade and automate our meter reading equipment. We invested approximately \$6.8 million for our rehabilitation program for transmission and distribution facilities by replacing aging or deteriorating mains and for new transmission and distribution facilities. We invested approximately \$2.9 million in mandatory utility plant expenditures due to governmental highway projects which require the relocation of water service mains in addition to facility improvements and upgrades. Developers financed \$8.0 million for the installation of water mains and hydrants in 2016 compared to \$3.8 million in 2015. We invested \$2.1 million for equipment purchases, treatment facility upgrades and computer hardware and software upgrades. An additional \$1.1 million was invested in wastewater projects in Delaware.

The following chart summarizes our investment in plant and systems over the past three fiscal years.

In thousands	2016	2015	2014
Source of supply	\$302	\$584	\$945
Treatment and pumping	2,021	3,808	6,914
Transmission and distribution	14,865	8,854	10,220
General plant and equipment	2,083	2,670	2,622
Developer financed utility plant	7,996	3,849	2,784
Wastewater facilities	1,130	1,092	457
Allowance for Funds Used During Construction, AFUDC	(146)	(163)	(212)
Total	\$28,251	\$20,694	\$23,730

Of the \$51.5 million we expect to invest in 2017, approximately \$16.1 million will be invested in transmission and distribution facilities, including the replacement of facilities, and the extension of facilities to address service needs in growth areas of our service territory. Approximately \$6.7 million will be invested in the relocations of facilities as a result of government mandates and renewals associated with the rehabilitation of aging infrastructure. Approximately \$5.5 million will be invested for new treatment facilities, facility upgrades, equipment and wells throughout Delaware and Maryland to identify, develop, treat and protect sources of water supply to assure uninterrupted service to our customers. Approximately \$1.2 million will be invested in the purchase of existing water assets and for the provision of potable water and fire suppression services in the Fort DuPont National Historic District, which includes investment in both new water assets as well as improvements and upgrades to the existing water assets. In addition, we will refund \$1.1 million to customers, real estate developers and builders related to previous advances for

construction they provided to Artesian in order to extend water service to their properties.

We also plan to invest \$5.0 million in general plant, which includes new corporate automation, building renovations and transportation and equipment upgrades. Additionally, \$15.9 million will be invested in Artesian Wastewater for ongoing construction of wastewater plants, of which \$12.4 million will be used to construct an 8 mile pipeline and a 67 million gallon storage lagoon for spray irrigation to dispose of treated wastewater from a new industrial customer. Our projected capital expenditures and other investments are subject to periodic review and revision to reflect changes in economic conditions and other factors. The company's investment for 2017 is expected to be offset by developer contributions and advances of \$10.8 million for a net investment of \$40.7 million in 2017.

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Financing

We expect to fund our activities for the next twelve months using our available cash balances, bank credit lines, projected cash generated from operations and financing in the capital markets as necessary.

We have several sources of liquidity to finance our investment in utility plant and other fixed assets. We estimate that the projected investment will be financed by our operations and external sources, including a combination of capital investment as well as short-term borrowings under our revolving credit agreements discussed below.

Our cash flows from operations are primarily derived from water sales revenues and may be materially affected by changes in water sales due to weather and the timing and extent of increases in rates approved by state Public Service Commissions.

Lines of Credit

At December 31, 2016, Artesian Resources had a \$40 million line of credit with Citizens Bank of Pennsylvania, or Citizens, which is available to all subsidiaries of Artesian Resources. As of December 31, 2016, there was \$36.4 million of available funds under this line of credit. The interest rate for borrowings under this line is the London Interbank Offered Rate, or LIBOR, plus 1.00%. This is a demand line of credit and therefore the financial institution may demand payment for any outstanding amounts at any time. The term of this line of credit expires on the earlier of May 26, 2017 or any date on which Citizens demands payment. The Company expects to renew this line of credit.

At December 31, 2016, Artesian Water had a \$20 million line of credit with CoBank, ACB, or CoBank, that allows for the financing of operations for Artesian Water, with up to \$10 million of this line available for the operations of Artesian Water Maryland. As of December 31, 2016, there was \$16.5 million of available funds under this line of credit. The interest rate for borrowings under this line is LIBOR plus 1.50%. CoBank may make an annual patronage refund, which has been equal to 1.00% of the average line of credit and loan volume outstanding by Artesian during each of the years ended December 31, 2016, December 31, 2015, and December 31, 2014. The patronage refunds, associated with all debt with CoBank, earned by Artesian for the years ended December 31, 2016, December 31, 2015 and December 31, 2014 were \$702,000, \$689,000 and \$682,000, respectively. The term of this line of credit expires on July 20, 2017. The Company expects to renew this line of credit.

Line of Credit Commitments Commitment Due by Period

	Less than 1 Year	1-3 Years	4-5 Years	Over 5 Years
In thousands				
Lines of Credit	\$7,130	\$-----	\$-----	\$-----

Long-Term Debt

Artesian Water's trust indentures, which set certain criteria for the issuance of new long-term debt, limit long-term debt, including the short-term portion thereof, to 66 % of total capitalization. Our debt to total capitalization, including the short-term portion thereof, was 42.7% at December 31, 2016. In addition, our revolving line of credit with CoBank contains customary affirmative and negative covenants that are binding on us (which are in some cases subject to certain exceptions), including, but not limited to, restrictions on our ability to make certain loans and investments, guaranty certain obligations, enter into, or undertake, certain mergers, consolidations or acquisitions, transfer certain assets, change our business or incur additional indebtedness. In addition, this line of credit requires us to abide by certain financial covenants and ratios. As of December 31, 2016, we were in compliance with these covenants.

Contractual Obligations	Payments Due by Period				
	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years	Total
In thousands					
First mortgage bonds (principal and interest)	\$5,955	\$33,569	\$8,325	\$110,135	\$157,984
State revolving fund loans (principal and interest)	1,002	2,005	2,005	4,975	9,987
Operating leases	76	110	115	1,394	1,695
Unconditional purchase obligations	3,824	7,649	7,659	-	19,132
Tank painting contractual obligation	426	852	-	-	1,278
Total contractual cash obligations	\$11,283	\$44,185	\$18,104	\$116,504	\$190,076

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Long-term debt obligations reflect the maturities of certain series of our first mortgage bonds, which we intend to refinance when due. The state revolving fund loan obligation has an amortizing mortgage payment payable over a 20-year period, and will be refinanced as future securities are issued. Both the long-term debt and the state revolving fund loan have certain financial covenant provisions, the violation of which could result in default and require the obligation to be immediately repaid, including all interest. We have not experienced conditions that would result in our default under these agreements, and we do not anticipate any such occurrence. Payments for unconditional purchase obligations reflect minimum water purchase obligations based on rates that are subject to change under our interconnection agreement with the Chester Water Authority, which expires December 31, 2021.

On January 18, 2017, Artesian Water and CoBank entered into a Bond Purchase Agreement relating to the issue and sale by the Company to CoBank of a \$40 million principal amount First Mortgage Bond, Series T, or the Bond, due December 20, 2036 (the "Maturity Date"). The Bond was issued pursuant to the Company's Indenture of Mortgage dated as of July 1, 1961, as amended and supplemented by supplemental indentures, including the Twenty-Second Supplemental Indenture (the "Supplemental Indenture"), dated as of January 18, 2017 from the Company to Wilmington Trust Company, as Trustee. The Indenture is a first mortgage lien against substantially all of the Company's utility plant. The proceeds from the sale of the Bond will be use to prepay indebtedness of the Company under two existing First Mortgage Bonds: Series O, principal amount \$20 million with interest rate of 8.17% and related prepayment costs of \$4.5 million; and Series Q, principal amount \$15.4 million with interest rate of 4.75%. The DEPSC approved the issuance of the Bond on December 20, 2016. The DEPSC also approved deferral of the prepayment costs associated with the First Mortgage Bond, Series O.

The Bond carries an annual interest rate of 4.24% through and including the Maturity Date. Interest is payable on June 30th and December 31st of each year, beginning June 30, 2017 until the Company's obligation with respect to the payment of principal, premium (if any) and interest shall be discharged. Overdue payments shall bear interest as provided in the Supplemental Indenture. The term of the Bonds also include certain limitations on the Company's indebtedness.

In order to control purchased power costs, in October 2015 Artesian Water entered into an electric supply contract at a fixed rate that was 11.0% lower than its contract that expired in May 2016 and was less than the rate charged by the local electric supplier at the time of entering into the contract. The new fixed price contract is effective from May 2016 through May 2019.

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

See Note 17 to our Consolidated Financial Statements for a full description of the impact of recent accounting pronouncements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Company is subject to the risk of fluctuating interest rates in the normal course of business. Our policy is to manage interest rates through the use of fixed rate long-term debt and, to a lesser extent, short-term debt. The Company's exposure to interest rate risk related to existing fixed rate, long-term debt is due to the term of the majority of our First Mortgage Bonds, which have final maturity dates ranging from 2018 to 2036, and interest rates ranging from 4.24% to 6.58%, which exposes the Company to interest rate risk as interest rates may drop below the existing fixed rate of the long-term debt prior to such debt's maturity. In addition, the Company has interest rate exposure on \$60 million of variable rate lines of credit with two banks, under which the interim bank loans payable at December 31, 2016 were approximately \$7.1 million. An increase in interest rates will result in an increase in the cost of borrowing on this variable rate line. We are also exposed to market risk associated with changes in commodity prices. Our risks associated with price increases in chemicals, electricity and other commodities are mitigated by our ability to recover our costs through rate increases to our customers. We have also sought to mitigate future significant electric

price increases by signing a multi-year supply contract, at a fixed price.

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SUPPLEMENTARY DATA

CONSOLIDATED BALANCE SHEETS

In thousands

	December 31, 2016	December 31, 2015
ASSETS		
Utility plant, at original cost less accumulated depreciation	\$425,502	\$405,606
Current assets		
Cash and cash equivalents	226	209
Accounts receivable (less allowance for doubtful accounts 2016 - \$263; 2015-\$277)	7,796	6,350
Income tax receivable	150	1,428
Unbilled operating revenues	1,403	1,535
Materials and supplies	1,564	1,713
Prepaid property taxes	1,669	1,591
Prepaid expenses and other	1,827	1,618
Total current assets	14,635	14,444
Other assets		
Non-utility property (less accumulated depreciation 2016-\$611; 2015-\$535)	3,881	3,956
Other deferred assets	3,584	4,176
Total other assets	7,465	8,132
Regulatory assets, net	3,374	3,444
	\$450,976	\$431,626
LIABILITIES AND STOCKHOLDERS' EQUITY		
Stockholders' equity		
Common stock	\$9,127	\$9,058
Preferred stock	—	—
Additional paid-in capital	97,480	95,631
Retained earnings	32,416	27,642
Total stockholders' equity	139,023	132,331
Long-term debt, net of current portion	102,331	103,647
	241,354	235,978
Current liabilities		
Lines of credit	7,130	10,487
Current portion of long-term debt	1,316	1,289
Accounts payable	5,532	4,914
Accrued expenses	1,309	1,254
Overdraft payable	32	546
Accrued interest	1,000	1,032
Customer deposits	864	704
Other	2,145	2,177
Total current liabilities	\$19,328	\$22,403
Commitments and contingencies (Note 10)	—	—
Deferred credits and other liabilities		

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Net advances for construction	\$ 8,169	\$ 8,752
Postretirement benefit obligation	149	230
Utility plant retirement cost obligation	873	883
Deferred investment tax credits	544	562
Deferred income taxes	68,453	62,971
Total deferred credits and other liabilities	\$ 78,188	\$ 73,398
Net contributions in aid of construction	112,106	99,847
	\$ 450,976	\$ 431,626

The notes are an integral part of the consolidated financial statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS

In thousands, except per share amounts

	For the Year Ended December 31,		
	2016	2015	2014
Operating revenues			
Water sales	\$70,587	\$68,932	\$64,667
Other utility operating revenue	3,816	3,694	3,648
Non-utility operating revenue	4,686	4,398	4,150
	79,089	77,024	72,465
Operating expenses			
Utility operating expenses	35,658	36,148	34,893
Non-utility operating expenses	2,602	2,305	2,193
Depreciation and amortization	9,188	8,837	8,673
Taxes			
State and federal income taxes			
Current	2,849	2,667	(900)
Deferred	5,482	5,117	7,275
Property and other taxes	4,491	4,368	4,285
	60,270	59,442	56,419
Operating income	18,819	17,582	16,046
Other income, net			
Allowance for funds used during construction (AFUDC)	222	249	329
Miscellaneous	557	472	524
	779	721	853
Income before interest charges	19,598	18,303	16,899
Interest charges	6,644	6,998	7,393
Net income applicable to common stock	\$12,954	\$11,305	\$9,506
Income per common share:			
Basic	\$1.42	\$1.26	\$1.07
Diluted	\$1.41	\$1.26	\$1.07
Weighted average common shares outstanding:			
Basic	9,098	8,960	8,884
Diluted	9,161	9,005	8,926
Cash dividends per share of common stock	\$0.8997	\$0.8733	\$0.8477

The notes are an integral part of the consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

In thousands

	For the Year Ended December		
	31,		
	2016	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	\$12,954	\$11,305	\$9,506
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	9,188	8,837	8,673
Deferred income taxes, net	5,464	5,097	7,255
Stock compensation	92	183	135
AFUDC, equity portion	(146)	(163)	(212)
Changes in assets and liabilities:			
Accounts receivable, net of allowance for doubtful accounts	(292)	(867)	147
Income tax receivable	1,278	1,640	(2,613)
Unbilled operating revenues	132	1,779	(305)
Materials and supplies	149	177	(405)
Prepaid property taxes	(78)	(190)	90
Prepaid expenses and other	(209)	49	(390)
Other deferred assets	(175)	(167)	(172)
Regulatory assets	734	187	(187)
Accounts payable	618	1,131	(357)
Accrued expenses	55	(259)	(2,197)
Accrued interest	(32)	(396)	374
Customer deposits and other, net	128	102	(832)
Postretirement benefit obligation	(81)	(38)	(41)
NET CASH PROVIDED BY OPERATING ACTIVITIES	29,779	28,407	18,469
CASH FLOWS USED IN INVESTING ACTIVITIES			
Capital expenditures (net of AFUDC, equity portion)	(28,251)	(20,694)	(23,730)
Proceeds from sale of assets	96	48	35
NET CASH USED IN INVESTING ACTIVITIES	(28,155)	(20,646)	(23,695)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net (repayments) borrowings under lines of credit agreements	(3,357)	(8,004)	8,159
Increase (decrease) in overdraft payable	(514)	405	(605)
Net advances and contributions in aid of construction	9,907	5,829	3,808
Net proceeds from issuance of common stock	1,826	3,049	1,651
Dividends paid	(8,180)	(7,811)	(7,523)
Issuance of long-term debt	—	-	689
Principal repayments of long-term debt	(1,289)	(1,263)	(1,132)
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(1,607)	(7,795)	5,047
NET (DECREASE) IN CASH AND CASH EQUIVALENTS	17	(34)	(179)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	209	243	422
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$226	\$209	\$243

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Supplemental Disclosures of Cash Flow Information:

Utility plant received as construction advances and contributions	\$2,499	\$1,451	\$1,491
Contractual amounts of contributions in aid of construction due from developers included in accounts receivable	\$1,542	\$796	\$456
Contractual amounts of contributions in aid of construction received from developers previously included in accounts receivable	\$388	\$377	\$361

Supplemental Disclosures of Cash Flow Information:

Interest paid	\$6,676	\$7,394	\$7,019
Income taxes paid	\$1,434	\$2,608	\$1,615

The notes are an integral part of the consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

In thousands

	Common Shares Outstanding Class A Non-Voting (1) (3) (4)	Common Shares Outstanding Class B Voting (2)	\$1 Par Value Class A Non-Voting	\$1 Par Value Class B Voting	Additional Paid-in Capital	Retained Earnings	Total
Balance as of December 31, 2013	7,948	882	\$ 7,948	\$ 882	\$ 90,841	\$ 22,165	\$ 121,836
Net income	—	—	—	—	—	9,506	9,506
Cash dividends declared							
Common stock	—	—	—	—	—	(7,523)	(7,523)
Issuance of common stock							
Dividend reinvestment plan	21	—	21	—	438	—	459
Employee stock options and awards(4)	44	—	44	—	920	—	964
Employee Retirement Plan(3)	17	—	17	—	346	—	363
Balance as of December 31, 2014	8,030	882	\$ 8,030	\$ 882	\$ 92,545	\$ 24,148	\$ 125,605
Net income	—	—	—	—	—	11,305	11,305
Cash dividends declared							
Common stock	—	—	—	—	—	(7,811)	(7,811)
Issuance of common stock							
Dividend reinvestment plan	18	—	18	—	366	—	384
Employee stock options and awards(4)	111	—	111	—	2,419	—	2,530
Employee Retirement Plan(3)	17	—	17	—	301	—	318
Balance as of December 31, 2015	8,176	882	\$ 8,176	\$ 882	\$ 95,631	\$ 27,642	\$ 132,331
Net income	—	—	—	—	—	12,954	12,954
Cash dividends declared							
Common stock	—	—	—	—	—	(8,180)	(8,180)
Issuance of common stock							
Dividend reinvestment plan	13	—	13	—	387	—	400
Employee stock options and awards(4)	38	—	38	—	939	—	977
Employee Retirement Plan(3)	18	—	18	—	523	—	541
Balance as of December 31, 2016	8,245	882	\$ 8,245	\$ 882	\$ 97,480	\$ 32,416	\$ 139,023

(1) At December 31, 2016, 2015, and 2014, Class A Common Stock had 15,000,000 shares authorized. For the same periods, shares issued, inclusive of treasury shares, were 8,275,010, 8,205,190 and 8,059,654, respectively.

(2) At December 31, 2016, 2015, and 2014, Class B Common Stock had 1,040,000 shares authorized and 882,000 shares issued.

(3) Artesian Resources Corporation registered 500,000 shares of Class A Common Stock available for purchase through the Artesian Retirement Plan and the Artesian Supplemental Retirement Plan.

(4) Under the Equity Compensation Plan, effective December 9, 2015 Artesian Resources Corporation authorized up to 331,500 shares of Class A Common Stock for issuance of grants in forms of stock options, stock units, dividend

equivalents and other stock-based awards, subject to adjustment in certain circumstances as discussed in the Plan.

The notes are an integral part of the consolidated financial statements.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The audited consolidated financial statements are presented in accordance with the requirements of Form 10-K and accounting principles generally accepted in the United States and consequently include all the disclosures required in the consolidated financial statements included in the Company's annual report on Form 10-K. The accompanying consolidated financial statements include the accounts of Artesian Resources Corporation and its subsidiaries and all intercompany balances and transactions between subsidiaries have been eliminated.

Reclassification

Certain accounts in the prior year financial statements have been reclassified for comparative purposes to conform with the presentation in the current year financial statements. These reclassifications had no effect on net income or stockholders' equity.

In 2016, the Company adopted amended guidance on the Presentation of Debt Issuance Costs and amended guidance on Income Taxes, both of which were issued by the Financial Accounting Standards Board, or FASB, in 2015. The amended guidance on the Presentation of Debt Issuance Costs requires entities to present debt issuance costs related to a debt liability as a direct deduction from the carrying amount of that debt liability on the balance sheet as opposed to being presented as a deferred charge. The amended guidance on Income Taxes simplified the presentation of deferred income taxes, permitting all deferred income tax liabilities be classified as noncurrent on the balance sheet.

For all periods presented in this Form 10-K for the year ended December 31, 2016, unamortized debt issuance costs related to the Company's long-term debt are reported on the Condensed Consolidated Balance Sheets within "Regulatory Assets, Net" under FASB ASC Topic 980 as this amount will be recovered in future rates charged to our customers. Prior to adoption, the Company reported the unamortized debt issuance costs in "Other Assets" on the Condensed Consolidated Balance Sheets. Deferred income taxes are reported as noncurrent on the Condensed Consolidated Balance Sheets. Prior to adoption, the Company reported current and noncurrent deferred income tax liabilities as separate amounts on the Condensed Consolidated Balance Sheets.

Utility Subsidiary Accounting

The accounting records of Artesian Water Company, Inc., or Artesian Water, and Artesian Wastewater Management, Inc., or Artesian Wastewater, are maintained in accordance with the uniform system of accounts as prescribed by the Delaware Public Service Commission, or the DEPSC. The accounting records of Artesian Water Pennsylvania, Inc., or Artesian Water Pennsylvania, are maintained in accordance with the uniform system of accounts as prescribed by the Pennsylvania Public Utility Commission, or the PAPUC. The accounting records of Artesian Water Maryland, Inc., or Artesian Water Maryland, and Artesian Wastewater Maryland, Inc., or Artesian Wastewater Maryland, are maintained in accordance with the uniform system of accounts as prescribed by the Maryland Public Service Commission, or the MDPSC. All five subsidiaries follow the provisions of FASB ASC Topic 980, which provides guidance for companies in regulated industries. These regulated subsidiaries account for the majority of our operating revenue. The operating revenues of our non-regulated division are presented in the Consolidated Statements of Operations.

Utility Plant

Utility plant is stated at original cost. Cost includes direct labor, materials, AFUDC (see description below) and indirect charges for such capitalized items as transportation, supervision, pension, medical, and other fringe benefits related to employees engaged in construction activities. When depreciable units of utility plant are retired, any cost associated with retirement, less any salvage value or proceeds received, is charged to the regulated retirement liability. Maintenance, repairs, and replacement of minor items of plant are charged to expense as incurred.

In accordance with a rate order issued by the DEPSC, Artesian Water accrues an Allowance for Funds Used during Construction, or AFUDC. AFUDC, which represents the cost of funds devoted to construction projects through the date the project is placed in service, is capitalized as part of construction work in progress. The rate used for the AFUDC calculation is based on Artesian Water's weighted average cost of debt and the rate of return on equity authorized by the DEPSC. The rate used to capitalize AFUDC in 2016, 2015, and 2014 was 8.1%, 8.1%, and 8.2% respectively.

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Utility plant comprises:

In thousands

		December 31,	
	Estimated Useful Life (In Years)	2016	2015
Utility plant at original cost			
Utility plant in service-Water			
Intangible plant	—	\$ 140	\$ 140
Source of supply plant	45-85	19,627	19,313
Pumping and water treatment plant	8-62	78,542	77,221
Transmission and distribution plant			
Mains	81	236,261	224,104
Services	39	38,803	36,060
Storage tanks	76	24,108	23,992
Meters	26	24,710	24,150
Hydrants	60	12,870	12,037
General plant	3-31	53,417	52,434
Utility plant in service-Wastewater			
Treatment and disposal plant	35-62	15,613	14,012
Collection mains & lift stations	81	8,675	7,833
General plant	3-31	931	906
Property held for future use	—	14,815	14,345
Construction work in progress	—	6,674	3,809
		535,186	510,356
Less – accumulated depreciation		109,684	104,750
		\$425,502	\$405,606

Depreciation and Amortization

For financial reporting purposes, depreciation is recorded using the straight-line method at rates based on estimated economic useful lives, which range from 3 to 85 years. Composite depreciation rates for water utility plant were 2.25%, 2.29% and 2.30% for 2016, 2015 and 2014, respectively. In a rate order issued by the DEPSC, the Company was directed effective January 1, 1998 to begin using revised depreciation rates for utility plant. In rate orders issued by the DEPSC, Artesian Water was directed, effective May 28, 1991 and August 25, 1992, to offset depreciation recorded on utility plant by depreciation on utility property funded by Contributions in Aid of Construction, or CIAC, and Advances for Construction, or Advances, respectively. This reduction in depreciation expense is also applied to outstanding CIAC and Advances. Other deferred assets are amortized using the straight-line method over applicable lives, which range from 2 to 40 years.

Utility Plant Retirement Cost Obligation

The utility plant retirement cost obligation consists of estimated costs related to the potential removal and replacement of facilities and equipment on the Company's water and wastewater properties. Effective January 1, 2012, as authorized by the DEPSC, when depreciable units of utility plant are retired, any cost associated with retirement, less any salvage value or proceeds received is charged to a regulated retirement liability. Each year the liability is

increased by an annual amount authorized by the DEPSC. Previously, when depreciable units of utility plant were retired, the cost of retired property, together with any cost associated with retirement less any salvage value or proceeds received, was charged to accumulated depreciation. Maintenance, repairs, and replacement of minor items of plant are charged to expense as incurred.

Regulatory Assets

FASB ASC Topic 980 stipulates generally accepted accounting principles for companies whose rates are established or subject to approvals by a third-party regulatory agency. Certain expenses are recoverable through rates charged to our customers, without a return on investment, and are deferred and amortized during future periods using various methods as permitted by the Delaware Public Service Commission, or DEPSC, the Maryland Public Service Commission, or MDPSC, and the Pennsylvania Public Utility Commission, or PAPUC.

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The postretirement benefit obligation is the recognition of an offsetting regulatory asset as it relates to the accrual of the expected cost of providing postretirement health care and life insurance benefits to retired employees when they render the services necessary to earn the benefits. Artesian Water contributed \$81,000 to its postretirement benefit plan in 2016. These contributions consist of insurance premium payments for medical, dental and life insurance benefits made on behalf of the Company's eligible retired employees.

The deferred income taxes will be amortized over future years as the tax effects of temporary differences that previously flowed through to our customers are reversed.

Other regulatory expenses are amortized on a straight-line basis as noted below:

Expense	Years Amortized
Depreciation and salary studies	5
Delaware rate proceedings	2.5
Maryland rate proceedings	5
	10 to 30
Debt issuance costs (as of December 31, 2016)	(based on term of related debt)
	15 to 25
Debt issuance costs (after First Mortgage Bond Purchase in January 2017)	(based on term of related debt)
	50
Goodwill (resulting from acquisition of Mountain Hill Water Company in 2008)	50
Deferred acquisition costs (resulting from purchase of water assets in Cecil County, Maryland in 2011 and Port Deposit, Maryland in 2010)	20
Franchise Costs (resulting from purchase of water assets in Cecil County, Maryland in 2011)	80

Regulatory assets, net of amortization, comprise:

(in thousands)	December 31, 2016	December 31, 2015
Postretirement benefit obligation	\$ 186	\$ 329
Deferred income taxes	431	446
Expense of rate and regulatory proceedings	116	616
Debt issuance costs	1,648	1,747
Goodwill	310	318
Deferred acquisition and franchise costs	683	720
	\$ 3,374	\$ 4,176

Impairment or Disposal of Long-Lived Assets

Our long-lived assets consist primarily of utility plant in service and regulatory assets. A review of our long-lived assets is performed in accordance with the requirements of FASB ASC Topic 360. In addition, the regulatory assets are reviewed for the continued application of FASB ASC Topic 980. The review determines whether there have been changes in circumstances or events that have occurred requiring adjustments to the carrying value of these assets. FASB ASC Topic 980 stipulates that adjustments to the carrying value of these assets would be made in instances where the inclusion in the rate-making process is unlikely.

Other Deferred Assets

The investment in Co-Bank, which is a cooperative bank, is related to certain outstanding First Mortgage Bonds and is a required investment in the bank based on the underlying long term debt agreements. A large portion of the remaining other deferred assets, approximately \$0.3 million, is in relation to the Mountain Hill acquisition.

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Other deferred assets at December 31, net of amortization, comprise:

In thousands	2016	2015
Investment in CoBank	\$3,198	\$3,023
Other	386	421
	\$3,584	\$3,444

Advances for Construction

Cash advances to reimburse Artesian Water for its costs to construct water mains, services and hydrants are contributed to Artesian Water by real estate developers and builders in order to extend water service to their properties. The Company only accepts advances related to new phases of existing developments that are grandfathered into the refundable arrangement through pre-existing contracts. The value of these contributions is recorded as Advances for Construction. Artesian Water makes refunds on these advances over a specific period of time based on operating revenues generated by the specific plant or as new customers are connected to the mains. After all refunds are made within the contract period, any remaining balance is transferred to CIAC.

Contributions in Aid of Construction

CIAC includes the non-refundable portion of advances for construction and direct contributions of water mains, services and hydrants, and wastewater treatment facilities and collection systems, or cash to reimburse our water and wastewater divisions for costs to construct water mains, services and hydrants, and wastewater treatment and disposal plant.

Income Taxes

Deferred income taxes are provided in accordance with FASB ASC Topic 740 on all differences between the tax basis of assets and liabilities and the amounts at which they are carried in the consolidated financial statements based on the enacted tax rates expected to be in effect when such temporary differences are expected to reverse. Under FASB ASC Topic 740, an uncertain tax position represents our expected treatment of a tax position taken, or planned to be taken in the future, that has not been reflected in measuring income tax expense for financial reporting purposes. In 2014, the Company changed its tax method of accounting for qualifying utility system repairs effective with the tax year ended December 31, 2014 and for prior tax years. The tax accounting method was changed to permit the expensing of qualifying utility asset improvement costs that were previously being capitalized and depreciated for book and tax purposes.

The Company establishes reserves for uncertain tax positions based upon management's judgment as to the sustainability of these positions. These accounting estimates related to the uncertain tax position reserve require judgments to be made as to the sustainability of each uncertain tax position based on its technical merits. The Company believes its tax positions comply with applicable law and that it has adequately recorded reserves as required. However, to the extent the final tax outcome of these matters is different than the estimates recorded, the Company would then adjust its tax reserves or unrecognized tax benefits in the period that this information becomes known. The Company has elected to recognize accrued interest (net of related tax benefits) and penalties related to uncertain tax positions as a component of its income tax expense. The Company remains subject to examination by federal authorities for the tax year 2015 and state authorities for the tax years 2013 through 2015. The Company was under federal audit by the Internal Revenue Service for tax years 2012 through 2014 during 2016. The audit was concluded during the year resulting in no change to the tax liability.

The Tax Reform Act of 1986 mandated that Advances and CIAC received subsequent to December 31, 1986, generally are taxable income. The 1996 Tax Act provided an exclusion from taxable income for CIAC and Advances received after June 12, 1996 except for certain contributions for large services that are not included in rate base for rate-making purposes.

Investment tax credits were deferred through 1986 and are recognized as a reduction of deferred income tax expense over the estimated economic useful lives of the related assets.

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Stock Compensation Plans

On December 9, 2015, the Company's stockholders approved the 2015 Equity Compensation Plan, or the 2015 Plan. The 2015 Plan replaced the 2005 Equity Compensation Plan, or the 2005 Plan, which expired on May 24, 2015. The 2015 Plan authorizes an aggregate number of shares of our Class A common stock that may be issued or transferred under the Plan equal to the sum of: 331,500 shares, plus the number of shares of Class A common stock subject to outstanding grants under the 2005 Plan as of December 9, 2015 that terminate, expire or are cancelled, forfeited, exchanged or surrendered without having been exercised, vested or paid under the 2005 Plan. The Company accounts for stock options issued after January 1, 2006 under FASB ASC Topic 718. Compensation costs for restricted stock grants and options were \$92,000, \$183,000 and \$135,000 in 2016, 2015 and 2014, respectively. Cost for options and restricted stock grants were determined based on the fair value at the grant dates and those costs were charged to income over the associated service periods. The \$135,000 in 2014 was the amount amortized for stock options awarded in 2014 and 2013. The \$183,000 in 2015 was the amount amortized for restricted stock awarded in 2015 and stock options awarded in 2014. The \$92,000 in 2016 was the amount amortized for restricted stock awarded in 2016. As of December 31, 2016 there is \$47,000 unrecognized expense related to non-vested awards of restricted shares granted under the 2015 Plan.

There was no stock compensation cost capitalized as part of an asset.

Stock Options

The fair value of each option grant is estimated using the Black-Scholes-Merton option pricing model with the following weighted-average assumptions used for grants issued in 2014 under the 2005 Equity Compensation Plan (See Note 8 "Stock Compensation Plans"). No options were granted in 2015 or 2016.

	2014
Expected Dividend Yield	3.88%
Expected Stock Price Volatility	26.50%
Weighted Average Risk Free Interest Rate	2.24%
Weighted Average Expected Life of Options (in years)	7.52

The expected dividend yield was based on a 12 month rolling average of the Company's current dividend yield. The expected volatility is the standard deviation of the change in the natural logarithm of the stock price (expressed as an annual rate) for the expected term shown above. The expected term was based on historic exercise patterns for similar grants. The risk free interest rate for the 2014 options is the weighted average of the 7-year and 10-year US Treasury Yield rates.

Shares of Class A Stock have been reserved for future issuance under the 2015 Equity Compensation Plan.

Stock Awards

On May 4, 2016, 5,000 shares of Class A common stock were granted as restricted stock awards. The fair market value per share was \$27.70, the closing price of the Class A common stock as recorded on the Nasdaq Global Market on May 4, 2016. The restricted shares vest one year from the date of grant. A total of \$92,000 was recorded as compensation cost for the awards granted in May 2016.

On December 18, 2015 5,000 shares of Class A common stock were issued as fully vested unrestricted stock awards. The fair market value per share was \$27.38, the closing price of the Class A common stock as recorded on the Nasdaq Global market on December 18, 2015. A total of \$137,000 was recorded as compensation cost for the stock awards granted in December 2015.

Revenue Recognition and Unbilled Revenues

Water service revenue for financial statement purposes includes amounts billed to Delaware customers on a monthly basis, amounts billed to Maryland customers on a quarterly or monthly cycle basis, depending on water system, and amounts billed to Pennsylvania customers on a quarterly basis. Water service revenues also include unbilled amounts based upon estimated usage from the date of the last meter reading to the end of the accounting period. As actual usage amounts are received, adjustments are made to the unbilled estimates in the next billing cycle based on an accrual basis.

Other utility operating revenue includes wastewater service revenue derived from monthly fixed fees billed to customers, and is recognized on an accrual basis.

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Non-utility operating revenue is primarily derived from Service Line Protection Plans and from the design, construction and operation of contract water and wastewater projects. The Company recognizes non-utility operating revenue ratably over the service period with markup for overhead and profit. The Company records contract monthly fees for non-utility operating revenue when billed to the customer. Service line protection plan revenues are recognized on an accrual basis.

Accounts Receivable

Accounts receivable are recorded at the invoiced amounts. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in our existing accounts receivable. The Company reviews the allowance for doubtful accounts on a quarterly basis. Account balances are written off against the allowance when it is probable the receivable will not be recovered. The allowance for doubtful accounts was \$0.3 million and \$0.3 million at December 31, 2016 and December 31, 2015 respectively. The corresponding expense for the year ended December 31, 2016 and 2015 was \$0.2 million and \$0.2 million, respectively. The following table summarizes the changes in the Company's accounts receivable balance:

In thousands	December 31,		
	2016	2015	2014
Customer accounts receivable – water	\$5,437	\$5,017	\$4,020
Contractual amounts due from developers and other	2,622	1,610	1,295
	8,059	6,627	5,315
Less allowance for doubtful accounts	263	277	250
Net accounts receivable	\$7,796	\$6,350	\$5,065

The activities in the allowance for doubtful accounts are as follows:

In thousands	December 31,		
	2016	2015	2014
Beginning balance	\$277	\$250	\$221
Allowance adjustments	195	205	194
Recoveries	64	53	64
Write off of uncollectible accounts	(273)	(231)	(229)
Ending balance	\$263	\$277	\$250

Cash and Cash Equivalents

For purposes of the Consolidated Statement of Cash Flows, Artesian Resources considers all temporary cash investments with an original maturity of three months or less to be cash equivalents. Artesian Resources and its subsidiaries utilize their bank's zero balance account disbursement service to reduce the use of their lines of credit by funding checks as they are presented to the bank for payment rather than at issuance. If the checks currently outstanding, but not yet funded, exceed the cash balance on our books, the net liability is recorded as a current liability on the Consolidated Balance Sheet in the Overdraft Payable account.

Use of Estimates in the Preparation of Consolidated Financial Statements

The consolidated financial statements were prepared in conformity with generally accepted accounting principles in the U.S., which require management to make estimates about the reported amounts of assets and liabilities including

unbilled revenues, reserve for a portion of revenues received under temporary rates and regulatory asset recovery and contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management's estimate.

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NOTE 2

FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value.

Current Assets and Liabilities

For those current assets and liabilities that are considered financial instruments, the carrying amounts approximate fair value because of the short maturity of those instruments.

Long-term Financial Liabilities

All of Artesian Resources' outstanding long-term debt as of December 31, 2016 and December 31, 2015 was fixed-rate. The fair value of the Company's long-term debt is determined by discounting their future cash flows using current market interest rates on similar instruments with comparable maturities consistent with FASB ASC 825. Under the fair value hierarchy, the fair value of the long-term debt in the table below is classified as Level 2 measurements. The fair values for long-term debt differ from the carrying values primarily due to interest rates that differ from the current market interest rates. The carrying amount and fair value of Artesian Resources' long-term debt are shown below:

In thousands	December 31,	
	2016	2015
Carrying amount	\$103,647	\$104,936
Estimated fair value	111,864	120,243

The fair value of Advances for Construction cannot be reasonably estimated due to the inability to accurately estimate the timing and amounts of future refunds expected to be paid over the life of the contracts. Refund payments are based on the water sales to new customers in the particular development constructed. The fair value of Advances for Construction would be less than the carrying amount because these financial instruments are non-interest bearing.

NOTE 3

INCOME TAXES

Deferred income taxes reflect temporary differences between the valuation of assets and liabilities for financial and tax reporting.

As of December 31, 2016, Artesian Resources had fully utilized all of its federal net operating loss carrybacks and carry-forwards. As of December 31, 2016, Artesian Resources has separate company state net operating loss carry-forwards aggregating approximately \$13.4 million. These net operating loss carry-forwards will expire if unused between 2019 and 2037. Artesian Resources has recorded a valuation allowance to reflect the estimated amount of deferred tax assets that may not be realized due to the expiration of the state net operating loss carry-forwards. The valuation allowance increased to approximately \$286,000 in 2016 from approximately \$182,000 in 2015. Management believes that it is more likely than not that the Company will realize the benefits of these net deferred tax assets.

At December 31, 2016, for federal income tax purposes, there were alternative minimum tax credit carry-forwards aggregating \$2.5 million resulting from the payment of alternative minimum tax in prior years. These alternative minimum tax credit carry-forwards may be carried forward indefinitely to offset future regular federal income taxes. The Company remains subject to examination by federal authorities for the tax year 2015 and state authorities for the tax years 2013 through 2015.

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Components of Income Tax Expense

In thousands	For the Year Ended		
	December 31,		
State income taxes	2016	2015	2014
Current	\$1,050	\$499	\$173
Deferred	860	1,299	1,231
Total state income tax expense	\$1,910	\$1,798	\$1,404

In thousands	For the Year Ended		
	December 31,		
Federal income taxes	2016	2015	2014
Current	\$1,799	\$2,168	\$(1,073)
Deferred	4,622	3,818	6,044
Total federal income tax expense	\$6,421	\$5,986	\$4,971

Reconciliation of effective tax rate:

In thousands	For the Year Ended December 31,					
	2016	2016	2015	2015	2014	2014
	Amount	Percent	Amount	Percent	Amount	Percent
Reconciliation of effective tax rate						
Income before federal and state income taxes	\$21,285	100.0 %	\$19,088	100.0 %	\$15,881	100.0 %
Amount computed at statutory rate	7,237	34.0 %	6,490	34.0 %	5,400	34.0 %
Reconciling items						
State income tax-net of federal tax benefit	1,327	6.2 %	1,214	6.4 %	918	5.8 %
Other	(233)	(1.1)%	80	0.4 %	57	0.4 %
Total income tax expense and effective rate	\$8,331	39.1 %	\$7,784	40.8 %	\$6,375	40.2 %

Deferred income taxes at December 31, 2016, 2015, and 2014 were comprised of the following:

In thousands	For the Year Ended December		
	31,		
	2016	2015	2014
Deferred tax assets related to:			
Federal alternative minimum tax credit carry-forwards	\$2,474	\$3,971	\$5,459
Federal and state operating loss carry-forwards	752	675	1,045
Bad debt allowance	104	110	99
Valuation allowance	(286)	(182)	(65)
Stock options	452	415	397
Other	320	291	269
Total deferred tax assets	\$3,816	\$5,280	\$7,204
Deferred tax liabilities related to:			
Property plant and equipment basis differences	\$(70,711)	\$(66,508)	\$(63,427)
Uncertain tax position	(80)	(247)	(179)
Expenses of rate proceedings	(19)	(213)	(214)
Property taxes	(663)	(527)	(505)
Other	(796)	(756)	(734)
Total deferred tax liabilities	\$(72,269)	\$(68,251)	\$(65,059)

Net deferred tax liability	\$(68,453)	\$(62,971)	\$(57,855)
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