(In thousands of dollars, except per share amounts)

Acquisitions

Heater – Pursuant to our strategy to grow through acquisitions, on June 1, 2004 the Company acquired the capital stock of Heater Utilities, Inc. for $48,000 in cash and the assumption of long-term debt of $19,219 and short-term debt of $8,500. The acquired operation provides water and wastewater service to over 50,000 water and wastewater customers primarily in the areas of suburban Raleigh, Charlotte, Gastonia and Fayetteville, North Carolina. For the fiscal year ended December 31, 2003, Heater had operating revenues of $19,489. The acquisition was accounted for as a purchase and accordingly, the purchase price is allocated to the net tangible and intangible assets based upon their estimated fair values at the date of the acquisition. The Company obtained a third-party valuation of these assets and liabilities, and it resulted in the recording of a purchase accounting fair value adjustment of $3,141 to increase the carrying-value of long-term debt assumed. The purchase price allocation is as follows:

	June 1, 2004
Property, plant and equipment, net	$ 96,779
Current assets	4,133
Other long-term assets	6,005
Goodwill	18,842
Total assets acquired	125,759
Current liabilities	3,063
Loans payable	8,500
Long-term debt	22,360
Other long-term liabilities	43,836
Total liabilities assumed	77,759
Net assets acquired	$ 48,000

The Company has recorded goodwill of $18,842, and a substantial portion of the goodwill is expected to be deductible for tax purposes. The purchase price was arrived at through arms-length negotiations with the seller and is consistent with the multiples paid in other comparable transactions. Aqua America considered important regulatory, strategic and valuation considerations in arriving at the final purchase price. During 2004, through the North Carolina Utilities Commission approval process, a mechanism has been developed through which the Company could recover up to two-thirds of the goodwill through customer rates in the future upon achieving certain objectives. The Company intends to pursue these objectives to facilitate recognition of this premium in customer rates. However, there can be no assurance that the Company will be able to achieve these objectives and recover such amount of goodwill, if any.

Florida Water - On June 30, 2004, the Company acquired certain utility assets of Florida Water Services Corporation, comprised of 63 water and wastewater systems located in central Florida for $14,747 in cash, which is less than the depreciated original cost of these assets. In accordance with Florida procedures, the acquisition remains subject to regulatory approval by the Florida Public Service Commission. This process is not expected to be completed prior to September 2005. Under the terms of the purchase agreement, the Commission's review process may result in an adjustment of the final purchase price, which would be settled in cash, based on the Commission's determination of plant investment for the systems. Since the purchase price adjusts by the change in the determined plant investment or rate base, effectively the rate base adjustment is directly offset by the change in purchase price. The final purchase price is not expected to result in the recognition of goodwill.

(In thousands of dollars, except per share amounts)

AquaSource - Pursuant to our strategy to grow through acquisitions, on July 31, 2003, the Company completed its acquisition of four operating water and wastewater subsidiaries of AquaSource, Inc. (a subsidiary of DQE, Inc.), including selected, integrated operating and maintenance contracts and related assets (individually and collectively the acquisition is referred to as "AquaSource") for $190,717 in cash, as adjusted pursuant to the purchase agreement based on working capital at closing. On August 27, 2004, we were awarded and received $12,289 plus interest in an arbitration related to the calculation of the final purchase price under the terms of the purchase agreement, which resulted in a final purchase price of $178,428. In the consolidated statement of cash flow for 2004, the $12,289 award has been reported as proceeds on the line titled acquisitions of water and wastewater systems, net.

The results of AquaSource have been included in the Company's consolidated financial statements beginning August 1, 2003. The acquired operations of AquaSource serve over 130,000 water and wastewater customer accounts in 11 states (including the Connecticut and Kentucky operations which were subsequently sold to other parties). Please refer to the Dispositions footnote for a discussion of the AquaSource operations located in Connecticut, Kentucky and New York. The AquaSource acquisition was initially funded by a portion of the proceeds from the July 2003 issuance of $135,000 of unsecured notes due 2023, with an interest rate of 4.87%, and the issuance of a $90,000 unsecured note by Aqua America. In August 2003, the $90,000 unsecured note was repaid with the proceeds from the issuance of 5,000,000 shares of common stock through a shelf registration.

Under the purchase method of accounting, the purchase price is allocated to AquaSource's net tangible and intangible assets based upon their estimated fair values at the date of the acquisition. The purchase price allocation, which reflects the effects of the August 2004 purchase price arbitration proceeding, is as follows:

	July 31, 2003
Property, plant and equipment, net	$ 197,719
Current assets	9,687
Other long-term assets	14,204
Assets held for sale, net	4,096
Total assets acquired	225,706
Current liabilities	8,214
Long-term debt	7,170
Other long-term liabilities	31,894
Total liabilities assumed	47,278
Net assets acquired	$ 178,428

The following supplemental pro forma information is presented to illustrate the effects of the AquaSource acquisition, which was completed on July 31, 2003, on the historical operating results for the year ended December 31, 2003 and 2002 as if the acquisition had occurred at the beginning of the respective periods (unaudited):

	Years Ended December 31, 2003	Years Ended December 31, 2002
Operating revenues	$ 407,628	$ 391,569
Net income	$ 74,436	$ 72,420
Net income per common share:		
Basic	$ 0.81	$ 0.80
Diluted	$ 0.81	$ 0.79

The supplemental information is not necessarily representative of the actual results that may have occurred for these periods or of the results that may occur in the future. This information does not reflect the effects of recent rate increases or cost savings that may result from the acquisition, such as the effects of a reduction in administrative costs. This information is based upon the historical operating results of AquaSource for periods prior to the acquisition date of July 31, 2003 as provided to the Company by AquaSource, Inc. and DQE, Inc. management.

Other Acquisitions - During 2004, in addition to the Heater and Florida Water acquisitions, the Company completed 27 acquisitions or other growth ventures in the various states in which the Company operates for an aggregate purchase price of $3,842 in cash. The operating revenues included in the consolidated financial statements of the Company during the period owned by the Company were $617.

During 2003, in addition to the AquaSource acquisition, the Company completed 17 acquisitions or other growth ventures in the various states in which the Company operates for an aggregate purchase price of $1,614 in cash. Operating revenues included in the consolidated financial statements of the Company related to these systems were $860 in 2004 and $312 in 2003.

During 2002, the Company completed 25 acquisitions or other growth ventures in various states. The total purchase price of $11,659 for the systems acquired in 2002 consisted of $8,914 in cash and the issuance of 178,864 shares of the Company's common stock. Operating revenues included in the consolidated financial statements of the Company related to the systems acquired in 2002 were $2,932 in 2004, $2,920 in 2003 and $1,341 in 2002.

Dispositions

In December 2004, as a result of the settlement of a condemnation action, the Company's Ohio operating subsidiary sold its water utility assets within the municipal boundaries of the City of Geneva in Ashtabula County, Ohio for net proceeds of approximately $4,716, which was in excess of the book value for these assets. The proceeds were used to pay-down short-term debt and the sale resulted in the recognition in the fourth quarter of 2004 of a gain on the sale of these assets, net of expenses, of $2,342. The gain is reported in the 2004 consolidated statement of income as a reduction to operations and maintenance expense. We continue to operate this water system for the City of Geneva under an operating contract that began upon the closing of the sale for a period through December 2006. The operating contract provides for an annual base operating fee of $135 and allows for additional fees to be earned commensurate with the services provided. These water utility assets represent less than 1% of Aqua America's total assets, and the total number of customers included in the water system sold represents less than 1% of our total customer base.

In July 2004, the Company sold it only operations in Kentucky. The sale price approximates our investment in this operation. The operation represented approximately 0.2% of the operations acquired from AquaSource, Inc. In October 2003, the Company sold its only operation in Connecticut. The sale price of $4,000 approximates our investment in this operation. The operation represented approximately 2% of the operations acquired from AquaSource, Inc. In May 2003, the Company announced an agreement for the sale of the AquaSource regulated operation located in New York to a New England-based water company. In January 2005, after the expiration of the sale agreement, the Company did not renew the sale agreement. The New York operations represented approximately 1% of the operations acquired from AquaSource, Inc.

In December 2002, as a result of the settlement of a condemnation action, the Company's Ohio operating subsidiary sold to Ashtabula County, Ohio the water utility assets in the unincorporated areas of Ashtabula County and the area within the Village of Geneva on the Lake for $12,118, net of certain closing costs. The sale was in excess of the book value for these assets and the sale generated a gain of $5,676 (or an after-tax gain of $3,690 and $0.04 per share) recorded in the fourth quarter of 2002. We continue to operate this water system for Ashtabula County, beginning after the closing of the sale, under a multi-year operating contract. The water utility assets sold represent less than 1% of our total assets, and the total number of customers included in the water system sold represents less than 1% of our total customer base.

(In thousands of dollars, except per share amounts)

The City of Fort Wayne, Indiana has authorized the acquisition, by eminent domain or otherwise, of a portion of the utility assets of one of the operating subsidiaries that the Company acquired in connection with the AquaSource acquisition in 2003. The Company has challenged whether the City is following the correct legal procedures in connection with the City's attempted condemnation and the Company has challenged the City's valuation of this portion of its system. The portion of the system under consideration represents approximately 1% of the Company's total customer base. While the Company continues to discuss this matter with officials from the City of Fort Wayne, the Company continues to protect its interests in this proceeding. The Company believes that it will be entitled to fair market value for its assets if they are condemned, and it is believed that the fair market value will be in excess of the book value for such assets.

Property, Plant and Equipment

	December 31, 2004	December 31, 2003	Approximate range of remaining lives
Utility plant and equipment:			
Mains and accessories	$ 1,087,712	$ 962,439	15 to 85 years
Services, hydrants, treatment plants and reservoirs	607,331	547,622	5 to 56 years
Operations structures and water tanks	218,888	175,663	15 to 61 years
Miscellaneous pumping and purification equipment	342,985	259,468	10 to 50 years
Meters, data processing, transportation and operating equipment	298,015	251,721	5 to 50 years
Land and other non-depreciable assets	67,260	58,223	-
Utility Plant and equipment	2,622,191	2,255,136	
Utility construction work in progress	63,754	92,106	-
Net utility plant acquisition adjustment	(63,347)	(48,054)	0 to 20 years
Non-utility plant and equipment	3,553	3,116	2 to 40 years
Total property, plant and equipment	$ 2,626,151	$ 2,302,304	

Accounts Receivable

	December 31, 2004	December 31, 2003
Billed utility revenue	$ 39,783	$ 41,843
Unbilled utility revenue	27,927	23,876
Other	1,677	2,452
	69,387	68,171
Less allowance for doubtful accounts	4,849	5,851
Net accounts receivable	$ 64,538	$ 62,320

The Company's customers are located principally in the following states: 49% in Pennsylvania, 10% in Ohio, 8% in North Carolina, 8% in Illinois, 6% in Texas, 5% in New Jersey, 4% in Florida, and 4% in Indiana. No single customer accounted for more than one percent of the Company's operating revenues during the years ended December 31, 2004, 2003 or 2002. The following table summarizes the changes in the Company's allowance for doubtful accounts:

(In thousands of dollars, except per share amounts)

	2004	2003	2002
Balance at January 1,	$ 5,851	$ 3,580	$ 2,482
Amounts charged to expense	2,621	2,643	3,182
Accounts written off	(4,255)	(2,715)	(2,375)
Recoveries of accounts written off	556	253	291
Allowance acquired through acquisitions	76	2,090	-
Balance at December 31,	$ 4,849	$ 5,851	$ 3,580

Regulatory Assets and Liabilities

The regulatory assets represent costs that are expected to be fully recovered from customers in future rates while regulatory liabilities represent amounts that are expected to be refunded to customers in future rates or amounts recovered from customers in advance of incurring the costs. Except for income taxes and the competitive transition charge payment, regulatory assets and regulatory liabilities are excluded from the Company's rate base and do not earn a return. The components of regulatory assets and (liabilities) are as follows:

	December 31, 2004	2003
Income taxes, asset	$ 68,990	$ 68,917
Income taxes, liability	(3,283)	(3,434)
CTC payment	6,879	8,026
Postretirement benefits	11,403	6,698
Merger costs	2,170	2,700
Water tank painting	4,593	3,240
Utility plant retirement costs, asset	14,729	13,699
Utility plant retirement costs, liability	(8,184)	(7,484)
Rate case filing expenses & other	13,696	6,399
	$ 110,993	$ 98,761

Items giving rise to deferred state income taxes, as well as a portion of deferred Federal income taxes related to certain differences between tax and book depreciation expense, are recognized in the rate setting process on a cash or flow-through basis and will be recovered as they reverse. The regulatory asset associated with the Competitive Transition Charge ("CTC") payment represents the full payoff in 2001, net of amortization, of the allocable share of a CTC as negotiated by Aqua Pennsylvania, Inc. from its electric distribution company, PECO Energy Company. The Pennsylvania Electricity Generation Customer Choice and Competition Act permitted electric distribution utilities to recover their stranded costs from its customers in the form of a CTC. Rate recovery of the $11,465 CTC payment began in 2000 and is expected to conclude in 2010.

Postretirement benefits include pension and other postretirement benefits. The pension costs include deferred net pension expense in excess of amounts funded which the Company believes will be recoverable in future years as pension funding is required, and in addition includes an additional minimum liability for pensions as a result of a decline in the discount rate assumed for pension obligations and a change in the fair market value of plan assets. The additional minimum liability equals the excess of the accumulated benefit obligation over the fair value of plan assets. The regulatory asset related to postretirement benefits other than pensions represents costs that were deferred between the time that the accrual method of accounting for these benefits was adopted in 1993 and the recognition of the accrual method in the Company's rates as prescribed in subsequent rate filings. Amortization of the amount deferred for postretirement benefits other than pensions began in 1994 and is currently being recovered in rates.

(In thousands of dollars, except per share amounts)

The regulatory asset related to the recovery of merger costs represents the portion of the Consumers Water Company merger costs that will be recovered in rates as a result of a rate settlement in 2000 and is being amortized over the recovery period. Expenses associated with water tank painting are deferred and amortized over a period of time as approved in the regulatory process. The regulatory asset for utility plant retirement costs, including cost of removal, represents costs already incurred that are expected to be recovered in future rates over a five year recovery period. The regulatory liability for utility plant retirement costs represents amounts recovered through rates during the life of the associated asset and before the costs are incurred. The regulatory asset related to rate case filing expenses represents the costs associated with filing for rate increases that are deferred and amortized over periods that generally range from one to five years.

Income Taxes

The provision for income taxes consists of:

	Years Ended December 31, 2004	2003	2002
Current:			
Federal	$ 2,042	$ 11,933	$ 16,619
State	7,553	7,249	6,647
	9,595	19,182	23,266
Deferred:			
Federal	41,414	25,521	17,921
State	1,115	1,220	859
	42,529	26,741	18,780
Total tax expense	$ 52,124	$ 45,923	$ 42,046

The statutory Federal tax rate is 35% and for states with a corporate net income tax, the state corporate net income tax rates range from 5.00% to 9.99% for all years presented. The Company's Federal income tax returns for all years through 2000 have been closed, and 2002 was closed as a result of the conclusion of a tax audit.

The reasons for the differences between amounts computed by applying the statutory Federal income tax rate to income before income tax expense are as follows:

	Years Ended December 31, 2004	2003	2002
Computed Federal tax expense at statutory rate	$ 46,245	$ 40,852	$ 38,238
Increase in tax expense for depreciation expense to be recovered in future rates	1,376	1,125	558
Merger transaction costs	(24)	(96)	(680)
Charitable contribution	-	(424)	(98)
Deduction for Aqua America common dividends paid under employee benefit plan	(245)	(241)	(207)
Amortization of deferred investment tax credits	(285)	(285)	(283)
Prior year rate reductions	(538)	(431)	(315)
State income taxes, net of federal tax benefit	5,634	5,505	4,879
Other, net	(39)	(82)	(46)
Actual income tax expense	$ 52,124	$ 45,923	$ 42,046

(In thousands of dollars, except per share amounts)

The tax effects of temporary differences between book and tax accounting that give rise to the deferred tax assets and deferred tax liabilities are as follows:

	December 31, 2004	December 31, 2003
Deferred tax assets:		
Customers' advances for construction	$ 17,057	$ 17,133
Costs expensed for book not deducted for tax, principally accrued expenses	1,989	6,525
Utility plant acquisition adjustment basis differences	30,920	21,784
Minimum pension liability adjustment	938	-
Total gross deferred tax assets	50,904	45,442
Deferred tax liabilities:		
Utility plant, principally due to depreciation and differences in the basis of fixed assets due to variation in tax and book accounting	243,953	203,706
Deferred taxes associated with the gross-up of revenues necessary to recover, in rates, the effect of temporary differences	23,670	24,634
Deferred investment tax credit	6,328	6,618
Unrealized gain on marketable securities	-	141
Other	840	738
Total gross deferred tax liabilities	274,791	235,837
Net deferred tax liability	$ 223,887	$ 190,395

On October 22, 2004, the American Jobs Creation Act ("AJCA") was signed into law. Among other provisions, the AJCA creates a new deduction for qualified domestic production activities. Certain activities of the Company, such as our water treatment activity, are considered as qualifying production activities for purposes of determining the deduction for qualified production activities. The AJCA did not impact the Company's 2004 consolidated financial statements. Thus, the Company is currently assessing the impact, if any, of the AJCA on its consolidated financial statements in future periods. See Summary of Significant Accounting Policies – Recent Accounting Pronouncements for a discussion of the AJCA.

Commitments

The Company maintains agreements with other water purveyors for the purchase of water to supplement its water supply, particularly during periods of peak demand. The agreements stipulate purchases of minimum quantities of water to the year 2026. The estimated annual commitments related to such purchases are expected to approximate $10,924 through 2009 and $82,388 thereafter. The Company purchased approximately $8,724, $8,014 and $7,079 of water under these agreements during the years ended December 31, 2004, 2003 and 2002, respectively.

(In thousands of dollars, except per share amounts)

The Company leases motor vehicles, buildings and other equipment under operating leases that are noncancelable. The future annual minimum lease payments due are: $2,452 in 2005, $1,833 in 2006, $1,192 in 2007, $857 in 2008, $488 in 2009 and $692 thereafter. The Company leases parcels of land on which treatment plants and other facilities are situated and adjacent parcels that are used for watershed protection. The operating leases are noncancelable, expire between 2012 and 2052 and contain certain renewal provisions. Certain leases are subject to an adjustment every five years based on changes in the Consumer Price Index. Subject to the aforesaid adjustment, during each of the next five years, approximately $477 of annual lease payments for land are due, and $15,215 thereafter. The Company leases treatment plants to other parties under lease agreements that require payments to the Company of $567 in 2005, $567 in 2006, $267 in 2007, $308 in 2008, $246 in 2009 and $3,676 thereafter.

Rent expense was $3,267, $2,993 and $2,182 for the years ended December 31, 2004, 2003 and 2002, respectively.

Long-term Debt and Loans Payable

The Consolidated Statements of Capitalization provides a summary of long-term debt and loans outstanding as of December 31, 2004 and 2003. The supplemental indentures with respect to certain issues of the First Mortgage Bonds restrict the ability of Aqua Pennsylvania, Inc. and certain other operating subsidiaries of the Company to declare dividends, in cash or property, or repurchase or otherwise acquire the stock of these companies. As of December 31, 2004, approximately $249,000 of Aqua Pennsylvania's retained earnings and $62,000 of the retained earnings of certain other subsidiaries were free of these restrictions. Certain supplemental indentures also prohibit Aqua Pennsylvania and certain other subsidiaries of the Company from making loans to, or purchasing the stock of, the Company.

Annual sinking fund payments are required for certain issues of First Mortgage Bonds by the supplemental indentures. The future sinking fund payments and debt maturities of the Company's long-term debt are as follows:

Interest Rate Range	2005	2006	2007	2008	2009	Thereafter
0.00% to 2.49%	$ 1,267	$ 1,337	$ 1,351	$ 1,364	$ 1,388	$ 13,344
2.50% to 2.99%	1,453	6,495	1,529	1,572	1,619	17,256
3.00% to 3.49%	267	266	12,273	280	290	4,170
3.50% to 3.99%	679	689	700	710	722	3,623
4.00% to 4.99%	-	50	50	50	55	144,230
5.00% to 5.49%	-	-	-	-	-	165,615
5.50% to 5.99%	-	-	-	-	-	89,260
6.00% to 6.49%	-	144	644	10,172	-	100,360
6.50% to 6.99%	10,000	10,000	10,000	-	-	12,000
7.00% to 7.49%	28,500	2,539	2,580	2,625	714	8,147
7.50% to 7.99%	180	194	210	227	245	24,175
8.00% to 8.49%	126	138	152	167	184	25,947
8.50% to 8.99%	-	-	-	-	-	9,000
9.00% to 9.49%	6,568	576	584	594	604	44,318
9.50% to 9.99%	1,155	2,195	995	5,995	995	30,753
10.00% to 10.50%	-	-	-	-	-	6,000
Total	$ 50,195	$ 24,623	$ 31,068	$ 23,756	$ 6,816	$ 698,198

Aqua Pennsylvania had a five-year $300,000 medium-term note program that expired in December 2004 that provided for the issuance of long-term debt with maturities ranging between one and 35 years at fixed rates of interest, as determined at the time of issuance. The bonds issued under this program were secured by the Thirty-Third Supplement to the trust indenture relating to Aqua Pennsylvania's First Mortgage Bonds. In May 2004, Aqua Pennsylvania issued $87,000 of First Mortgage Bonds through the program with a weighted-average interest rate of approximately 5.1% and a weighted-average maturity of 13.7 years. The proceeds from this issuance were used to refinance short-term debt and to fund long-term debt maturities.

In May 2004, an unsecured note of $70,000 was issued by the Company. Interest under this note is based, at the borrower's option, on either a defined base rate or an adjusted London Interbank Offered Rate corresponding to the interest period selected. The proceeds of this financing were used to fund acquisitions and to refinance existing debt. In November 2004, $34,000 of the $70,000 unsecured note was repaid with the proceeds from an equity offering. The remaining balance of the note of $36,000 is classified as loans payable. In connection with the acquisition of Heater Utilities, Inc. in June 2004, the Company assumed $22,360 of long-term debt at interest rates ranging from 7.05% to 8.24% due 2012 to 2025, which includes the purchase accounting fair value adjustment of $3,141, increasing the carrying-value of long-term debt. In November 2004, Aqua Pennsylvania issued $14,000 tax-exempt bonds due 2039 at a rate of 5.05% and secured by a supplement to the trust indenture relating to Aqua Pennsylvania's First Mortgage Bonds. The proceeds from the bonds issued were used to retire previously issued tax-exempt bonds. At various times during 2004, Aqua Pennsylvania and other operating subsidiaries issued other notes payable and first mortgage bonds in aggregate of $31,239 at a weighted-average interest rate of 3.76% due at various times ranging from 2006 to 2037. The proceeds from these issuances were used to reduce a portion of the balance of the short-term debt at each of the respective operating subsidiaries and to redeem $6,000 of first mortgage bonds with a weighted-average interest rate of 9.19%. As of December 31, 2004, the Trustees for eight issues held $17,196 pending completion of the projects financed with the issues and are reported in the consolidated balance sheet as funds restricted for construction activity.

In July 2003, the Company issued $135,000 of unsecured notes due 2023 and with an interest rate of 4.87%. The proceeds of this financing were used to fund the acquisition of the AquaSource operations and to refinance existing debt. In July 2003, the Company also issued a $90,000 unsecured note payable and the proceeds were also used to fund the acquisition of the AquaSource operations. In August 2003, the $90,000 note payable was repaid with the proceeds from an equity offering. At various times during 2003, Aqua Pennsylvania, other operating subsidiaries and the Company issued other notes payable and first mortgage bonds in aggregate of $27,894 at a weighted average interest rate of 4.50% due at various times ranging from 2013 to 2032. The proceeds from these issuances were used to reduce a portion of the balance of the short-term debt at each of the respective operating subsidiaries, to redeem $7,000 of first mortgage bonds of operating subsidiaries with a weighted average interest rate of 6.35% and redeem the Company's preferred stock of $172. In connection with the acquisition of the AquaSource operations in July 2003, the Company assumed $8,131 of long-term debt of which $7,415 was retired during 2003. The weighted average cost of long-term debt at December 31, 2004 and 2003 was 6.00% and 6.19%, respectively.

Aqua Pennsylvania has a $70,000 364-day revolving credit facility with four banks and the Company has a $20,000 364-day bank revolving credit facility. Funds borrowed under these agreements are classified as loans payable and are used to provide working capital. As of December 31, 2004 and 2003, funds borrowed under the Aqua Pennsylvania revolving credit agreements were $29,000 and $52,068, respectively, and $0 and $19,801 were borrowed under the Company's revolving credit agreement, respectively. Interest under these facilities is based, at the borrower's option, on the prime rate, an adjusted federal funds rate, an adjusted London Interbank Offered Rate corresponding to the interest period selected, an adjusted Euro-Rate corresponding to the interest period selected or at rates offered by the banks. These agreements restrict the total amount of short-term borrowings of Aqua Pennsylvania and the Company. A commitment fee ranging from 1/4 to 1/10 of 1% is charged on the unused portion of the revolving credit agreements. The average cost of borrowing under these facilities was 1.4% and 1.6%, and the average borrowing was $50,115 and $62,528, during 2004 and 2003, respectively. The maximum amount outstanding at the end of any one month was $89,519 in 2004 and $73,079 in 2003.

(In thousands of dollars, except per share amounts)

At December 31, 2004 and 2003, the Company had combined short-term lines of credit of $108,000 and $88,000, respectively. Funds borrowed under these lines are classified as loans payable and are used to provide working capital. As of December 31, 2004 and 2003, funds borrowed under the short-term lines of credit were $9,810 and $24,590, respectively. The average borrowing under the lines was $34,711 and $50,353 during 2004 and 2003, respectively. The maximum amount outstanding at the end of any one month was $51,288 in 2004 and $73,700 in 2003. Interest under the lines is based at the Company's option, depending on the line, on the prime rate, an adjusted Euro-Rate, an adjusted federal funds rate or at rates offered by the banks. The average cost of borrowings under all lines during 2004 and 2003 was 2.3% and 2.4%, respectively.

Interest income of $1,762, $395 and $287 was netted against interest expense on the consolidated statements of income for the years ended December 31, 2004, 2003 and 2002, respectively. The total interest cost was $50,441, $45,057 and $40,683 in 2004, 2003 and 2002, including amounts capitalized of $2,304, $2,127 and $1,389, respectively.

Fair Value of Financial Instruments

The carrying amount of current assets and liabilities that are considered financial instruments approximates their fair value as of the dates presented. The carrying amount and estimated fair value of the Company's long-term debt are as follows:

	December 31,	
	2004	2003
Carrying amount	$ 834,656	$ 736,052
Estimated fair value	863,247	781,502

The fair value of long-term debt has been determined by discounting the future cash flows using current market interest rates for similar financial instruments of the same duration. The Company's customers' advances for construction and related tax deposits have a carrying value of $73,095 and $72,500 at December 31, 2004 and 2003, respectively. Their relative fair values cannot be accurately estimated because future refund payments depend on several variables, including new customer connections, customer consumption levels and future rate increases. Portions of these non-interest bearing instruments are payable annually through 2017 and amounts not paid by the contract expiration dates become non-refundable. The fair value of these amounts would, however, be less than their carrying value due to the non-interest bearing feature.

Preferred Stock

At December 31, 2004, the Company had 1,770,819 shares of Series Preferred Stock with a $1.00 par value authorized, of which 100,000 shares are designated as Series A Preferred Stock. During 1996, the Company designated and issued in connection with an acquisition 32,200 shares as Series B Preferred Stock, $1.00 par value. The Series B Preferred Stock was recorded on the consolidated balance sheet at its liquidation value of $100 per share. In December 2003, the remaining shares of Series B Preferred Stock were redeemed as provided under the provisions of the issue through the issuance of debt of $960 with a five-year maturity at an interest rate of 6.05% per annum. The Series A Preferred Stock, as well as the undesignated shares of Series Preferred Stock, remains unissued. As of December 31, 2004, the Company did not have any preferred stock outstanding.

Stockholders' Equity

At December 31, 2004, the Company had 300,000,000 shares of common stock authorized; par value $0.50. Shares outstanding at December 31, 2004, 2003 and 2002 were 95,384,833, 92,589,040 and 84,895,543, respectively. Treasury shares held at December 31, 2004, 2003 and 2002 were 686,747, 681,384 and 2,151,350, respectively.

The Company has a universal shelf registration with the Securities and Exchange Commission to allow for the sale, over time, of up to $250,000 of various debt and equity securities, including common stock. The Company has issued common stock in these transactions under the universal shelf registration:

- In November 2004, the Company issued 1,955,000 shares of common stock in a public offering for proceeds of $42,600, net of expenses. The net proceeds were used to repay a portion of our short-term debt. The indebtedness was incurred by Aqua America in connection with acquisitions.

- In August 2003, the Company issued 5,000,000 shares of common stock in a public offering for proceeds of $90,100, net of expenses. The net proceeds were used to repay an unsecured note of $90,000. The indebtedness was incurred by Aqua America in connection with the acquisition of the operations that were purchased from AquaSource, Inc.

- In May 2003, the Company issued 1,868,750 shares of common stock in a public offering for proceeds of $33,100, net of expenses. The net proceeds were used to repay short-term debt, including the repayment of $22,000 of indebtedness incurred in connection with the Company's repurchase of 1,513,275 shares of common stock from affiliates of Veolia Environnement, S.A. (formerly Vivendi Environnement, S.A.) in October 2002.

The balance remaining available for use under the universal shelf registration as of December 31, 2004 is $77,517. In addition, the Company has a shelf registration statement filed with the Securities and Exchange Commission to permit the offering from time to time of shares of common stock and shares of preferred stock for acquisitions. During 2002, 178,664 shares of common stock totaling $2,745 were issued by the Company to acquire water and wastewater systems. The balance remaining available for use under the acquisition shelf registration as of December 31, 2004 is 2,218,947 shares. The form and terms of such securities shall be determined when and if these securities are issued under these shelf registrations.

In May 2002, Veolia Environnement, S.A. which through its affiliates (collectively "VE") owned approximately 16.8% of our outstanding common stock, advised the Company of their decision to sell its investment in Aqua America, Inc. VE announced that its decision was part of its overall strategy to divest non-core assets and focus on other business strategies. In September 2002, in order to facilitate the orderly re-distribution of the shares held by VE into the market, the Company completed a secondary offering of 12,356,570 shares of Aqua America common stock held by VE. The number of outstanding shares of common stock was not changed and the Company did not receive any proceeds as a result of this secondary offering. In addition, in October 2002 the Company repurchased 1,513,275 shares of Aqua America, Inc. common stock representing the remainder of the shares of Aqua America, Inc. common stock held by VE. The repurchase of shares was funded with proceeds of $22,000 from a short-term credit facility. In May 2003, this $22,000 short-term credit facility was repaid with a portion of the funds from the issuance of 1,868,750 shares of common stock through a shelf registration as described above.

In addition, the Board of Directors has authorized the Company to purchase its common stock, from time to time, in the open market or through privately negotiated transactions. The Company has not repurchased any shares under this authorization since 2000. As of December 31, 2004, 411,209 shares remain available for purchase by the Company.

The Company has a Dividend Reinvestment and Direct Stock Purchase Plan ("Plan") that allows reinvested dividends to be used to purchase shares of common stock at a five percent discount from the current market value. Under the direct stock purchase program, shares are purchased by investors at market price. The shares issued under the Plan are either original issue shares or shares purchased by the Company's transfer agent in the open-market. During 2004, 2003 and 2002, under the dividend reinvestment portion of the Plan, 384,457, 395,605 and 402,084 original issue shares of common stock were sold providing the Company with proceeds of $7,808, $7,000 and $6,407, respectively.

The Company reports comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income." Accordingly, the Company's accumulated other comprehensive income is reported in the Stockholders' Equity section of the Consolidated Balance Sheets, the Consolidated Statements of Stockholders' Equity and the related other comprehensive income is reported in the Consolidated Statements of Income and Comprehensive Income. The Company reports its unrealized gains on securities and minimum pension liability adjustments as other comprehensive income or loss and accumulated other comprehensive income or loss.

Net Income per Common Share and Equity per Common Share

Basic net income per share is based on the weighted average number of common shares outstanding. Diluted net income per share is based on the weighted average number of common shares outstanding and potentially dilutive shares. The dilutive effect of employee stock options is included in the computation of Diluted net income per share. The following table summarizes the shares, in thousands, used in computing Basic and Diluted net income per share:

	Years ended December 31,		
	2004	2003	2002
Average common shares outstanding during the period for Basic computation	93,247	88,275	85,674
Dilutive effect of employee stock options	1,035	969	864
Average common shares outstanding during the period for Diluted computation	94,282	89,244	86,538

For the year ended December 31, 2004, employee stock options outstanding to purchase 569,900 shares of common stock were excluded from the calculation of diluted net income per share as the options' exercise price was greater than the average market price of the Company's common stock. For the years ended December 31, 2003 and 2002, there were no outstanding employee stock options excluded from the calculation of diluted net income per share as the average market price of the Company's common stock was greater than the options' exercise price.

Equity per common share was $7.83 and $7.11 at December 31, 2004 and 2003, respectively. These amounts were computed by dividing common stockholders' equity by the number of shares of common stock outstanding at the end of each year.

(In thousands of dollars, except per share amounts)

Shareholder Rights Plan

The Company has a Shareholder Rights Plan designed to protect the Company's shareholders in the event of an unsolicited unfair offer to acquire the Company. Each outstanding common share is entitled to one Right which is evidenced by the common share certificate. In the event that any person acquires 20% or more of the outstanding common shares or commences a tender or exchange offer which, if consummated, would result in a person or corporation owning at least 20% of the outstanding common shares of the Company, the Rights will begin to trade independently from the common shares and, if certain circumstances occur, including the acquisition by a person of 20% or more of the outstanding common shares, each Right would then entitle its holder to purchase a number of common shares of the Company at a substantial discount. If the Company is involved in a merger or other business combination at any time after the Rights become exercisable, the Rights will entitle the holder to acquire a certain number of shares of common stock of the acquiring company at a substantial discount. The Rights are redeemable by the Company at a redemption price of $.01 per Right at any time before the Rights become exercisable. The Rights will expire on March 1, 2008, unless previously redeemed.

Employee Stock and Incentive Plan

In May 2004, the 2004 Equity Compensation Plan ("the 2004 Plan") was approved by the shareholders to replace the 1994 Equity Compensation Plan ("the 1994 Plan"), the Company may grant qualified and non-qualified stock options to officers, key employees and consultants. Officers and key employees may also be granted dividend equivalents and restricted stock. Restricted stock may also be granted to non-employee members of the Board of Directors ("Board"). The 2004 Plan authorizes 3,675,000 shares for issuance under the Plan. A maximum of 50% of the shares available for issuance under the 2004 Plan may be issued as restricted stock and the maximum number of shares that may be subject to grants under the plans to any one individual in any one year is 150,000. Awards under the 2004 Plan are, and awards under the 1994 plan were, made by a committee of the Board of Directors.

Options under the plans were issued at the market price of the stock on the day of the grant. Options are exercisable in installments of 33% annually, starting one year from the date of the grant and expire 10 years from the date of the grant. The following table summarizes stock option transactions for the plans:

	As of or For the Years Ended December 31,					
	2004		2003		2002	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options:						
Outstanding, beginning of year	2,993,421	$ 13.31	2,830,133	$ 12.06	2,559,763	$ 10.66
Granted	582,650	21.53	613,654	16.98	617,813	16.64
Terminated	(98,286)	16.63	(15,533)	14.78	(8,265)	12.99
Exercised	(427,548)	11.95	(434,833)	10.28	(339,178)	9.82
Outstanding, end of year	3,050,237	$ 14.96	2,993,421	$ 13.31	2,830,133	$ 12.06
Exercisable, end of year	1,911,805	$ 12.43	1,756,300	$ 11.01	1,555,483	$ 9.70

(In thousands of dollars, except per share amounts)

Options exercised during 2004 ranged in price from $4.56 per share to $21.53 per share. At December 31, 2004, 3,678,584 options under the 2004 Plan were still available for grant, although under the terms of the 2004 Plan, terminated, expired or forfeited grants under the 1994 Plan and shares withheld to satisfy tax withholding requirements under the 1994 Plan may be re-issued under the 2004 Plan. The following table summarizes the price ranges of the options outstanding and options exercisable as of December 31, 2004:

	Options Outstanding			Options Exercisable	
	Shares	Weighted Average Remaining Life (years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Range of prices:					
$ 4.56 - 7.99	342,302	1.4	$ 6.25	342,302	$ 6.25
$ 8.00 - 9.99	245,471	5.3	9.39	245,471	9.39
$10.00 - 12.99	396,510	3.9	11.10	396,510	11.10
$13.00 - 15.99	433,175	6.3	15.28	433,175	15.28
$16.00 - 16.99	941,578	7.9	16.65	454,295	16.65
$17.00 - 21.53	691,201	9.1	20.97	40,052	18.33
	3,050,237	6.5	$ 14.96	1,911,805	$ 12.43

Under SFAS No. 123 "Accounting for Stock-Based Compensation" and SFAS No. 148 "Accounting for Stock-Based Compensation – Transition and Disclosure", the Company currently applies the provisions of APB Opinion No. 25 and provides the pro forma disclosure provisions of this statement. Accordingly, no compensation cost has been recognized in the financial statements for stock options that have been granted. Pursuant to the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, pro forma net income available to common stock and earnings per share are presented in the Summary of Significant Accounting Policies - Stock-Based Compensation as if compensation cost for stock options was determined as of the grant date under the fair value method. In December 2004, the FASB issued SFAS No. 123R, "Share-Base Payment" which will change the Company's accounting for the compensation costs for its stock options granted as described in the Summary of Significant Accounting Policies - Recent Accounting Pronouncements.

Restricted stock awards provide the grantee with the rights of a shareholder, including the right to receive dividends and to vote such shares, but not the right to sell or otherwise transfer the shares during the restriction period. During 2004, 2003 and 2002, 34,151, 20,156 and 37,031 shares of restricted stock were granted with a restriction period ranging from six to 36 months. The value of restricted stock awards, which are "compensatory", is equal to the fair market value of the stock on the date of the grant and is amortized ratably over the restriction period. The company recorded compensation expense related to restricted stock awards of $439, $369 and $769 during 2004, 2003 and 2002, respectively.

(In thousands of dollars, except per share amounts)

Pension Plans and Other Postretirement Benefits

The Company maintains a qualified, defined benefit pension plan that covers a majority of its full-time employees who were hired prior to April 1, 2003. Retirement benefits under the plan are generally based on the employee's total years of service and compensation during the last five years of employment. The Company's policy is to fund the plan annually at a level which is deductible for income tax purposes and which provides assets sufficient to meet its pension obligations. To offset certain limitations imposed by the Internal Revenue Code with respect to payments under qualified plans, the Company has a non-qualified Excess Benefit Plan for Salaried Employees in order to prevent certain employees from being penalized by these limitations. The Company also has non-qualified Supplemental Executive Retirement Plans for certain current and retired employees. The net pension costs and obligations of the qualified and non-qualified plans are included in the tables which follow. Employees hired after April 1, 2003 may participate in a defined contribution plan that provides a Company matching contribution on amounts contributed by participants and an annual profit-sharing contribution based upon a percentage of the eligible participants' compensation.

In addition to providing pension benefits, the Company offers certain Postretirement Benefits other than Pensions ("PBOPs") to employees hired before April 1, 2003 and retiring with a minimum level of service. These PBOPs include continuation of medical and prescription drug benefits for eligible retirees and life insurance benefits for certain eligible retirees. The Company funds its gross PBOP cost through various trust accounts. The benefits of retired officers and certain other retirees are paid by the Company and not from plan assets due to limitations imposed by the Internal Revenue Code.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid in the years indicated:

	Pension Benefits	Other Postretirenent Benefits
Years:		
2005	$ 6,453	$ 1,852
2006	6,541	1,950
2007	6,747	2,047
2008	7,129	2,176
2009	7,452	2,310
2010 - 2014	47,220	14,012

In May 2004, the FASB issued FASB Staff Position ("FSP") No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." FSP 106-2 supersedes FSP 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," which was issued in January 2004 and permitted a sponsor of a postretirement health care plan that provides a prescription drug benefit to make a one-time election to defer accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") until more authoritative guidance on the accounting for the federal subsidy was issued. The Company had elected the one-time deferral allowed under FSP 106-1 and as a result adopted FSP 106-2 as required in the third quarter of 2004 and it did not have a material impact on our results of operations or financial position.

(In thousands of dollars, except per share amounts)

The changes in the benefit obligation and fair value of plan assets, the funded status of the plans and the assumptions used in the measurement of the company's benefit obligation are as follows:

	Pension Benefits		Other Postretirement Benefits	
	2004	2003	2004	2003
Change in benefit obligation:				
Benefit obligation at January 1,	$ 150,098	$ 131,059	$ 29,134	$ 25,436
Service cost	4,312	3,627	1,112	987
Interest cost	9,512	8,999	1,825	1,703
Plan amendments	567	-	6	-
Actuarial loss	12,742	12,222	1,676	1,978
Plan participants' contributions	-	-	631	513
Benefits paid	(6,155)	(5,809)	(1,580)	(1,483)
Benefit obligation at December 31,	171,076	150,098	32,804	29,134
Change in plan assets:				
Fair value of plan assets at January 1,	108,731	94,438	14,391	12,200
Actual return on plan assets	8,535	20,021	641	816
Employer contributions	4,181	81	2,522	2,345
Benefits paid	(6,155)	(5,809)	(948)	(970)
Fair value of plan assets at December 31,	115,292	108,731	16,606	14,391
Funded status of plan:				
Funded status at December 31,	55,784	41,367	16,198	14,743
Unrecognized actuarial loss	(41,531)	(29,164)	(6,853)	(4,857)
Unrecognized prior service cost	(2,090)	(1,942)	527	590
Unrecognized net transition obligation	1,017	1,227	(6,428)	(7,231)
Net amount recognized	$ 13,180	$ 11,488	$ 3,444	$ 3,245

The Company's pension plans had an accumulated benefit obligation of $136,851 and $121,521 at December 31, 2004 and 2003, respectively. The following table provides the net liability recognized on the Consolidated Balance Sheets at December 31,:

	Pension Benefits		Other Postretirement Benefits	
	2004	2003	2004	2003
Prepaid benefits cost	$ -	$ -	$ 762	$ 937
Accrued benefit cost	(13,180)	(11,488)	(4,206)	(4,182)
Additional minimum liability	(8,928)	(2,003)	-	-
Intangible assets	2,108	1,962	-	-
Regulatory asset	4,140	41	-	-
Accumulated other comprehensive loss	2,680	-	-	-
Net liability recognized	$ (13,180)	$ (11,488)	$ (3,444)	$ (3,245)

(In thousands of dollars, except per share amounts)

At December 31, 2004 and 2003, the Company's pension plans had benefit obligations in excess of its plan assets. The following tables provide the projected benefit obligation, the accumulated benefit obligation and fair market value of the plan assets as of December, 31:

	Projected Benefit Obligation Exceeds the Fair Value of Plan Assets	
	2004	2003
Projected benefit obligation	$ 171,076	$ 150,098
Fair value of plan assets	115,292	108,731

	Accumulated Benefit Obligation Exceeds the Fair Value of Plan Assets	
	2004	2003
Accumulated benefit obligation	$ 136,851	$ 121,521
Fair value of plan assets	115,292	108,731

The following table provides the components of net periodic benefit costs for the years ended December 31,:

	Pension Benefits			Other Postretirement Benefits		
	2004	2003	2002	2004	2003	2002
Service cost	$ 4,312	$ 3,627	$ 3,205	$ 1,112	$ 987	$ 840
Interest cost	9,512	8,999	8,501	1,825	1,703	1,620
Expected return on plan assets	(9,169)	(7,775)	(9,945)	(1,086)	(917)	(953)
Amortization of transition obligation (asset)	(209)	(209)	(209)	803	803	803
Amortization of prior service cost	419	395	414	(57)	(57)	(57)
Amortization of actuarial (gain) loss	1,009	1,282	(2)	125	62	(5)
Amortization of regulatory asset	-	-	-	144	136	136
Capitalized costs	(1,021)	(205)	(66)	(629)	(598)	(520)
Net periodic benefit cost	$ 4,853	$ 6,114	$ 1,898	$ 2,237	$ 2,119	$ 1,864

Accounting for pensions and other postretirement benefits requires an extensive use of assumptions about the discount rate, expected return on plan assets, the rate of future compensation increases received by the Company's employees, mortality, turnover and medical costs. Each assumption is reviewed annually with assistance from the Company's actuarial consultant who provides guidance in establishing the assumptions. The assumptions are selected to represent the average expected experience over time and may differ in any one year from actual experience due to changes in capital markets and the overall economy. These differences will impact the amount of pension and other postretirement benefit expense that the Company recognizes.

(In thousands of dollars, except per share amounts)

The significant assumptions related to the Company's pension and other postretirement benefit plans are as follows:

	Pension Benefits		Other Postretirement Benefits	
	2004	2003	2004	2003
Weighted-average Assumptions Used to Determine Benefit Obligations as of December 31,				
Discount rate	5.75%	6.25%	5.75%	6.25%
Rate of compensation increase	4.0-5.0%	4.0-5.0%	4.0%	4.0%
Assumed Health Care Cost Trend Rates Used to Determine Benefit Obligations as of December 31,				
Health care cost trend rate	n/a	n/a	10%	10%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	n/a	n/a	5%	5%
Year that the rate reaches the ultimate trend rate	n/a	n/a	2010	2009
Weighted-average Assumptions Used to Determine Net Periodic Benefit Costs for Years Ended December 31,				
Discount rate	6.25%	6.75%	6.25%	6.75%
Expected return on plan assets	8.50%	8.50%	6.0-9.0%	6.0-9.0%
Rate of compensation increase	4.0-5.0%	4.0-5.0%	4.0%	4.0%
Assumed Health Care Cost Trend Rates Used to Determine Net Periodic Benefit Costs for Years Ended December 31,				
Health care cost trend rate	n/a	n/a	10%	10%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	n/a	n/a	5%	5%
Year that the rate reaches the ultimate trend rate	n/a	n/a	2009	2006

n/a – Assumption is not applicable to pension benefits.

Assumed health-care trend rates have a significant effect on the expense and liabilities for other postretirement benefit plans. The health care trend rate is based on historical rates and expected market conditions. A one-percentage point change in the expected health-care cost trend rates would have the following effects:

	1-Percentage-Point Increase	1-Percentage-Point Decrease
Effect on the health-care component of the accrued other postretirement benefit obligation	$ 863	$ (910)
Effect on total service and interest cost components of net periodic postretirement health-care benefit cost	$ 92	$ (102)

(In thousands of dollars, except per share amounts)

The discount rate is based on a market rate for a recognized-rating agency's high-quality long-term bond portfolio with durations matching the expected payouts under our retirement plans. The Company's pension expense and liability (benefit obligations) increases as the discount rate is reduced.

The Company's expected return on assets is determined by evaluating the asset class return expectations with its advisors as well as actual, long-term, historical results of our asset returns. The Company's pension expense increases as the expected return on assets decreases. The Company believes its actual long-term asset allocation on average will approximate the targeted allocation. The Company's investment strategy is to earn a reasonable rate of return while maintaining risk at acceptable levels through the diversification of investments across and within various asset categories. Investment returns are compared to benchmarks that include the S&P 500 Index, the Lehman Brothers Intermediate Government/Credit Index, and a combination of the two indices. The Pension Committee meets semi-annually to review plan investments and management monitors investment performance quarterly through a performance report prepared by an external consulting firm.

The Company's pension plan asset allocation and the target allocation by asset category are as follows:

	2005 Target Allocation	Percentage of Plan Assets at December 31, 2004	2003
Asset Category:			
Equity securities	65%	62%	66%
Debt securities	35%	27%	32%
Cash	0%	11%	2%
Total	100%	100%	100%

Equity securities include Aqua America, Inc. common stock in the amounts of $7,373 or 6.4% of total plan assets and $6,469 or 5.9% of total plan assets as of December 31, 2004 and 2003, respectively.

The asset allocation for the Company's other postretirement benefit plans and the target allocation by asset category are as follows:

	2005 Target Allocation	Percentage of Plan Assets at December 31, 2004	2003
Asset Category:			
Cash	65%	60%	64%
Equity securities	35%	40%	36%
Total	100%	100%	100%

Minimum funding requirements for qualified defined benefit pension plans are determined by government regulations and not by accounting pronouncements. In accordance with funding rules and the Company's funding policy, during 2005 our pension contribution is expected to be $7,278. The Company's funding of its PBOP cost during 2005 is expected to approximate $2,804.

As of December 31, 2004, the Company has an additional minimum liability of $6,820 associated with our defined benefit plan. The additional minimum liability is a result of the accumulated benefit obligation exceeding the fair value of plan assets. The portion of the additional minimum liability related to our employees in one of our rate jurisdictions results in the establishment of a regulatory asset of $4,140, as the Company expects recovery of the future, increased pension expense through customer rates. Since the balance of the additional minimum liability of $2,680 may not be recovered through rates, the accounting requirements for recording a regulatory asset are not met and as a result this amount is recorded as an other comprehensive loss for 2004 through a charge to accumulated other comprehensive income, net of income tax benefits of $938. The change in the additional minimum liability from December 31, 2003 to December 31, 2004 resulted from the effect of a decreased discount rate, offset partially by an increase in the pension plan assets during 2004 due to positive equity market performance and pension contributions.

The Company has 401(k) savings plans that cover substantially all employees. The Company makes matching contributions that are invested in Aqua America, Inc. common stock based on a percentage of an employee's contribution, subject to certain limitations. The Company's matching contribution, recorded as compensation expense, was $1,160, $921 and $859 for the years ended December 31, 2004, 2003 and 2002, respectively.

Water and Wastewater Rates

On August 5, 2004, the Pennsylvania Public Utility Commission ("PAPUC") granted Aqua Pennsylvania, Inc. a $13,800 base rate increase. The rates in effect at the time of the filing included $11,200 in Distribution System Improvement Charges ("DSIC") or 5.0% above the prior base rates. Consequently, the total base rates increased by $25,000 and the DSIC was reset to zero. On August 1, 2002, the PAPUC granted Aqua Pennsylvania, Inc. a $21,226 or 10.2% base rate increase. The rates in effect at the time of the filing included $9,400 in DSIC at 5.0%. Consequently, the total base rates increased by $30,626 and the DSIC was reset to zero.

In May 2004, the Company's operating subsidiary in Texas filed an application with the Texas Commission on Environmental Quality to increase rates by $11,920 over a multi-year period. The application seeks to increase annual revenues in phases and is accompanied by a plan to defer and amortize a portion of the Company's depreciation, operating and other tax expense over a similar multi-year period, such that the annual impact on operating income approximates the requested amount. The application is currently pending before the Commission. The Company commenced billing for the requested rates and implemented the deferral plan in August 2004, in accordance with authorization from the Texas Commission on Environmental Quality in July 2004. The additional revenue billed and collected prior to the final ruling are subject to refund based on the outcome of the ruling. The revenue recognized and the expenses deferred by the Company reflect an estimate of the final outcome of the ruling.

The Company's other operating subsidiaries were allowed annual rate increases of $6,673 in 2004, $1,275 in 2003 and $3,024 in 2002, represented by fourteen, eight and thirteen rate decisions, respectively. Revenues from these increases realized in the year of grant were approximately $3,995, $839 and $1,403 in 2004, 2003 and 2002, respectively.

Four states in which the Company operates permit water utilities, and in some states wastewater utilities, to add a surcharge to their water or wastewater bills to offset the additional depreciation and capital costs related to infrastructure system replacement and rehabilitation projects completed and placed into service between base rate filings. Currently, Pennsylvania, Illinois, Ohio and Indiana allow for the use of infrastructure rehabilitation surcharges. These mechanisms typically adjust periodically based on additional qualified capital expenditures completed or anticipated in a future period. The infrastructure rehabilitation surcharge is capped as a percentage of base rates, generally 5% of base rates, and is reset to zero when new base rates that reflect the costs of those additions become effective or when a utility's earnings exceed a regulatory benchmark. Infrastructure rehabilitation surcharges provided revenues in 2004, 2003 and 2002 of $7,817, $8,147 and $5,518, respectively.

Selected Quarterly Financial Data (Unaudited) Aqua America, Inc. and Subsidiaries
(in thousands of dollars, except per share amounts)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
2004					
Operating revenues	$ 99,768	$ 106,524	$ 120,305	$ 115,442	$ 442,039
Operations and maintenance expense	41,831	44,483	46,526	45,505	178,345
Operating income	36,444	40,473	50,997	49,320	177,234
Net income available to common stock	15,575	17,871	24,087	22,474	80,007
Basic net income per common share	0.17	0.19	0.26	0.24	0.86
Diluted net income per common share	0.17	0.19	0.26	0.24	0.85
Dividend paid per common share	0.12	0.12	0.12	0.13	0.49
Dividend declared per common share	0.12	0.12	0.25	-	0.49
Price range of common stock					
- high	22.85	21.96	22.22	24.64	24.64
- low	20.00	18.98	18.90	20.77	18.90
2003					
Operating revenues	$ 80,489	$ 83,379	$ 102,153	$ 101,212	$ 367,233
Operations and maintenance expense	30,664	31,029	36,777	42,132	140,602
Operating income	32,446	35,290	46,302	39,523	153,561
Net income available to common stock	13,324	15,235	23,620	18,606	70,785
Basic net income per common share	0.16	0.18	0.26	0.20	0.80
Diluted net income per common share	0.16	0.18	0.26	0.20	0.79
Dividend paid per common share	0.112	0.112	0.112	0.120	0.456
Dividend declared per common share	0.112	0.112	0.232	-	0.456
Price range of common stock					
- high	17.83	19.85	20.07	22.40	22.40
- low	15.77	17.22	18.28	18.71	15.77

High and low prices of the Company's common stock are as reported on the New York Stock Exchange Composite Tape. The cash dividends paid in December 2004 of $0.13 and December 2003 of $0.12 were declared in August 2004 and August 2003, respectively.

Beginning August 1, 2003, the financial results for the operations acquired in the AquaSource acquisition have been included in the Company's consolidated financial statements.

Summary of Selected Financial Data
(in thousands of dollars, except per share amounts)

Years ended December 31,	2004	2003 (a)	2002	2001	2000
PER COMMON SHARE:					
Net income					
Basic	$0.86	0.80	0.78	0.71	0.65
Diluted	0.85	0.79	0.78	0.70	0.65
Cash dividends declared and paid	0.49	0.46	0.43	0.40	0.38
Return on average stockholders' equity	11.4%	12.3%	13.9%	13.3%	13.2%
Book value at year end	$7.83	$7.11	$5.80	$5.52	$5.10
Market value at year end	24.59	22.10	16.48	18.04	15.68
INCOME STATEMENT HIGHLIGHTS:					
Operating revenues	$442,039	$367,233	$322,028	$307,280	$274,014
Depreciation and amortization	58,864	51,463	44,322	40,168	34,100
Interest expense, net (b)	46,375	42,535	39,007	38,637	37,775
Income before income taxes	132,131	116,718	109,252	99,087	86,995
Provision for income taxes	52,124	45,923	42,046	38,976	34,105
Net income available to common stock	80,007	70,785	67,154	60,005	52,784
BALANCE SHEET HIGHLIGHTS:					
Total assets	$2,340,248	$2,069,736	$1,717,069	$1,555,108	$1,413,723
Property, plant and equipment, net	2,069,812	1,824,291	1,486,703	1,364,282	1,249,652
Stockholders' equity	748,468	659,030	493,097	472,717	430,587
Long-term debt, including current portion	834,656	736,052	617,175	531,455	472,712
Total debt	919,771	832,511	732,288	641,123	573,706
ADDITIONAL INFORMATION:					
Net cash flows from operating activities	$173,603	$143,373	$121,560	$102,165	$86,972
Capital additions	195,736	163,320	136,164	124,088	129,740
Net cash expended for acquisitions of utility systems	54,300	192,331	8,914	9,517	3,546
Dividends on common stock	45,807	39,917	36,789	34,234	30,406
Number of customers served	835,512	749,491	605,474	587,537	565,146
Number of shareholders of common stock	24,082	22,726	21,389	20,920	20,978
Common shares outstanding (000)	95,385	92,589	84,896	85,483	83,869
Employees (full-time)	1,442	1,260	971	951	943

(a) Beginning August 1, 2003, the financial results for the operations acquired in the AquaSource acquisition have been included in Aqua America's consolidated financial statements.

(b) Includes dividends on preferred stock of subsidiary and minority interest; net of allowance for funds used during construction.

AQUA AMERICA, INC. AND SUBSIDIARIES
INVESTOR RELATIONS INFORMATION

Financial Reports and Investor Relations

Copies of the company's public financial reports, including annual reports and Forms 10–K and 10–Q, are available on line and can be downloaded from the investor relations section of our Web site at www.aquaamerica.com. You may also obtain these reports by writing to that:

ATTN: Investor Relations
Aqua America, Inc.
762 W. Lancaster Avenue
Bryn Mawr, PA 19010-3489
www.aquaamerica.com

Corporate Governance

We are committed to maintaining high standards of corporate governance and have implemented the corporate governance rules of the Securities and Exchange Commission (SEC) and the New York Stock Exchange. Copies of our key corporate governance documents, including our Corporate Governance Guidelines, Code of Ethical Business Conduct, and the charters of each committee of our Board of Directors can be obtained from the corporate governance portion of the investor relations section of our Web site—www.aquaamerica.com—or requests may be directed to the address above. Amendments to the Code, and any grant of waiver from a provision of the Code requiring disclosure under applicable SEC rules will be disclosed on our Web site. The certifications of the company's chief executive officer and chief financial officer required by the Sarbanes-Oxley Act have been included as Exhibits 31.1 and 31.2 in the company's Form 10-K. In addition, in 2004 the company's chief executive officer provided to the New York Stock Exchange the Annual CEO certification regarding the company's compliance with the New York Stock Exchange's corporate governance listing standards.

Annual Meeting

10:00 A.M. Eastern Daylight Time
Thursday, May 19, 2005
Springfield Country Club
400 West Sproul Road
Springfield, PA 19064

Transfer Agent and Registrar

EquiServe Trust Company, N.A.
P.O. Box 43010
Providence, RI 02940-3010
800-205-8314 or 781-575-3100
www.equiserve.com

Independent Registered Public Accounting Firm

PricewaterhouseCoopers LLP
Two Commerce Square
Suite 1700
2001 Market St.
Philadelphia, PA 19103-7042

Stock Exchanges

The Common Stock of the company is listed on the New York Stock Exchange and the Philadelphia Stock Exchange under the ticker symbol WTR. The daily closing price is printed in *The Wall Street Journal* as AquaAmer. Listings might vary in other major newspapers.

Dividend Reinvestment and Direct Stock Purchase Plan

The company's Dividend Reinvestment and Direct Stock Purchase Plan ("Plan") enables shareholders to reinvest all, or a designated portion of, dividends paid on up to 100,000 shares of Common Stock in additional shares of Common Stock at a five percent discount from a price based on the market value of the stock. In addition, shareholders may purchase additional shares of Aqua America Common Stock at any time with a minimum investment of $50, up to a maximum of $250,000 annually. Individuals may become shareholders by making an initial investment of at least $500. A Plan prospectus may be obtained by calling EquiServe Trust Company at 800-205-8314 or by visiting www.equiserve.com. **Please read the prospectus carefully before you invest.**

AQUA AMERICA, INC. AND SUBSIDIARIES
INVESTOR RELATIONS INFORMATION

IRA, Roth IRA, Education IRA

An IRA, Roth IRA or Education IRA may be opened through the Plan to hold shares of Common Stock of the company and to make contributions to the IRA to purchase shares of Common Stock. Participants in the Plan may roll over an existing IRA or other qualified plan distribution in cash into an IRA under the Plan to purchase the company's Common Stock. Participants may also transfer the company's Common Stock from an existing IRA into an IRA under the Plan. A prospectus, IRA forms and a disclosure statement may be obtained by calling EquiServe Trust Company at 800-472-7428. **Please read the prospectus carefully before you invest.**

Direct Deposit

With direct deposit, Aqua America cash dividends are deposited automatically on the dividend payment date of each quarter. Shareholders will receive confirmation of their deposit in the mail. Shareholders interested in direct deposit should call the Company's transfer agent at 800-205-8314.

Delivery of voting materials to shareholders sharing an address

To reduce the expense of delivering duplicate voting materials to our shareholders who have more than one Aqua America stock account, we are delivering only one annual report and proxy statement to registered shareholders who share an address unless otherwise requested. A separate proxy card is included in the voting materials for each of these shareholders.

How to obtain a separate set of voting materials

If you are a registered shareholder who shares an address with another registered shareholder and have received only one set of voting materials for the 2005 annual meeting, you may write or call us to request a separate copy of this material at no cost to you at 610-645-1196 or Attn: Investor Relations, Aqua America, Inc., 762 W. Lancaster Avenue, Bryn Mawr, PA, 19010. For future annual meetings, you may request separate voting material by calling the Company's transfer agent at 800-205-8314.

Account Access

Aqua America shareholders may access their account by visiting www.equiserve.com. Shareholders may view their account, purchase additional shares, and make changes to their account. To learn more, visit www.equiserve.com or call 800-205-8314.

Dividends

Aqua America has paid dividends since 1946. The normal Common Stock dividend dates for 2005 and the first six months of 2006 are:

Declaration Date	Ex-Dividend Date	Record Date	Payment Date
January 28, 2005	February 10, 2005	February 14, 2005	March 1, 2005
May 5, 2005	May 16, 2005	May 18, 2005	June 1, 2005
August 5, 2005	August 16, 2005	August 18, 2005	September 1, 2005
November 4, 2005	November 15, 2005	November 17, 2005	December 1, 2005
February 2, 2006	February 13, 2006	February 15, 2006	March 1, 2006
May 5, 2006	May 16, 2006	May 18, 2006	June 1, 2006

To be an owner of record, and therefore eligible to receive the quarterly dividend, shares must have been purchased before the ex-dividend date. Owners of any share(s) on or after the ex-dividend date will not receive the dividend for that quarter. The previous owner—the owner of record—will receive the dividend.

Only the Board of Directors may declare dividends and set record dates. Therefore, the payment of dividends and these dates may change at the discretion of the Board. Announcement of the dividend declaration is usually published in *The Wall Street Journal* and several other newspapers.

Dividends paid on the company's Common Stock are subject to Federal and State income tax.

Lost Dividend Checks and Stock Certificates

Dividend checks lost by shareholders, or those that might be lost in the mail, will be replaced upon notification of the lost or missing check. All inquiries concerning lost or missing dividend checks should be made to the Company's transfer agent at 800-205-8314. Shareholders should call or write the Company's transfer agent to report a lost certificate. Appropriate documentation will be prepared and sent to the shareholder with instructions.

Safekeeping of Stock Certificates

Under the Direct Stock Purchase Plan, shareholders may have their stock certificates deposited with the transfer agent for safekeeping free of charge. Stock certificates and written instructions should be forwarded to: EquiServe Trust Company, N.A., P.O. Box 43010, Providence, RI 02940-3010.

AQUA America

Board of Directors

Nicholas DeBenedictis, 59
Chairman, President and CEO
Aqua America, Inc.
Director since 1992

Mary C. Carroll, 64
Consultant and
Community Volunteer
Director since 1981

G. Fred DiBona, Jr., 54
President and CEO
Independence Blue Cross
Director since 1993

Richard Glanton, 58
Senior Vice President
Exelon Corporation
Director since 1995

William P. Hankowsky, 53
Chairman, President and CEO
Liberty Property Trust
Director since 2004

John F. McCaughan, 69
Chairman (Retired)
Betz Laboratories, Inc.
Director since 1984

John E. Menario, 69
Assistant to the President (Retired)
Banknorth Group, Inc.
Director since 1999

Richard L. Smoot, 64
Regional Chairman,
Advisory Board (Retired)
PNC Financial Services Group
Philadelphia and
Southern New Jersey
Director since 1997

Officers

Nicholas DeBenedictis, 59
Chairman, President and CEO

Richard D. Hugus, 55
Regional President
Aqua America – South

Karl M. Kyriss, 54
President
Aqua Pennsylvania, Inc.

Robert G. Liptak, 57
Regional President
Aqua America – North

Richard R. Riegler, 58
Senior Vice President
Engineering and
Environmental Affairs

David P. Smeltzer, 46
Senior Vice President
Finance and CFO

Roy H. Stahl, Esq., 52
Executive Vice President,
General Counsel
and Corporate Secretary

In Memoriam

Aqua America honors the life and legacy of its friend and long-time board member,

G. Fred DiBona, Jr.

We thank him for helping us grow into the nation's largest publicly-traded water utility.

AQUA America

AQUA America

762 West Lancaster Avenue
Bryn Mawr, PA 19010-3489
T: 610.525.1400 • F: 610.645.1061

www.aquaamerica.com