AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(In thousands, except per share amounts)
Years ended December 31, 2006, 2005 and 2004

	2006	2005	2004
Operating revenues	$ 533,491	$ 496,779	$ 442,039
Costs and expenses:			
Operations and maintenance	219,560	203,088	178,345
Depreciation	70,895	60,747	54,564
Amortization	4,146	4,741	4,300
Taxes other than income taxes	33,343	31,696	27,596
	327,944	300,272	264,805
Operating income	205,547	196,507	177,234
Other expense (income):			
Interest expense, net	58,432	52,062	48,679
Allowance for funds used during construction	(3,941)	(2,447)	(2,304)
Gain on sale of other assets	(1,194)	(1,177)	(1,272)
Income before income taxes	152,250	148,069	132,131
Provision for income taxes	60,246	56,913	52,124
Net income	$ 92,004	$ 91,156	$ 80,007
Net income	$ 92,004	$ 91,156	$ 80,007
Other comprehensive income (loss), net of tax:			
Minimum pension liability adjustment	3,082	(1,340)	(1,742)
Unrealized holding gains on investments	194	-	59
Reclassification adjustment for gains reported in net income	-	-	(230)
	3,276	(1,340)	(1,913)
Comprehensive income	$ 95,280	$ 89,816	$ 78,094
Net income per common share:			
Basic	$ 0.70	$ 0.72	$ 0.64
Diluted	$ 0.70	$ 0.71	$ 0.64
Average common shares outstanding during the period:			
Basic	130,725	127,364	124,329
Diluted	131,774	129,206	125,710

See accompanying notes to consolidated financial statements.

AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands of dollars, except per share amounts)

December 31, 2006 and 2005

	2006	2005
Assets		
Property, plant and equipment, at cost	$ 3,185,111	$ 2,900,585
Less: accumulated depreciation	679,116	620,635
Net property, plant and equipment	2,505,995	2,279,950
Current assets:		
Cash and cash equivalents	44,039	11,872
Accounts receivable and unbilled revenues, net	72,149	62,690
Income tax receivable	-	8,321
Inventory, materials and supplies	8,359	7,798
Prepayments and other current assets	10,153	7,596
Total current assets	134,700	98,277
Regulatory assets	165,063	130,953
Deferred charges and other assets, net	38,075	37,061
Funds restricted for construction activity	11,490	68,625
Goodwill	22,580	20,180
	$ 2,877,903	$ 2,635,046
Liabilities and Stockholders' Equity		
Common stockholders' equity:		
Common stock at $.50 par value, authorized 300,000,000 shares, issued 133,017,325 and 129,658,806 in 2006 and 2005	$ 66,509	$ 64,829
Capital in excess of par value	548,806	478,508
Retained earnings	319,113	285,132
Treasury stock, at cost, 691,746 and 688,625 shares in 2006 and 2005	(12,992)	(12,914)
Accumulated other comprehensive income	194	(3,082)
Unearned compensation	-	(550)
Total common stockholders' equity	921,630	811,923
Minority interest	1,814	1,551
Long-term debt, excluding current portion	951,660	878,438
Commitments and contingencies	-	-
Current liabilities:		
Current portion of long-term debt	31,155	24,645
Loans payable	119,150	138,505
Accounts payable	49,406	55,455
Accrued interest	14,050	13,052
Accrued taxes	19,350	9,432
Other accrued liabilities	22,500	30,571
Total current liabilities	255,611	271,660
Deferred credits and other liabilities:		
Deferred income taxes and investment tax credits	273,199	250,346
Customers' advances for construction	76,820	74,828
Regulatory liabilities	11,592	11,751
Other	64,879	31,969
Total deferred credits and other liabilities	426,490	368,894
Contributions in aid of construction	320,698	302,580
	$ 2,877,903	$ 2,635,046

See accompanying notes to consolidated financial statements.

AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CAPITALIZATION
(In thousands of dollars, except per share amounts)
December 31, 2006 and 2005

	2006	2005
Common stockholders' equity:		
Common stock, $.50 par value	$ 66,509	$ 64,829
Capital in excess of par value	548,806	478,508
Retained earnings	319,113	285,132
Treasury stock, at cost	(12,992)	(12,914)
Accumulated other comprehensive income	194	(3,082)
Unearned compensation	-	(550)
Total common stockholders' equity	921,630	811,923
Long-term debt:		
Long-term debt of subsidiaries (substantially secured by utility plant):		
Interest Rate Range		
0.00% to 2.49%	25,740	21,574
2.50% to 2.99%	25,272	28,684
3.00% to 3.49%	17,220	17,380
3.50% to 3.99%	6,073	6,748
4.00% to 4.99%	30,645	30,695
5.00% to 5.49%	262,496	262,588
5.50% to 5.99%	79,000	79,000
6.00% to 6.49%	94,360	88,504
6.50% to 6.99%	22,000	32,000
7.00% to 7.49%	13,288	15,878
7.50% to 7.99%	24,778	25,012
8.00% to 8.49%	26,288	26,507
8.50% to 8.99%	9,000	9,000
9.00% to 9.49%	46,101	46,764
9.50% to 9.99%	38,738	40,933
10.00% to 10.50%	6,000	6,000
	726,999	737,267
Unsecured notes payable, 4.87%, maturing in various installments 2010 through 2023	135,000	135,000
Unsecured notes payable, 5.95%, due in 2023 through 2034	40,000	-
Unsecured notes payable, 5.64%, due in 2014 through 2021	20,000	-
Unsecured notes payable, 5.54%, due in 2013 through 2018	30,000	-
Unsecured notes payable, 5.01%, due 2015	18,000	18,000
Unsecured notes payable, 5.20%, due 2020	12,000	12,000
Notes payable, 6.05%, maturing in 2007 and 2008	816	816
	982,815	903,083
Current portion of long-term debt	31,155	24,645
Long-term debt, excluding current portion	951,660	878,438
Total capitalization	$ 1,873,290	$ 1,690,361

See accompanying notes to consolidated financial statements.

AQUA AMERICA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDERS' EQUITY

(In thousands of dollars, except per share amounts)

	Common stock	Capital in excess of par value	Retained earnings	Treasury stock	Accumulated Other Comprehensive Income	Unearned Compensation on Restricted Stock	Total
Balance at December 31, 2003	$46,635	$413,008	$210,915	$(12,611)	$ 171	$ -	$658,118
Net income	-	-	80,007	-	-	-	80,007
Other comprehensive income (loss):							
Minimum pension liability adjustment, net of income tax of $938	-	-	-	-	(1,742)	-	(1,742)
Unrealized gain on securities, net of income tax of $32	-	-	-	-	59	-	59
Less: reclassification adjustment for gains reported in net income, net of income tax of $173	-	-	-	-	(230)	-	(230)
Dividends	-	-	(45,807)	-	-	-	(45,807)
Sale of stock (3,181,203 shares)	1,170	48,971	-	991	-	-	51,132
Repurchase of stock (51,808 shares)	-	-	-	(1,082)	-	-	(1,082)
Equity Compensation Plan (45,535 shares)	17	692	-	-	-	-	709
Exercise of stock options (570,064 shares)	214	4,847	-	-	-	-	5,061
Employee stock plan tax benefits	-	1,006	-	-	-	-	1,006
Balance at December 31, 2004	48,036	468,524	245,115	(12,702)	(1,742)	-	747,231
Net income	-	-	91,156	-	-	-	91,156
Other comprehensive loss: minimum pension liability adjustment, net of income tax of $722	-	-	-	-	(1,340)	-	(1,340)
Dividends	-	-	(51,139)	-	-	-	(51,139)
Stock issued for acquisitions (24,684 shares)	12	663	-	-	-	-	675
Stock split	16,095	(16,095)	-	-	-	-	-
Sale of stock (471,682 shares)	161	7,943	-	1,537	-	-	9,641
Repurchase of stock (56,930 shares)	-	-	-	(1,749)	-	-	(1,749)
Equity Compensation Plan (37,751 shares)	14	708	-	-	-	(722)	-
Exercise of stock options (1,327,717 shares)	511	11,264	-	-	-	-	11,775
Employee stock plan tax benefits	-	5,501	-	-	-	-	5,501
Amortization of unearned compensation	-	-	-	-	-	172	172
Balance at December 31, 2005	64,829	478,508	285,132	(12,914)	(3,082)	(550)	811,923
Net income	-	-	92,004	-	-	-	92,004
Other comprehensive income:							
Unrealized holding gain on investments, net of income tax of $105	-	-	-	-	194	-	194
Minimum pension liability adjustment, net of income tax of $1,660	-	-	-	-	3,082	-	3,082
Dividends	-	-	(58,023)	-	-	-	(58,023)
Sale of stock (2,688,332 shares)	1,328	55,866	-	894	-	-	58,088
Repurchase of stock (36,346 shares)	-	-	-	(972)	-	-	(972)
Equity Compensation Plan (37,200 shares)	19	(19)	-	-	-	-	-
Reclassification of unearned compensation	-	(550)	-	-	-	550	-
Exercise of stock options (666,212 shares)	333	7,629	-	-	-	-	7,962
Stock-based compensation	-	4,235	-	-	-	-	4,235
Employee stock plan tax benefits	-	3,137	-	-	-	-	3,137
Balance at December 31, 2006	$66,509	$548,806	$319,113	$(12,992)	$ 194	$ -	$921,630

See accompanying notes to consolidated financial statements.

AQUA AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands of dollars)
Years ended December 31, 2006, 2005 and 2004

	2006	2005	2004
Cash flows from operating activities:			
Net income	$ 92,004	$ 91,156	$ 80,007
Adjustments to reconcile net income to net cash flows from operating activities:			
Depreciation and amortization	75,041	65,488	58,864
Deferred income taxes	10,794	26,027	40,577
Stock-based compensation	3,604	-	-
Gain on sale of water system	-	-	(2,342)
Gain on sale of other assets	(1,194)	(1,177)	(1,272)
Net decrease (increase) in receivables, inventory and prepayments	(8,769)	7,572	(2,766)
Net increase (decrease) in payables, accrued interest, accrued taxes and other accrued liabilities	(5,609)	12,933	863
Other	4,855	(2,325)	(328)
Net cash flows from operating activities	170,726	199,674	173,603
Cash flows from investing activities:			
Property, plant and equipment additions, including allowance for funds used during construction of $3,941, $2,447 and $2,304	(271,706)	(237,462)	(195,736)
Acquisitions of utility systems and other, net	(11,848)	(11,633)	(54,300)
Release of funds previously restricted for construction activity	59,467	56,137	14,015
Additions to funds restricted for construction activity	(2,332)	(107,566)	(2,772)
Net proceeds from the sale of water systems	-	-	4,716
Net proceeds from the sale of other assets	1,283	1,300	2,098
Other	(213)	102	(517)
Net cash flows used in investing activities	(225,349)	(299,122)	(232,496)
Cash flows from financing activities:			
Customers' advances and contributions in aid of construction	12,031	14,728	14,269
Repayments of customers' advances	(5,168)	(4,792)	(4,930)
Net proceeds (repayments) of short-term debt	(19,355)	63,695	(30,150)
Proceeds from long-term debt	103,360	147,012	130,258
Repayments of long-term debt	(24,606)	(83,235)	(55,928)
Change in cash overdraft position	11,166	(8,808)	(2,190)
Proceeds from issuing common stock	58,088	9,641	51,132
Proceeds from exercised stock options	7,962	11,775	5,061
Stock-based compensation windfall tax benefits	2,307	-	-
Repurchase of common stock	(972)	(1,749)	(1,082)
Dividends paid on common stock	(58,023)	(51,139)	(45,807)
Other	-	-	179
Net cash flows from financing activities	86,790	97,128	60,812
Net increase (decrease) in cash and cash equivalents	32,167	(2,320)	1,919
Cash and cash equivalents at beginning of year	11,872	14,192	12,273
Cash and cash equivalents at end of year	$ 44,039	$ 11,872	$ 14,192
Cash paid during the year for:			
Interest, net of amounts capitalized	$ 53,222	$ 48,278	$ 45,261
Income taxes	$ 28,700	$ 30,734	$ 22,322

See Summary of Significant Accounting Policies-Customers' Advances for Construction, Acquisitions and Employee Stock and Incentive Plans footnotes for description of non-cash activities.
See accompanying notes to consolidated financial statements.

Summary of Significant Accounting Policies

Nature of Operations—Aqua America, Inc. ("Aqua America" or the "Company") is the holding company for regulated utilities providing water or wastewater services in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, New York, Florida, Indiana, Virginia, Maine, Missouri and South Carolina. Our largest operating subsidiary, Aqua Pennsylvania, Inc., accounted for approximately 55% of our operating revenues for 2006 and provided water or wastewater services to customers in the suburban areas north and west of the City of Philadelphia and in 23 other counties in Pennsylvania. The Company's other subsidiaries provide similar services in 12 other states. In addition, the Company provides water and wastewater service through operating and maintenance contracts with municipal authorities and other parties, and septage hauling services, close to our utility companies' service territories.

The company has identified fourteen operating segments and has one reportable segment named the Regulated segment. The reportable segment is comprised of thirteen operating segments for our water and wastewater regulated utility companies which are organized by the states where we provide these services. These operating segments are aggregated into one reportable segment since each of the Company's operating segments has the following similarities: economic characteristics, nature of services, production processes, customers, water distribution or wastewater collection methods, and the nature of the regulatory environment. In addition, one segment is not quantitatively significant to be reportable and is comprised of the businesses that provide on-site septic tank pumping, sludge hauling services and certain other non-regulated water and wastewater services. This segment is included as a component of "other," in addition to corporate costs that have not been allocated to the Regulated segment and intersegment eliminations.

Regulation—Most of the operating companies that are regulated public utilities are subject to regulation by the public utility commissions of the states in which they operate. The respective public utility commissions have jurisdiction with respect to rates, service, accounting procedures, issuance of securities, acquisitions and other matters. Some of the operating companies that are regulated public utilities are subject to rate regulation by county or city government. Regulated public utilities follow Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation." SFAS No. 71 provides for the recognition of regulatory assets and liabilities as allowed by regulators for costs or credits that are reflected in current rates or are considered probable of being included in future rates. The regulatory assets or liabilities are then relieved as the cost or credit is reflected in rates.

Consolidation—The consolidated financial statements include the accounts of the Company and its subsidiaries. All material intercompany accounts and transactions have been eliminated.

Recognition of Revenues—Revenues include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the latest billing to the end of the accounting period. Non-regulated revenues are recognized when services are performed and are primarily associated with septage hauling services, operating and maintenance contracts and data processing service fees. The Company's Regulated segment includes non-regulated revenues that totaled $13,525 in 2006, $13,161 in 2005 and $11,556 in 2004. In addition to the Regulated segment operating revenues, the Company has other non-regulated revenues of $7,198 in 2006, $3,323 in 2005 and $2,067 in 2004.

Property, Plant and Equipment and Depreciation—Property, plant and equipment consist primarily of utility plant. The cost of additions includes contracted cost, direct labor and fringe benefits, materials, overheads and, for certain utility plant, allowance for funds used during construction. Water systems acquired are recorded at estimated original cost of utility plant when first devoted to utility service and the applicable depreciation is recorded to accumulated depreciation. The difference between the estimated original cost, less applicable accumulated depreciation, and the purchase price is recorded as an acquisition adjustment within utility plant. At December 31, 2006, utility plant includes a net credit acquisition adjustment of $51,434, which is generally being amortized from 0 to 20 years. Amortization of the acquisition adjustments totaled $4,239 in 2006, $3,674 in 2005 and $3,961 in 2004.

Utility expenditures for maintenance and repairs, including major maintenance projects and minor renewals and betterments, are charged to operating expenses when incurred in accordance with the system of accounts prescribed by the public utility commissions of the states in which the company operates. The cost of new units of property and betterments are capitalized. Utility expenditures for water main cleaning and relining of pipes are deferred and recorded in net property, plant and equipment in accordance with SFAS No. 71. As of December 31, 2006, $5,192 of costs has been incurred since the last rate proceeding and the Company expects to recover these costs in future rates.

The cost of software upgrades and enhancements are capitalized if they result in added functionality which enable the software to perform tasks it was previously incapable of performing. Certain information technology costs associated with major system installations, conversions and improvements, such as software training, data conversion and business process reengineering costs, are deferred as a regulatory asset if the Company expects to recover these costs in future rates. If these costs are not deferred in accordance with SFAS No. 71, then these costs are charged to operating expenses when incurred. As of December 31, 2006, $5,597 of costs have been deferred, since the last rate proceeding, as a regulatory asset, and the deferral is reported as a component of net property, plant and equipment.

When units of utility property are replaced, retired or abandoned, the recorded value thereof is credited to the asset account and such value, together with the net cost of removal, is charged to accumulated depreciation. To the extent the Company recovers cost of removal or other retirement costs through rates after the retirement costs are incurred, a regulatory asset is recorded. In some cases, the Company recovers retirement costs through rates during the life of the associated asset and before the costs are incurred. These amounts result in a regulatory liability being reported based on the amounts previously recovered through customer rates.

The straight-line remaining life method is used to compute depreciation on utility plant. Generally, the straight-line method is used with respect to transportation and mechanical equipment, office equipment and laboratory equipment.

In accordance with the requirements of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the long-lived assets of the Company, which consist primarily of Utility Plant in Service and regulatory assets, are reviewed for impairment when changes in circumstances or events occur. There has been no change in circumstances or events that have occurred that require adjustments to the carrying values of these assets.

Allowance for Funds Used During Construction—The allowance for funds used during construction ("AFUDC") is a non-cash credit which represents the estimated cost of funds used to finance the construction of utility plant. In general, AFUDC is applied to construction projects requiring more than one month to complete. No AFUDC is applied to projects funded by customer advances for construction or contributions in aid of construction. AFUDC includes the net cost of borrowed funds and a rate of return on other funds when used, and is recovered through water rates as the utility plant is depreciated. The amount of AFUDC related to equity funds in 2006 was $6 and in 2005 was $1. There was no AFUDC related to equity funds in 2004. No interest was capitalized by our non-regulated businesses.

Cash and Cash Equivalents—The Company considers all highly liquid investments with an original maturity of three months or less, which are not restricted for construction activity, to be cash equivalents.

The Company had a book overdraft for certain of its disbursement cash accounts of $13,739 and $2,573 at December 31, 2006 and 2005, respectively. A book overdraft represents transactions that have not cleared the bank accounts at the end of the period. The Company transfers cash on an as-needed basis to fund these items as they clear the bank in subsequent periods. The balance of the book overdraft is reported as accounts payable and the change in the book overdraft balance is reported as cash flows from financing activities.

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, and is determined based on historical write-off experience and the aging of account balances. The Company reviews the allowance for doubtful accounts quarterly. Account balances are written off against the allowance when it is probable the receivable will not be recovered. When utility customers request extended payment terms, credit is extended based on regulatory guidelines, and collateral is not required.

Regulatory Assets, Deferred Charges and Other Assets—Deferred charges and other assets consist of financing expenses, other costs and marketable securities. Deferred bond issuance expenses are amortized by the straight-line method over the life of the related issues. Call premiums related to the early redemption of long-term debt, along with the unamortized balance of the related issuance expense, are deferred and amortized over the life of the long-term debt used to fund the redemption. Other costs, for which the Company has received or expects to receive prospective rate recovery, are deferred as a regulatory asset and amortized over the period of rate recovery in accordance with SFAS No. 71.

Marketable securities are considered "available-for-sale" and accordingly, are carried on the balance sheet at fair market value. Unrecognized gains are included in other comprehensive income.

(In thousands of dollars, except per share amounts)

Goodwill—Goodwill represents the excess cost over the fair value of net tangible and identifiable intangible assets acquired through acquisitions. Goodwill is not amortized but is tested for impairment annually, or more often, if circumstances indicate a possible impairment may exist. In accordance with the requirements of SFAS No. 142, "Goodwill and Other Intangible Assets," the Company tested the goodwill attributable to each of our reporting units for impairment as of July 31, 2006, in conjunction with the timing of our annual strategic business plan. Based on the Company's comparison of the estimated fair value of each reporting unit to their respective carrying amounts, the impairment test concluded that none of its goodwill was impaired. The following table summarizes the changes in the Company's goodwill:

	Regulated Segment	Other	Consolidated
Balance at December 31, 2004	$ 20,122	$ -	$ 20,122
Goodwill acquired during year	-	102	102
Reclassifications to utility plant acquisition adjustment	(44)	-	(44)
Balance at December 31, 2005	20,078	102	20,180
Goodwill acquired during year	226	3,941	4,167
Reclassifications to utility plant acquisition adjustment	(1,767)	-	(1,767)
Balance at December 31, 2006	$ 18,537	$ 4,043	$ 22,580

Income Taxes—The Company accounts for certain income and expense items in different time periods for financial reporting than for tax reporting purposes. Deferred income taxes are provided on the temporary differences between the tax basis of the assets and liabilities, and the amounts at which they are carried in the consolidated financial statements. The income tax effect of temporary differences not allowed currently in rates is recorded as deferred taxes with an offsetting regulatory asset or liability. These deferred income taxes are based on the enacted tax rates expected to be in effect when such temporary differences are projected to reverse. Investment tax credits are deferred and amortized over the estimated useful lives of the related properties.

Customers' Advances for Construction and Contributions in Aid of Construction—Water mains or, in some instances, cash advances to reimburse the Company for its costs to construct water mains, are contributed to the Company by customers, real estate developers and builders in order to extend water service to their properties. The value of these contributions is recorded as Customers' Advances for Construction. Non-cash property, in the form of water mains, has been received, generally from developers, as advances or contributions of $16,852, $15,729 and $9,273 in 2006, 2005 and 2004, respectively. The Company makes refunds on these advances over a specific period of time based on operating revenues related to the main or as new customers are connected to and take service from the main. After all refunds are made, any remaining balance is transferred to Contributions in Aid of Construction. Contributions in aid of construction include direct non-refundable contributions and the portion of customers' advances for construction that become non-refundable. Contributed property is generally not depreciated. Certain of the subsidiaries do depreciate contributed property and amortize contributions in aid of construction at the composite rate of the related property.

Inventories, Materials and Supplies—Inventories are stated at cost. Cost is principally determined using the first-in, first-out method.

Stock-Based Compensation—Effective January 1, 2006, the Company accounts for stock-based compensation using the fair value recognition provisions of SFAS No. 123R, "Share-Based Payment". Prior to January 1, 2006, the Company accounted for stock-based compensation using the intrinsic value method in accordance with APB Opinion No. 25. Accordingly, no compensation expense related to granting of stock options had been recognized in the financial statements prior to adoption of SFAS No. 123R for stock options that were granted. Please refer to the Recent Accounting Pronouncements section of this footnote for information concerning the Company's accounting for stock-based compensation. The following table provides the pro forma net income and earnings per share prior to January 1, 2006 as if compensation cost for stock-based employee compensation was determined as of the grant date under the fair value method of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148 "Accounting for Stock-Based Compensation – Transition and Disclosure."

(In thousands of dollars, except per share amounts)

	Years Ended December 31, 2005	2004
Net income, as reported	$ 91,156	$ 80,007
Add: stock-based employee compensation expense included in reported net income, net of tax	290	266
Less: pro forma expense related to stock options granted, net of tax effects	(2,054)	(1,990)
Pro forma	$ 89,392	$ 78,283
Basic net income per share:		
As reported	$ 0.72	$ 0.64
Pro forma	0.70	0.63
Diluted net income per share:		
As reported	$ 0.71	$ 0.64
Pro forma	0.69	0.62

For the purposes of this pro forma disclosure, the fair value of the options at the date of the grant was estimated using the Black-Scholes option-pricing model.

Use of Estimates in Preparation of Consolidated Financial Statements—The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications—Certain prior year amounts have been changed to conform with current year's presentation.

Recent Accounting Pronouncements—In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R)." This statement requires the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS No. 158, actuarial gains and losses, prior service costs or credits, and any remaining transition assets or obligations that have not been recognized under previous accounting standards that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects. The Company adopted SFAS No. 158 on December 31, 2006 as required. Because the Company is subject to regulation in the states in which it operates, the Company maintains its accounts in accordance with the regulatory authority's rules and guidelines, which may differ from other authoritative accounting pronouncements. In those instances, the Company follows the guidance of SFAS No. 71. Based on prior regulatory experience, and in accordance with SFAS No. 71, the Company has recorded a regulatory asset for the pension and other postretirement benefit costs associated with SFAS No. 158 that would otherwise be charged to common stockholders' equity, for which the Company anticipates recoverability through customer rates. As a result, the impact of adopting SFAS No. 158 on the Company's Consolidated Balance Sheet was to increase total liabilities by $30,305, and increase total assets by $30,305. The adoption of this standard had no impact on the Company's results of operations or cash flow, and the impact on financial position is described above. See the Pension Plans and Other Postretirement Benefits footnote to the consolidated financial statements for further information and the required disclosures under SFAS No. 158.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The statement applies when other statements require or permit the fair value measurement of assets and liabilities. This statement does not expand the use of fair value measurement. SFAS No. 157 is effective for the Company's fiscal year beginning January 1, 2008. The Company is currently evaluating the provisions of this statement and has not yet determined the effect of adoption on its results of operations or financial position.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides guidance on how prior year misstatements should be considered when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. The Company adopted SAB 108 as required for the fiscal year ended December 31, 2006 and it did not have a material impact on its results of operations or financial position.

In June 2006, the FASB issued FASB Interpretation No. ("FIN") 48, "Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109," which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company adopted FIN 48 as required on January 1, 2007 and it did not have a material effect on its results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment." SFAS No. 123R generally requires that we measure the cost of employee services received in exchange for stock-based awards on the grant-date fair value and this cost will be recognized over the period during which an employee provides service in exchange for the award. Prior to the adoption of SFAS No. 123R on January 1, 2006, the Company provided pro forma disclosure of its compensation costs associated with the fair value of stock options that had been granted, and accordingly, no compensation costs were recognized in its consolidated financial statements. The Company adopted this standard using the modified prospective method, and accordingly, the consolidated financial statement amounts for the prior periods presented in this report have not been restated to reflect the fair value method of expensing share-based compensation. During 2006, the adoption of SFAS No. 123R increased operations and maintenance expense by $2,894, lowered net income by $2,568, and lowered diluted net income per share by $0.019. The adoption of this standard had no material impact on the Company's overall financial position, no impact on cash flow, and results in the reclassification on the consolidated cash flow statements of related tax benefits from cash flows from operating activities to cash flows from financing activities to the extent these tax benefits exceed the associated compensation cost recognized in the income statement. See the Employee Stock and Incentive Plan footnote to the consolidated financial statements for further information and the required disclosures under SFAS No. 123R.

Acquisitions

New York Water Service Corporation—Pursuant to our strategy to grow through acquisitions, on January 1, 2007 the Company completed the acquisition of the capital stock of New York Water Service Corporation ("New York Water") for $28,866 in cash, as adjusted pursuant to the purchase agreement primarily based on working capital at closing, and the assumption of $23,460 of long-term debt. The operating results of New York Water will be included in our consolidated financial statements beginning January 1, 2007. The acquired operation provides water service to 44,792 customers in several water systems located in Nassau County, Long Island, New York. For the fiscal year ended December 31, 2005, New York Water had operating revenues of $21,773 (unaudited). The acquisition will be accounted for as a purchase and will be recorded in the first quarter of 2007.

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. At the date of acquisition, Heater provided 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. The acquisition was accounted for as a purchase and accordingly the Company recorded goodwill of $18,842.

As part of the North Carolina Utilities Commission approval process for this acquisition, the Commission approved a mechanism 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 is pursuing 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.

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 $13,090 in cash, the final purchase price as adjusted pursuant to the purchase agreement. In accordance with Florida Public Service Commission procedures, the acquisition was approved by the Commission and rate base was determined on December 20, 2005. Under the terms of the purchase agreement, the Commission's rate base determination resulted in a reduction of the final purchase price which did not result in the recognition of goodwill.

AquaSource—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. In August 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 utility systems and other, net.

Other Acquisitions— During 2006, the Company completed 27 acquisitions or other growth ventures in various states for an aggregate purchase price of $11,848 in cash. The operating revenues included in the consolidated financial statements of the Company during the period owned by the Company were $4,511.

During 2005, the Company completed 30 acquisitions or other growth ventures in various states. The total purchase price of $12,308 for the systems acquired in 2005 consisted of $11,633 in cash and the issuance of 24,684 shares of the Company's common stock. The operating revenues included in the consolidated financial statements of the Company during the period owned by the Company were $6,203 in 2006 and $2,145 in 2005.

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 $2,309 in 2006, $1,580 in 2005 and $617 in 2004.

Dispositions

In 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 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 a multi-year operating contract that expires in December 2008. These water utility assets represented less than 1% of Aqua America's total assets, and the total number of customers included in the water system sold represented less than 1% of our total utility customer base.

In 2004, the Company sold its 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.

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 utility customer base. While the Company continues to discuss this matter with officials from the City of Fort Wayne, the Company continues to protect its legal interests in this proceeding. A sanitary district in Illinois and a city in Texas have also indicated interest in acquisition, by eminent domain or otherwise, of all or a portion of the utility assets of two of the Company's operations. The systems represent approximately 3,000 customers or less than 0.5% of our total utility customer base. 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.

(In thousands of dollars, except per share amounts)

Property, Plant and Equipment

	December 31, 2006	December 31, 2005	Approximate range of remaining lives
Utility plant and equipment:			
Mains and accessories	$ 1,287,142	$ 1,187,597	15 to 82 years
Services, hydrants, treatment plants and reservoirs	801,755	660,279	5 to 85 years
Operations structures and water tanks	172,850	222,107	15 to 77 years
Miscellaneous pumping and purification equipment	381,149	376,599	5 to 50 years
Meters, data processing, transportation and operating equipment	428,326	341,550	5 to 50 years
Land and other non-depreciable assets	80,479	73,346	-
Utility Plant and equipment	3,151,701	2,861,478	
Utility construction work in progress	76,653	98,898	-
Net utility plant acquisition adjustment	(51,434)	(64,165)	0 to 20 years
Non-utility plant and equipment	8,191	4,374	3 to 25 years
Total property, plant and equipment	$ 3,185,111	$ 2,900,585	

Accounts Receivable

	December 31, 2006	December 31, 2005
Billed utility revenue	$ 49,129	$ 42,541
Unbilled utility revenue	23,842	21,419
Other	4,147	3,136
	77,118	67,096
Less allowance for doubtful accounts	4,969	4,406
Net accounts receivable	$ 72,149	$ 62,690

The Company's utility customers are located principally in the following states: 47% in Pennsylvania, 10% in Ohio, 9% in North Carolina, 8% in Illinois, 6% in Texas, 6% in New Jersey, 5% in Indiana and 4% in Florida. No single customer accounted for more than one percent of the Company's operating revenues during the years ended December 31, 2006, 2005 or 2004. The following table summarizes the changes in the Company's allowance for doubtful accounts:

	2006	2005	2004
Balance at January 1,	$ 4,406	$ 4,849	$ 5,851
Amounts charged to expense	3,716	3,116	3,695
Accounts written off	(3,607)	(4,113)	(5,460)
Recoveries of accounts written off	454	554	701
Allowance acquired through acquisitions	-	-	62
Balance at December 31,	$ 4,969	$ 4,406	$ 4,849

(In thousands of dollars, except per share amounts)

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 regulatory liabilities are as follows:

	December 31, 2006		December 31, 2005	
	Regulatory Assets	Regulatory Liabilities	Regulatory Assets	Regulatory Liabilities
Income taxes	$ 70,146	$ 2,104	$ 69,531	$ 2,203
Utility plant retirement costs	20,060	8,960	17,421	8,368
Postretirement benefits	36,469	-	10,871	-
Texas rate filing expense deferral	12,382	-	9,486	-
Competitive Transition Charge payment	4,586	-	5,733	-
Water tank painting	4,822	32	4,292	267
Fair value of long-term debt assumed in acquisition	2,594	-	2,804	-
Merger costs	1,111	-	1,641	-
Rate case filing expenses & other	12,893	496	9,174	913
	$ 165,063	$ 11,592	$130,953	$ 11,751

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 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.

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. In addition, a regulatory asset has been recorded for the costs that would otherwise be charged to common stockholders' equity in accordance with SFAS No. 158, for the underfunded status of our pension and other postretirement benefit plans. See the Pension Plans and Other Postretirement Benefits footnote to the consolidated financial statements for the effect on regulatory assets of the adoption of SFAS No. 158. 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.

The regulatory asset for the Texas rate filing of 2004 results from a multi-year plan to increase annual revenues in phases, and to defer and amortize a portion of the Company's depreciation, operating and other tax expense over a similar multi-year period. These costs will be amortized over a period of time, expected to approximate four years, as determined by the final rate order.

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 an electric distribution 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.

(In thousands of dollars, except per share amounts)

Expenses associated with water tank painting are deferred and amortized over a period of time as approved in the regulatory process. Water tank painting costs are generally being amortized over a period ranging from 5 to 17 years.

As a requirement of purchase accounting, the Company recorded a fair value adjustment for fixed-rate, long-term debt assumed in acquisitions. The regulatory asset results from the rate setting process continuing to recognize the historical interest cost of the assumed debt.

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 ten-year recovery period.

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. Other represents costs incurred by the Company for which it has received or expects to receive rate recovery.

The regulatory asset related to the costs incurred for information technology software projects and water main cleaning and relining projects are described in the Summary of Significant Accounting Policies – Property Plant and Equipment and Depreciation.

Income Taxes

The provision for income taxes consists of:

	Years Ended December 31,		
	2006	2005	2004
Current:			
Federal	$ 39,956	$ 24,417	$ 2,042
State	9,502	6,586	7,553
	49,458	31,003	9,595
Deferred:			
Federal	9,531	22,294	41,414
State	1,257	3,616	1,115
	10,788	25,910	42,529
Total tax expense	$ 60,246	$ 56,913	$ 52,124

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 2002 have been closed.

(In thousands of dollars, except per share amounts)

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, 2006	2005	2004
Computed Federal tax expense at statutory rate	$ 53,287	$ 51,824	$ 46,245
Increase in tax expense for depreciation expense to be recovered in future rates	716	806	1,376
Domestic Production Credit	(602)	(656)	-
Stock-based compensation	715	-	-
Deduction for Aqua America common dividends paid under employee benefit plan	(307)	(321)	(245)
Amortization of deferred investment tax credits	(274)	(359)	(285)
Prior year rate reductions	(154)	(437)	(538)
State income taxes, net of federal tax benefit	6,999	6,631	5,634
Other, net	(134)	(575)	(63)
Actual income tax expense	$ 60,246	$ 56,913	$ 52,124

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, 2006	2005
Deferred tax assets:		
Customers' advances for construction	$ 17,786	$ 17,549
Costs expensed for book not deducted for tax, principally accrued expenses	2,787	1,803
Utility plant acquisition adjustment basis differences	18,673	29,429
Postretirement benefits	12,530	1,660
Other	295	-
Total gross deferred tax assets	52,071	50,441
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	278,917	267,835
Deferred taxes associated with the gross-up of revenues necessary to recover, in rates, the effect of temporary differences	26,276	25,796
Tax effect of regulatory asset for postretirement benefits	12,530	-
Deferred investment tax credit	5,801	6,066
Other	1,746	1,090
Total gross deferred tax liabilities	325,270	300,787
Net deferred tax liability	$ 273,199	$ 250,346

In June 2006, the FASB issued FASB Interpretation No. ("FIN") 48, "Accounting for Uncertainty in Income Taxes–An Interpretation of FASB Statement No. 109," which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We adopted FIN 48 as required on January 1, 2007 and it did not have a material effect on our results of operations or financial position.

(In thousands of dollars, except per share amounts)

Taxes Other than Income Taxes

The following table provides the components of taxes other than income taxes:

	Years Ended December 31,		
	2006	2005	2004
Property	$ 14,953	$ 13,247	$ 10,919
Capital Stock	3,675	3,706	3,402
Gross receipts, excise and franchise	6,750	6,483	5,778
Payroll	5,701	5,648	5,134
Other	2,264	2,612	2,363
Total taxes other than income	$ 33,343	$ 31,696	$ 27,596

Commitments and Contingencies

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 through 2011 are expected to approximate $10,092 and $59,091 thereafter. The Company purchased approximately $10,497, $10,603 and $8,724 of water under these agreements during the years ended December 31, 2006, 2005 and 2004, respectively.

The Company leases motor vehicles, buildings and other equipment under operating leases that are noncancelable. The future annual minimum lease payments due are: $3,450 in 2007, $3,100 in 2008, $1,587 in 2009, $547 in 2010, $147 in 2011 and $132 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 2010 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 $554 of annual lease payments for land are due, and $17,004 thereafter. The Company leases treatment plants to other parties under lease agreements that require payments to the Company of $366 in 2007, $366 in 2008, $366 in 2009, $366 in 2010, $366 in 2011 and $5,553 thereafter.

Rent expense was $4,478, $3,390 and $3,267 for the years ended December 31, 2006, 2005 and 2004, respectively.

Contingencies–The Company is routinely involved in condemnation proceedings and legal matters during the ordinary course of business. See Water and Wastewater Rates footnote for a discussion of the rate proceeding process involving our subsidiaries in Texas. Although the results of legal proceedings cannot be predicted with certainty, there are no other pending legal proceedings to which the Company or any of its subsidiaries is a party or to which any of its properties is the subject that are material or are expected to have a material effect on the Company's financial position, results of operations or cash flows.

(In thousands of dollars, except per share amounts)

Long-term Debt and Loans Payable

The Consolidated Statements of Capitalization provide a summary of long-term debt as of December 31, 2006 and 2005. 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, 2006, approximately $326,000 of Aqua Pennsylvania's retained earnings of approximately $346,000 and $76,000 of the retained earnings of $85,000 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.

Sinking fund payments are required by the terms of certain issues of long-term debt. The future sinking fund payments and debt maturities of the Company's long-term debt are as follows:

Interest Rate Range	2007	2008	2009	2010	2011	Thereafter
0.00% to 2.49%	$ 1,514	$ 1,614	$ 1,657	$ 1,689	$ 1,714	$ 17,552
2.50% to 2.99%	1,533	1,604	1,649	1,682	1,729	17,075
3.00% to 3.49%	12,248	258	276	287	299	3,852
3.50% to 3.99%	685	695	706	717	328	2,942
4.00% to 4.99%	50	50	55	27,055	55	138,380
5.00% to 5.49%	-	-	-	-	-	292,496
5.50% to 5.99%	-	-	-	-	-	169,000
6.00% to 6.49%	644	10,172	-	-	15,000	69,360
6.50% to 6.99%	10,000	-	-	-	-	12,000
7.00% to 7.49%	2,540	2,585	634	687	744	6,098
7.50% to 7.99%	210	227	245	264	286	23,546
8.00% to 8.49%	152	167	184	202	222	25,361
8.50% to 8.99%	-	-	-	-	-	9,000
9.00% to 9.49%	584	594	604	20,615	5,627	18,077
9.50% to 9.99%	995	5,995	994	994	994	28,766
10.00% to 10.50%	-	-	-	-	-	6,000
Total	$ 31,155	$ 23,961	$ 7,004	$ 54,192	$ 26,998	$ 839,505

In March 2006, Aqua Pennsylvania issued $40,000 of unsecured notes at 5.95% of which $10,000 are due in 2023, 2024, 2033 and 2034. In September 2006, Aqua Pennsylvania issued $20,000 of unsecured notes at 5.64% with amounts due in 2014, 2016, 2020 and 2021. Proceeds from the sales of these notes were used to repay short-term borrowings. In December 2006, the Company issued $30,000 of unsecured notes with an interest rate of 5.54% of which $10,000 are due in 2013, 2017 and 2018. The proceeds of this financing were used to fund acquisitions. At various times during 2006, Aqua Pennsylvania and other operating subsidiaries issued other notes payable and first mortgage bonds in aggregate of $14,728 at a weighted average interest rate of 3.64% due at various times ranging from 2016 to 2036. 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.

In February 2005, the Company issued $30,000 of unsecured notes of which $18,000 are due in 2015 with an interest rate of 5.01% and $12,000 are due in 2020 with an interest rate of 5.20%. The proceeds of this financing were used to refinance existing short-term debt. In May 2005, Aqua Pennsylvania issued $72,000 of tax-exempt bonds secured by a supplement to its first mortgage indenture at the following terms: $22,000 at 4.87% due 2036, $25,000 at 4.88% due 2037 and $25,000 at 4.89% due 2038. Of the $72,000 in proceeds, $22,000 was used to retire previously issued tax-exempt bonds in August 2005 and the balance of proceeds are restricted to funding the costs of certain capital projects during the period 2005 through 2007. In December 2005, Aqua Pennsylvania issued $25,000 of tax-exempt bonds at 4.82% due 2035, which were secured by a supplement to its first mortgage indenture. The proceeds are restricted to funding certain capital projects during the period 2006 through 2008. At various times during 2005, Aqua Pennsylvania and other operating subsidiaries issued other notes payable, first mortgage bonds and tax-exempt bonds aggregating $24,677 at a weighted-average interest rate of 4.10% due at various times ranging from 2019 to 2035. The proceeds from these issuances were used to reduce a portion of the balance of short-term debt at each of the respective operating subsidiaries and to redeem $10,260 of first mortgage bonds of an operating subsidiary with an interest rate of 5.60%. As of December 31, 2006, the Trustees for ten issues held $11,490 pending construction of the projects to be financed with the issues and are reported in the consolidated balance sheet as funds restricted for construction activity. The weighted average cost of long-term debt at December 31, 2006 and 2005 was 5.72% and 5.74%, respectively.

(In thousands of dollars, except per share amounts)

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, 2006 and 2005, funds borrowed under the Aqua Pennsylvania revolving credit agreements were $3,000 and $65,000, respectively, and $20,000 and $17,000 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 short-term borrowings of Aqua Pennsylvania and the Company. A commitment fee of 1/10 of 1% is charged on the total commitment amount of Aqua Pennsylvania's revolving credit agreement. The average cost of borrowing under these facilities was 5.4% and 3.8%, and the average borrowing was $66,283 and $63,355, during 2006 and 2005, respectively. The maximum amount outstanding at the end of any one month was $85,000 in both 2006 and 2005.

At December 31, 2006 and 2005, the Company had combined short-term lines of credit of $148,000 and $127,000, respectively. Funds borrowed under these lines are classified as loans payable and are used to provide working capital. As of December 31, 2006 and 2005, funds borrowed under the short-term lines of credit were $96,150 and $56,505, respectively. The average borrowing under the lines was $77,528 and $35,610 during 2006 and 2005, respectively. The maximum amount outstanding at the end of any one month was $96,150 in 2006 and $56,505 in 2005. 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 2006 and 2005 was 5.5% and 3.9%, respectively.

Interest income of $3,241, $3,040 and $1,762 was netted against interest expense on the consolidated statements of income for the years ended December 31, 2006, 2005 and 2004, respectively. The total interest cost was $61,673, $55,102 and $50,441 in 2006, 2005 and 2004, including amounts capitalized of $3,941, $2,447 and $2,304, 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,	
	2006	2005
Carrying amount	$ 982,815	$ 903,083
Estimated fair value	986,487	950,479

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 $76,820 and $74,828 at December 31, 2006 and 2005, 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 2021 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.

Stockholders' Equity

At December 31, 2006, the Company had 300,000,000 shares of common stock authorized; par value $0.50. Shares outstanding at December 31, 2006, 2005 and 2004 were 132,325,579, 128,970,181 and 127,179,777, respectively. Treasury shares held at December 31, 2006, 2005 and 2004 were 691,746, 688,625 and 686,747, respectively. At December 31, 2006, the Company had 1,738,619 shares of authorized but unissued Series Preferred Stock, $1.00 par value.

In December 2005, the Company filed a universal shelf registration with the Securities and Exchange Commission to allow for the potential future sale by us, from time to time, in one or more public offerings, of an indeterminant amount of our common stock, preferred stock, debt securities and other securities specified therein at indeterminant prices.

In August 2006, the Company entered into a forward equity sale agreement for 3,525,000 shares of common stock with a third-party (the "forward purchaser"). In connection with the forward equity sale agreement, the forward purchaser borrowed an equal number of shares of the Company's common stock from stock lenders and sold the borrowed shares to the public. The Company will not receive any proceeds from the sale of its common stock by the forward purchaser until settlement of the forward equity sale agreement. The actual proceeds to be received by the Company will vary depending upon the settlement date, the number of shares designated for settlement on that settlement date and the method of settlement. Aqua America intends to use any proceeds received upon settlement of the forward equity sale agreement to fund the Company's future capital expenditure program and acquisitions, and for working capital and other general corporate purposes. The forward equity sale agreement is accounted for as an equity instrument and was recorded at a fair value of $0 at inception. It will not be adjusted so long as the Company continues to meet the accounting requirements for equity instruments.

The Company may elect to settle the forward equity sale agreement by means of a physical share settlement, net cash settlement, or net share settlement, on a settlement date or dates, no later than August 1, 2008. The forward equity sale agreement provides that the forward sale price will be computed based upon the initial forward sale price of $21.857 per share. Under limited circumstances or certain unanticipated events, the forward purchaser also has the ability to require the Company to physically settle the forward equity sale agreement in shares prior to the maturity date. The maximum number of shares that could be required to be issued by the Company to settle the forward equity sale agreement is 3,525,000 shares. As of December 31, 2006, a net cash settlement under the forward equity sale agreement would have resulted in a payment by the Company to the forward purchaser of $2,845 or a net share settlement would have resulted in the issuance of 124,876 shares by the Company to the forward purchaser. For each increase or decrease of one dollar in the average market price of Aqua America common stock above or below the forward sale price on December 31, 2006, the cash settlement option from the Company's perspective would decrease or increase by $3,525 and the net share settlement option would decrease by 161,846 shares or increase by 148,234 shares, respectively.

During the last three years, the Company completed the following offerings of equity:

- In June 2006, the Company sold 1,750,000 shares of common stock in a public offering for proceeds of $37,400, net of expenses. In August 2006, the Company sold 500,000 shares of common stock in a public offering for proceeds of $10,700, net of expenses. The net proceeds from these offerings were used to fund the Company's capital expenditure program and acquisitions, and for working capital and other general corporate purposes.
- In November 2004, the Company issued 2,606,667 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 the Company's short-term debt. The indebtedness was incurred by Aqua America in connection with acquisitions.

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 in connection with acquisitions. During 2005, 24,684 shares of common stock totaling $675 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, 2006 is 2,194,262 shares. The form and terms of any securities issued under these shelf registrations will be determined at the time of issuance.

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 2006, 2005 and 2004, under the dividend reinvestment portion of the Plan, 405,107, 401,503 and 512,609 original issue shares of common stock were sold providing the Company with proceeds of $9,341, $8,516 and $7,808, respectively.

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, 2006, 548,278 shares remain available for repurchase.

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 Common Stockholders' Equity section of the Consolidated Balance Sheets, the Consolidated Statements of Common 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 investments as other comprehensive income and accumulated other comprehensive income. Prior to the fourth quarter of 2006, a portion of the Company's minimum pension liability had been charged to accumulated other comprehensive income or loss. During the fourth quarter of 2006, the Company recorded a regulatory asset for its minimum pension liability as it anticipates recovery of its future pension expense through customer rates. Concurrent with this adjustment, the minimum pension liability was adjusted through other comprehensive income and removed from accumulated other comprehensive income.

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 and shares issuable under the forward equity sale agreement (from the date the company entered into the forward equity sale agreement to the settlement date) is included in the computation of diluted net income per share. The dilutive effect of stock options and shares issuable under the forward equity sale agreement is calculated using the treasury stock method and expected proceeds upon exercise of the stock options and settlement of the forward equity sale agreement. The following table summarizes the shares, in thousands, used in computing basic and diluted net income per share:

	Years ended December 31,		
	2006	2005	2004
Average common shares outstanding during the period for basic computation	130,725	127,364	124,329
Effect of dilutive securities:			
Employee stock options	978	1,842	1,381
Forward equity shares	71	-	-
Average common shares outstanding during the period for diluted computation	131,774	129,206	125,710

For the years ended December 31, 2006 and 2004, employee stock options outstanding to purchase 581,850 and 759,867 shares of common stock, respectively, were excluded from the calculations of diluted net income per share as the options' exercise prices were greater than the average market price of the Company's common stock. For the year ended December 31, 2005, 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 $6.96 and $6.30 at December 31, 2006 and 2005, 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.

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.

(In thousands of dollars, except per share amounts)

Employee Stock and Incentive Plan

Under the 2004 Equity Compensation Plan (the "2004 Plan"), as approved by the shareholders to replace the 1994 Equity Compensation Plan (the "1994 Plan"), qualified and non-qualified stock options may be granted to officers, key employees and consultants at prices equal to the market price of the stock on the day of the grant. 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. The 2004 Plan authorizes 4,900,000 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 200,000. Awards under the 2004 Plan are made by a committee of the Board of Directors. At December 31, 2006, 3,521,136 options underlying stock option and restricted stock awards were still available for grant under the 2004 Plan, 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 plan.

Stock Options – Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123R, "Share-Based Payment," which revised SFAS No. 123, "Accounting for Stock-based Compensation," and superseded APB No. 25, "Accounting for Stock Issued to Employees." Prior to January 1, 2006, the Company accounted for stock-based compensation using the intrinsic value method in accordance with APB Opinion No. 25. Accordingly, no compensation expense related to granting of stock options had been recognized in the financial statements prior to adoption of SFAS No. 123R for stock options that were granted, as the grant price equaled the market price on the date of grant.

The Company adopted this standard using the modified prospective method, and accordingly the financial statement amounts for the prior periods presented in this report have not been restated to reflect the fair value method of expensing share-based compensation. Under this transition method, compensation cost recognized in the year ended December 31, 2006 includes compensation cost for all share-based payments granted prior to, but not vested as of January 1, 2006, and share-based payments granted after January 1, 2006. For the year ended December 31, 2006, the impact of the adoption of SFAS No. 123R as compared to if the Company had continued to account for share-based compensation under APB Opinion No. 25: increased operations and maintenance expense by $2,894, increased capitalized compensation costs within property, plant and equipment by $631, lowered income tax expense by $326, lowered net income by $2,568, lowered diluted net income per share by $0.019, and lowered basic net income per share by $0.02. SFAS 123R requires the Company to estimate forfeitures in calculating the compensation expense instead of recognizing these forfeitures and the resulting reduction in compensation expense as they occur. As of January 1, 2006, the cumulative after-tax effect of this change in accounting for forfeitures, if this adjustment was recorded, would have been to reduce stock-based compensation by $12. The estimate of forfeitures will be adjusted over the vesting period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. The adoption of this standard had no impact on net cash flows and results in the reclassification on the consolidated cash flow statements of related tax benefits from cash flows from operating activities to cash flows from financing activities to the extent these tax benefits exceeded the associated compensation cost as determined under SFAS 123R. As of the date of adoption, the Company has calculated its pool of windfall tax benefits in accordance with the method outlined in SFAS 123R.

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 fair value of each option is amortized into compensation expense on a straight-line basis over their respective 36 month vesting period, net of estimated forfeitures. The fair value of options was estimated at the grant date using the Black-Scholes option-pricing model. The per share weighted-average fair value at the date of grant for stock options granted during the years ended December 31, 2006, 2005 and 2004 was $7.82, $4.54 and $4.07 per option, respectively. The application of this valuation model relies on the following assumptions that are judgmental and sensitive in the determination of the compensation expense for the periods reported:

	2006	2005	2004
Expected term (years)	5.2	5.2	4.5
Risk-free interest rate	4.7%	4.0%	4.0%
Expected volatility	25.8%	27.8%	29.9%
Dividend yield	1.76%	2.40%	2.23%

(In thousands of dollars, except per share amounts)

Historical information was the principal basis for the selection of the expected term and dividend yield. The expected volatility is based on a weighted-average combination of historical and implied volatilities over a time period that approximates the expected term of the option. The risk-free interest rate was selected based upon the U.S. Treasury yield curve in effect at the time of grant for the expected term of the option.

The following table summarizes stock option transactions for the year ended December 31, 2006:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Life (years)	Aggregate Intrinsic Value
Options:				
Outstanding, beginning of year	3,492,363	$ 13.70		
Granted	611,950	29.46		
Forfeited	(46,684)	22.84		
Expired	(26,639)	22.04		
Exercised	(666,212)	11.95		
Outstanding, end of year	3,364,778	$ 16.72	6.6	$ 24,268
Exercisable, end of year	2,044,825	$ 12.76	5.4	$ 20,486

The intrinsic value of stock options is the amount by which the market price of the stock on a given date, such as at the end of the period or on the day of exercise, exceeded the market price of stock on the date of grant. The following table summarizes the aggregate intrinsic value of stock options exercised and the fair value of stock options which became vested:

	Years ended December 31, 2006	2005	2004
Intrinsic value of options exercised	$ 9,779	$ 18,473	$ 4,180
Fair value of options vested	3,794	3,532	3,079

The following table summarizes information about the options outstanding and options exercisable as of December 31, 2006:

	Options Outstanding			Options Exercisable	
	Shares	Weighted Average Remaining Life (years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Range of prices:					
$ 5.81 - 9.99	382,949	2.3	$ 7.60	382,949	$ 7.60
$10.00 - 12.99	997,750	5.4	12.21	997,750	12.21
$13.00 - 15.99	90,779	6.4	13.76	90,779	13.76
$16.00 - 16.99	576,865	7.3	16.15	347,925	16.15
$17.00 - 18.33	734,585	8.2	18.33	225,422	18.33
$29.00 - 29.99	581,850	9.3	29.46	-	-
	3,364,778	6.6	$ 16.72	2,044,825	$ 12.76

As of December 31, 2006, there was $4,732 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the plans. The cost is expected to be recognized over a weighted-average period of 1.1 years.

(In thousands of dollars, except per share amounts)

Restricted Stock – 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. Restricted stock awards result in compensation expense which 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 adoption of SFAS No. 123R had no impact on the Company's recognition of stock-based compensation expense associated with restricted stock awards. The Company expects forfeitures of restricted stock to be de minimus. There were no forfeitures prior to the adoption of SFAS 123R for the grants that were under restriction as of January 1, 2006. During the years ended December 31, 2006, 2005 and 2004, the company recorded stock-based compensation related to restricted stock awards as operations and maintenance expense in the amounts of $710, $495 and $439, respectively. The following table summarizes nonvested restricted stock transactions for the year ended December 31, 2006:

	Number of Shares	Weighted Average Fair Value
Nonvested shares at beginning of period	43,998	$ 17.70
Granted	42,200	28.39
Vested	(24,310)	19.11
Forfeited	(5,000)	29.46
Nonvested shares at end of period	56,888	$ 23.98

The following table summarizes the value of restricted stock awards at the date the restriction lapsed:

	Years ended December 31,		
	2006	2005	2004
Intrinsic value of restricted stock awards vested	$ 660	$ 614	$ 449
Fair value of restricted stock awards vested	465	500	360

As of December 31, 2006, $890 of unrecognized compensation costs related to restricted stock is expected to be recognized over a weighted-average period of 1.0 year. The aggregate intrinsic value of restricted stock as of December 31, 2006 was $1,296. The aggregate intrinsic value of restricted stock is based on the number of shares of restricted stock and the market value of the Company's common stock as of the period end date.

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.

(In thousands of dollars, except per share amounts)

The Company adopted SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R)" on December 31, 2006. As a result of adopting SFAS No. 158, the Company recorded the underfunded status of its pension and other postretirement benefit plans on the balance sheet and recorded a regulatory asset for these costs that would otherwise be charged to common stockholders' equity, as we anticipate recoverability of the costs through customer rates. As a result of adopting SFAS No. 158, the additional minimum liability associated with the Company's defined benefit pension plan was eliminated as it is no longer required to be recorded under SFAS No. 158. Prior to the adoption of SFAS No. 158 on December 31, 2006, the Company's additional minimum liability was $3,498. The additional minimum liability was a result of the accumulated benefit obligation exceeding the fair value of plan assets. The decrease in the additional minimum liability from December 31, 2005 of $10,909 to December 31, 2006 of $3,498, prior to adoption of SFAS No. 158, resulted from the effect of an increased discount rate and an increase in pension plan assets during 2006 due to positive equity market performance and pension contributions. In accordance with SFAS No. 158, the Company's 2005 accounting and related disclosures were not affected by the adoption of the new accounting standard. The adoption of this standard had no impact on the Company's results of operations or cash flow. The table below summarizes the incremental effects of SFAS No. 158 adoption on the individual line items on the Company's Consolidated Balance Sheet at December 31, 2006:

	Pre - SFAS No. 158 Adoption	SFAS No. 158 Adjustment	Post - SFAS No. 158 Adoption
Assets:			
Regulatory assets	$ 4,167	$ 32,302	$ 36,469
Deferred charges and other assets, net	1,997	(1,997)	-
	$ 6,164	$ 30,305	$ 36,469
Liabilities:			
Other accrued liabilities	$ 10,391	$ (10,260)	$ 131
Other liabilities	18,718	40,565	59,283
	$ 29,109	$ 30,305	$ 59,414

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

	Pension Benefits	Other Postretirement Benefits
Years:		
2007	$ 7,017	$ 964
2008	7,363	1,024
2009	7,794	1,105
2010	8,259	1,210
2011	8,848	1,293
2012 - 2016	56,262	8,186

(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	
	2006	2005	2006	2005
Change in benefit obligation:				
Benefit obligation at January 1,	$179,741	$171,076	$ 29,161	$ 32,804
Service cost	4,784	4,847	1,002	1,223
Interest cost	10,094	9,805	1,581	1,882
Plan amendments	406	-	-	(7,047)
Actuarial (gain) loss	(10,469)	420	(2,941)	1,317
Plan participants' contributions		-	249	584
Benefits paid	(6,272)	(6,407)	(842)	(1,602)
Benefit obligation at December 31,	178,284	179,741	28,210	29,161
Change in plan assets:				
Fair value of plan assets at January 1,	117,671	115,292	18,942	16,606
Actual return on plan assets	8,757	7,790	933	675
Employer contributions	6,521	996	1,367	2,678
Benefits paid	(6,483)	(6,407)	(628)	(1,017)
Fair value of plan assets at December 31,	126,466	117,671	20,614	18,942
Funded status of plan:				
Funded status at December 31,	51,818	62,070	7,596	10,219
Unrecognized actuarial loss	-	(42,092)	-	(8,537)
Unrecognized prior service cost	-	(1,687)	-	7,517
Unrecognized net transition obligation	-	809	-	(5,624)
Net amount recognized	$ 51,818	$ 19,100	$ 7,596	$ 3,575

Company's pension plans had an accumulated benefit obligation of $150,999 and $148,629 at December 31, 2006 and 2005, respectively. The following table provides the net liability recognized on the Consolidated Balance Sheets at December 31:

	Pension Benefits		Other Postretirement Benefits	
	2006	2005	2006	2005
Current liability	$ (131)	$ -	$ -	$ -
Noncurrent liability	(51,687)	-	(7,596)	-
Prepaid benefits cost	-	-	-	555
Accrued benefit cost	-	(19,100)	-	(4,130)
Additional minimum liability	-	(12,726)	-	-
Intangible assets	-	1,817	-	-
Regulatory asset	-	6,167	-	-
Accumulated other comprehensive loss	-	4,742	-	-
Net liability recognized	$ (51,818)	$ (19,100)	$ (7,596)	$ (3,575)

(In thousands of dollars, except per share amounts)

At December 31, 2006 and 2005, 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	
	2006	2005
Projected benefit obligation	$ 178,284	$ 179,741
Fair value of plan assets	126,466	117,671

	Accumulated Benefit Obligation Exceeds the Fair Value of Plan Assets	
	2006	2005
Accumulated benefit obligation	$ 150,999	$ 148,629
Fair value of plan assets	126,466	117,671

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

	Pension Benefits			Other Postretirement Benefits		
	2006	2005	2004	2006	2005	2004
Service cost	$4,783	$ 4,847	$ 4,312	$ 1,003	$ 1,223	$ 1,112
Interest cost	10,094	9,805	9,512	1,582	1,882	1,825
Expected return on plan assets	(9,397)	(9,536)	(9,169)	(1,299)	(1,261)	(1,086)
Amortization of transition obligation (asset)	(209)	(209)	(209)	104	803	803
Amortization of prior service cost	216	403	419	(281)	(57)	(57)
Amortization of actuarial (gain) loss	1,756	1,606	1,009	300	219	125
Amortization of regulatory asset	-	-	-	152	136	144
Capitalized costs & other	(1,826)	(1,847)	(1,021)	(757)	(739)	(629)
Net periodic benefit cost	$5,417	$ 5,069	$ 4,853	$ 804	$ 2,206	$ 2,237

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	
	2006	2005	2006	2005
Weighted-average Assumptions Used to Determine Benefit Obligations as of December 31,				
Discount rate	5.90%	5.65%	5.90%	5.65%
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	9%	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	2011	2011
Weighted-average Assumptions Used to Determine Net Periodic Benefit Costs for Years Ended December 31,				
Discount rate	5.65%	5.75%	5.65%	5.75%
Expected return on plan assets	8.0%	8.5%	5.33-8.0%	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	2011	2010

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	$ 1,516	$ (1,483)
Effect on total service and interest cost components of net periodic postretirement health-care benefit cost	$ 150	$ (150)