

Mid America Regulatory Conference

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AQUASM



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U.S. Water Industry Today

- Highly fragmented; few providers of scale
- Relative price inelastic demand - No substitute exists
- Infrastructure concerns
 - EPA Needs Survey - hundreds of billions over the next 20 years
- Monopoly – Subject to state regulatory jurisdiction (environmental & economic)
- Only utility that is ingested



Aging Infrastructure

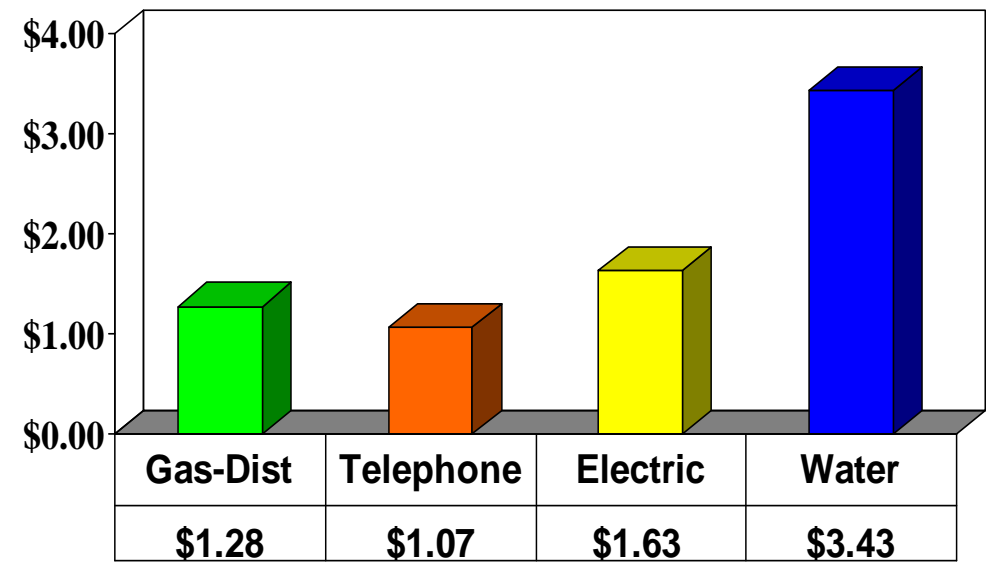
- EPA recommends over \$320 billion in infrastructure improvements over the next 20 years for water utilities
- Ongoing Problem: high plant rehabilitation and pipe replacement costs
 - Municipalities are deferring costs
 - Companies face regulatory lag (disincentive to invest)



Water Industry is the Most Capital Intensive Industry

- EPA rules require large investment in filtration plants
- Immense investment needed for distribution system and road repair
- More capital per revenue than all other utilities and manufacturing industries

Capital Invested per \$1 of Revenue

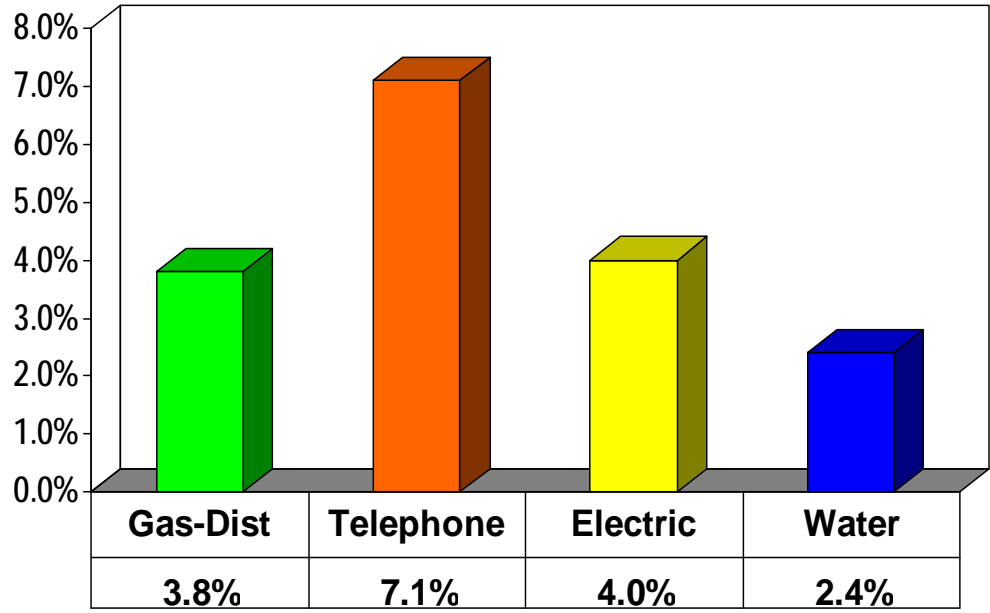


Source: 2003 C.A. Turner Utility Reports



Water Industry has the Lowest Depreciation Rate in the Industry

- Water industry has longest capital recovery period, which is viewed negatively by Wall Street
- Historic cost recorded is lower than replacement cost



Source: 2003 C.A. Turner Utility Reports



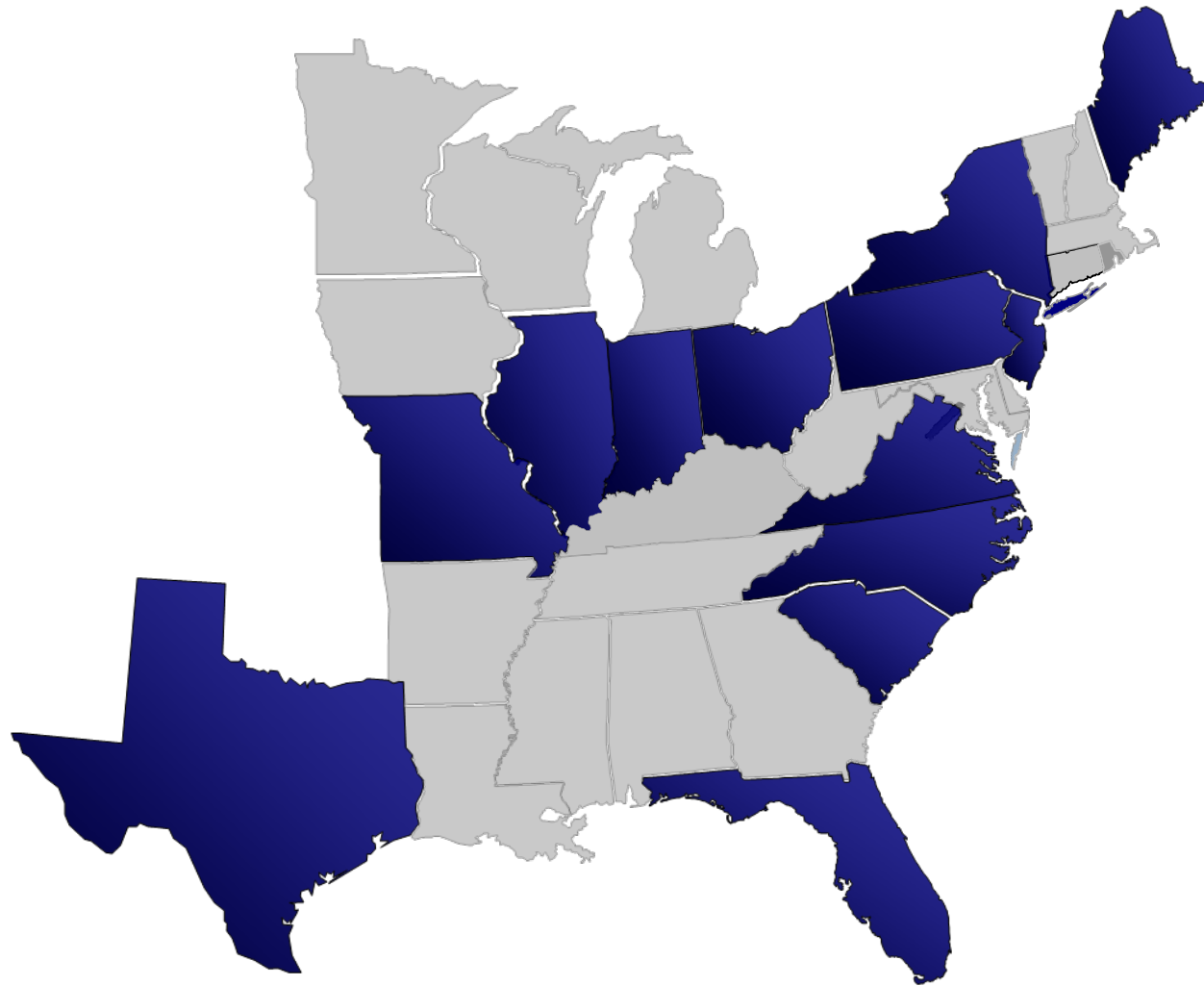
Aqua America Today



- One of the largest US-based publicly traded water utility - - Formed in 1886
- Focus on asset ownership model – invest needed capital and earn fair, regulated return
- Unique growth story – growth through acquisition strategy
- Financial strength; good credit quality
- Strong focus on improved regulatory and customer relations



Operating Locations



 Current operations



Challenges for the Responsible Water Company

- Significant restructuring over past 15 years
- Major spending recently due to EPA rules and aging infrastructure
- Population growth has slowed significantly
- External capital investment
- Implementation of conservation policies



Access to Capital Markets

- Recent volatility in financial market
- No new sources of capital - competitive
- Instability due to depressed earnings
- State by state review of ratings based on regulatory environment
- “Perfect Storm” scenario



New Challenges

- Inability to achieve authorized ROE
- Often unachievable on Day 1 of new rates
- Not related to efficiency or management
- Historic test years worked in past due to:
 - Above average customer growth
 - Little capital spending
- Dramatic infrastructure & security improvements



Reality Today

- Utilities have little or no natural customer growth
- Significant capital spending needed and required
- Historic test years produce rates not reflective of current capital projects
- Arbitrary caps on expenses or regulatory policies that do not reflect the current situation (Ex. bad debt caps)



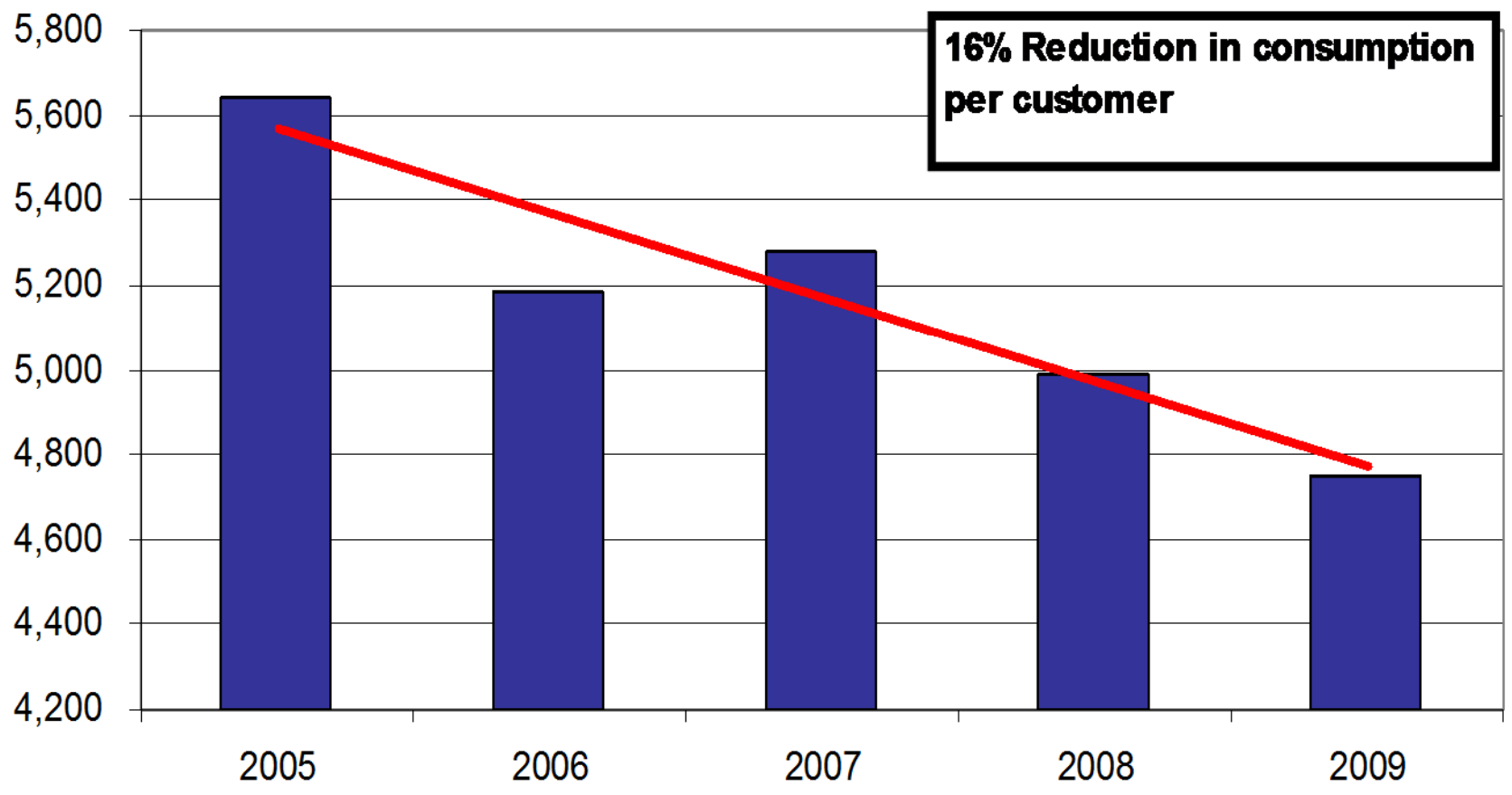
Conservation

- Voluntary – growing percentage of population is conserving
- Plumbing Codes
- Mandatory – drought restrictions yield an immediate reduction in consumption
- Rate Making – inclining block rates provide economic incentive to large users to conserve
- Reduced Demand = Reduced Revenue
- Maintenance of existing facilities and fixed costs remain the same



Ohio Consumption Per Customer

16% Reduction in consumption per customer





Innovative Ideas

- Repression adjustments
 - Due to decrease in consumption
 - Conservation rates (inclining blocks)
- Inclining Blocks without repression does not allow achievement of revenue requirement
- Recognition of decreased consumption patterns allows for more consistent and gradual rate filings



Innovative Ideas Continued

- Surcharge (DSIC) mechanisms
- Pass Throughs - purchased power, water & chemicals
- Index or COLA increases
- Future or Projected Test Years
- Interim rates subject to refund



More Ideas

- Allowing known and measurable changes
 - Projected test year
 - Pro Forma Allowance
- Solving small troubled water system issues
 - Acquisition incentives
 - Consolidated rates
- Amortization of:
 - Rate Case Expense
 - Required Tank Painting
 - Storm Damage (hurricanes etc.)



Conclusion

- Certain states encourage investment in infrastructure as a result of their use of regulatory tools.
- Regulation should adjust to today's conditions (i.e. slowed customer growth, immense need for capital)
- Explore innovative solutions
- Regulatory certainty provides utilities with confidence and facilitates investment



Environmentally and Socially Responsible

