

American Water Works Company, Inc.
Form 10-Q
November 05, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from _____ to _____

Commission file: number 001-34028

AMERICAN WATER WORKS COMPANY, INC.

(Exact name of registrant as specified in its charter)

| | |
|--|---------------------|
| Delaware | 51-0063696 |
| (State or other jurisdiction of | (I.R.S. Employer |
| incorporation or organization) | Identification No.) |
| 1025 Laurel Oak Road, Voorhees, NJ | 08043 |
| (Address of principal executive offices) | (Zip Code) |

(856) 346-8200

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes
 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.). Yes No

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

| Class | Outstanding at October 30, 2014 |
|--|---------------------------------|
| Common Stock, \$0.01 par value per share | 179,309,045 shares |

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AMERICAN WATER WORKS COMPANY, INC.

REPORT ON FORM 10-Q

FOR THE QUARTER ENDED September 30, 2014

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

American Water Works Company, Inc. and Subsidiary Companies

Consolidated Balance Sheets (Unaudited)

(In thousands, except per share data)

| | September 30, 2014 | December 31, 2013 |
|---|--------------------------|-------------------------|
| ASSETS | | |
| Property plant and equipment | | |
| Utility plant—at original cost, net of accumulated depreciation of \$4,010,604 at September 30 and \$3,894,326 at December 31 | \$ 12,668,123 | \$ 12,244,359 |
| Nonutility property, net of accumulated depreciation of \$239,780 at September 30 and \$215,083 at December 31 | 131,235 | 143,995 |
| Total property, plant and equipment | 12,799,358 | 12,388,354 |
| Current assets | | |
| Cash and cash equivalents | 74,128 | 26,964 |
| Restricted funds | 20,040 | 28,505 |
| Accounts receivable | 284,273 | 241,926 |
| Allowance for uncollectible accounts | (34,579) | (33,823) |
| Unbilled revenues | 227,037 | 215,725 |
| Income taxes receivable | 9,608 | 5,778 |
| Materials and supplies | 37,203 | 32,973 |
| Deferred income taxes | 104,251 | 18,609 |
| Assets of discontinued operations | 6,256 | 7,761 |
| Other | 28,744 | 28,276 |
| Total current assets | 756,961 | 572,694 |
| Regulatory and other long-term assets | | |
| Regulatory assets | 874,828 | 858,465 |
| Restricted funds | 17,243 | 754 |
| Goodwill | 1,208,065 | 1,207,764 |
| Other | 59,192 | 60,998 |
| Total regulatory and other long-term assets | 2,159,328 | 2,127,981 |
| TOTAL ASSETS | \$ 15,715,647 | \$ 15,089,029 |

The accompanying notes are an integral part of these consolidated financial statements.

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American Water Works Company, Inc. and Subsidiary Companies

Consolidated Balance Sheets (Unaudited)

(In thousands, except per share data)

| | September 30, 2014 | December 31, 2013 |
|---|--------------------------|-------------------------|
| CAPITALIZATION AND LIABILITIES | | |
| Capitalization | | |
| Common stock (\$0.01 par value, 500,000 shares authorized, 179,265 shares outstanding at September 30 and 178,379 at December 31) | \$ 1,793 | \$ 1,784 |
| Paid-in-capital | 6,297,187 | 6,261,396 |
| Accumulated deficit | (1,333,164) | (1,495,698) |
| Accumulated other comprehensive loss | (35,942) | (34,635) |
| Treasury stock | (10,222) | (5,043) |
| Total common stockholders' equity | 4,919,652 | 4,727,804 |
| Long-term debt | | |
| Long-term debt | 5,540,648 | 5,212,881 |
| Redeemable preferred stock at redemption value | 15,958 | 17,177 |
| Total capitalization | 10,476,258 | 9,957,862 |
| Current liabilities | | |
| Short-term debt | 313,979 | 630,307 |
| Current portion of long-term debt | 55,581 | 14,174 |
| Accounts payable | 260,713 | 264,115 |
| Taxes accrued | 46,945 | 32,166 |
| Interest accrued | 97,062 | 52,087 |
| Liabilities of discontinued operations | 1,667 | 3,824 |
| Other | 282,988 | 238,860 |
| Total current liabilities | 1,058,935 | 1,235,533 |
| Regulatory and other long-term liabilities | | |
| Advances for construction | 368,827 | 375,729 |
| Deferred income taxes | 2,118,499 | 1,841,584 |
| Deferred investment tax credits | 25,362 | 26,408 |
| Regulatory liabilities | 385,288 | 373,319 |
| Accrued pension expense | 90,026 | 108,542 |
| Accrued postretirement benefit expense | 88,338 | 88,419 |
| Other | 36,893 | 38,929 |
| Total regulatory and other long-term liabilities | 3,113,233 | 2,852,930 |
| Contributions in aid of construction | 1,067,221 | 1,042,704 |
| Commitments and contingencies (See Note 10) | — | — |
| TOTAL CAPITALIZATION AND LIABILITIES | \$ 15,715,647 | \$ 15,089,029 |

The accompanying notes are an integral part of these consolidated financial statements.

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American Water Works Company, Inc. and Subsidiary Companies

Consolidated Statements of Operations and Comprehensive Income (Unaudited)

(In thousands, except per share data)

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|-----------|-------------------|-------------|
| | September 30, | | September 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| Operating revenues | \$846,169 | \$822,190 | \$2,279,950 | \$2,172,694 |
| Operating expenses | | | | |
| Operation and maintenance | 341,348 | 337,674 | 1,004,377 | 962,853 |
| Depreciation and amortization | 106,789 | 102,495 | 318,398 | 303,002 |
| General taxes | 60,807 | 58,087 | 178,276 | 175,789 |
| (Gain) loss on asset dispositions and purchases | (60) | 768 | (616) | 529 |
| Total operating expenses, net | 508,884 | 499,024 | 1,500,435 | 1,442,173 |
| Operating income | 337,285 | 323,166 | 779,515 | 730,521 |
| Other income (expenses) | | | | |
| Interest, net | (75,445) | (77,389) | (222,673) | (233,260) |
| Allowance for other funds used during construction | 2,805 | 2,800 | 7,064 | 9,895 |
| Allowance for borrowed funds used during construction | 1,570 | 1,679 | 4,324 | 5,102 |
| Amortization of debt expense | (1,669) | (1,524) | (4,971) | (4,729) |
| Other, net | (733) | (449) | (2,591) | (1,481) |
| Total other income (expenses) | (73,472) | (74,883) | (218,847) | (224,473) |
| Income from continuing operations before income taxes | 263,813 | 248,283 | 560,668 | 506,048 |
| Provision for income taxes | 107,205 | 98,374 | 224,773 | 196,325 |
| Income from continuing operations | 156,608 | 149,909 | 335,895 | 309,723 |
| Income (loss) from discontinued operations, net of tax | (4,423) | 756 | (6,288) | (152) |
| Net income | \$152,185 | \$150,665 | \$329,607 | \$309,571 |
| Other comprehensive income (loss), net of tax: | | | | |
| Pension plan amortized to periodic benefit cost: | | | | |
| Prior service cost, net of tax of \$26 and \$28 for the three | | | | |
| months and \$79 and \$83 for the nine months, respectively | 41 | 43 | 124 | 130 |
| Actuarial loss, net of tax of \$(4) and \$1,424 for the three | | | | |
| months and \$(14) and \$4,273 for the nine months, | | | | |
| respectively | (7) | 2,228 | (22) | 6,683 |
| Foreign currency translation adjustment | (490) | 296 | (594) | (523) |
| Unrealized loss on cash flow hedge, net of tax of \$(439) for the | | | | |
| three and nine months | (815) | 0 | (815) | 0 |
| Other comprehensive income (loss) | (1,271) | 2,567 | (1,307) | 6,290 |
| Comprehensive income | \$150,914 | \$153,232 | \$328,300 | \$315,861 |

Basic earnings per share: (a)

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| | | | | |
|--|----------|----------|----------|------------|
| Income from continuing operations | \$0.87 | \$0.84 | \$1.88 | \$1.74 |
| Income (loss) from discontinued operations, net of tax | \$(0.02) |) \$0.00 | \$(0.04) |) \$(0.00) |
| Basic earnings per share | \$0.85 | \$0.85 | \$1.84 | \$1.74 |
| Diluted earnings per share: (a) | | | | |
| Income from continuing operations | \$0.87 | \$0.84 | \$1.87 | \$1.73 |
| Income (loss) from discontinued operations, net of tax | \$(0.02) |) \$0.00 | \$(0.03) |) \$(0.00) |
| Diluted earnings per share | \$0.85 | \$0.84 | \$1.83 | \$1.73 |
| Average common shares outstanding during the period | | | | |
| Basic | 178,992 | 177,965 | 178,800 | 177,671 |
| Diluted | 179,948 | 179,154 | 179,723 | 178,906 |
| Dividends declared per common share | \$0.62 | \$0.56 | \$0.93 | \$0.84 |

(a) Amounts may not sum due to rounding

The accompanying notes are an integral part of these consolidated financial statements.

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American Water Works Company, Inc. and Subsidiary Companies

Consolidated Statements of Cash Flows (Unaudited)

(In thousands, except per share data)

| | Nine Months Ended | |
|---|-----------------------|-----------|
| | September 30, 2014 | 2013 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$329,607 | \$309,571 |
| Adjustments | | |
| Depreciation and amortization | 318,398 | 303,002 |
| Provision for deferred income taxes | 213,125 | 195,240 |
| Amortization of deferred investment tax credits | (1,046) | (1,126) |
| Provision for losses on accounts receivable | 26,087 | 18,331 |
| Allowance for other funds used during construction | (7,064) | (9,895) |
| (Gain) loss on asset dispositions and purchases | (616) | 529 |
| Pension and non-pension postretirement benefits | 18,056 | 58,552 |
| Stock-based compensation expense | 9,670 | 8,916 |
| Other, net | (229) | (12,264) |
| Changes in assets and liabilities | | |
| Receivables and unbilled revenues | (77,323) | (108,062) |
| Taxes receivable, including income taxes | (3,830) | (5,513) |
| Other current assets | (15,292) | (13,188) |
| Pension and non-pension postretirement benefit contributions | (35,783) | (77,664) |
| Accounts payable | (30,141) | (28,577) |
| Taxes accrued, including income taxes | 14,779 | 10,064 |
| Interest accrued | 44,975 | 47,481 |
| Change in book overdraft | (2,052) | (7,993) |
| Other current liabilities | 39,581 | 1,145 |
| Operating cash flows provided by continuing operations | 840,902 | 688,549 |
| Operating cash flows provided by (used in) discontinued operations, net | (640) | 127 |
| Net cash provided by operating activities | 840,262 | 688,676 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Capital expenditures | (664,859) | (664,975) |
| Acquisitions | (6,053) | (16,554) |
| Proceeds from sale of assets | 804 | 749 |
| Removal costs from property, plant and equipment retirements, net | (51,959) | (49,639) |
| Net funds released | 738 | 11,339 |
| Investing cash flows used in continuing operations | (721,329) | (719,080) |
| Investing cash flows used in discontinued operations | (12) | (287) |
| Net cash used in investing activities | (721,341) | (719,367) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from long-term debt | 500,497 | 2,737 |
| Repayment of long-term debt | (136,739) | (13,149) |
| Proceeds from short-term borrowings with maturities greater than three months | 35,000 | 20,000 |
| Repayment of short-term borrowings with maturities greater than three months | (256,000) | 0 |
| Net short-term borrowings (repayments) with maturities less than three months | (95,328) | 99,450 |
| Proceeds from issuances of employee stock plans and DRIP | 15,446 | 19,788 |

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Advances and contributions for construction, net of refunds of \$16,305 and

| | | |
|--|------------|-----------|
| \$16,671 at September 30, 2014 and 2013, respectively | 21,293 | 13,486 |
| Debt issuance costs | (4,593) | (1,126) |
| Redemption of preferred stock | (1,200) | (2,920) |
| Dividends paid | (160,848) | (99,554) |
| Tax benefit realized from equity compensation | 10,715 | 0 |
| Net cash (used in) provided by financing activities | (71,757) | 38,712 |
| Net increase in cash and cash equivalents | 47,164 | 8,021 |
| Cash and cash equivalents at beginning of period | 26,964 | 24,433 |
| Cash and cash equivalents at end of period | \$74,128 | \$32,454 |
| Non-cash investing activity: | | |
| Capital expenditures acquired on account but unpaid at end of period | \$163,053 | \$119,807 |
| Non-cash financing activity: | | |
| Advances and contributions | \$8,876 | \$9,379 |
| Dividends accrued | \$55,494 | \$49,837 |
| Long-term debt issued | \$9,977 | \$0 |
| Long-term debt retired | \$(1,215) | \$0 |

The accompanying notes are an integral part of these consolidated financial statements.

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American Water Works Company, Inc. and Subsidiary Companies

Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

(In thousands, except per share data)

| | Common Shares | Stock Par Value | Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Loss | Treasury Stock Shares At Cost | Preferred Stock of Subsidiary Companies Without Mandatory Redemption Requirements | Total Stockholders' Equity | |
|--|------------------|-----------------------|--------------------|------------------------|---|-------------------------------------|--|----------------------------------|-------------|
| Balance at December 31, 2013 | 178,379 | \$1,784 | \$6,261,396 | \$(1,495,698) | \$(34,635) | (132) | \$(5,043) | \$0 | \$4,727,804 |
| Net income | 0 | 0 | 0 | 329,607 | 0 | 0 | 0 | 0 | 329,607 |
| Direct stock reinvestment and purchase plan, net of expense of \$22 Employee stock purchase plan Stock-based compensation activity Other comprehensive loss, net of tax of \$(374) Dividends | 34 | 0 | 1,568 | 0 | 0 | 0 | 0 | 0 | 1,568 |
| | 75 | 1 | 3,458 | 0 | 0 | 0 | 0 | 0 | 3,459 |
| | 777 | 8 | 30,765 | (640) | 0 | (122) | (5,179) | 0 | 24,954 |
| | 0 | 0 | 0 | 0 | (1,307) | 0 | 0 | 0 | (1,307) |
| | 0 | 0 | 0 | (166,433) | 0 | 0 | 0 | 0 | (166,433) |
| Balance at September 30, 2014 | 179,265 | \$1,793 | \$6,297,187 | \$(1,333,164) | \$(35,942) | (254) | \$(10,222) | \$0 | \$4,919,652 |
| | Common Stock | | | | Accumulated Other | Treasury Stock | Preferred Stock of | Total | |

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| | Shares | Par Value | Paid-in Capital | Accumulated Deficit | Comprehensive Loss | Shares | At Cost | Subsidiary Companies Without Mandatory Redemption Requirements | Stockholders' Equity |
|---|---------|-----------|-----------------|---------------------|--------------------|--------|-----------|--|----------------------|
| Balance at December 31, 2012 | 176,988 | \$1,770 | \$6,222,644 | \$(1,664,955) | \$(116,191) | 0 | \$0 | \$ 1,720 | \$4,444,988 |
| Net income | 0 | 0 | 0 | 309,571 | 0 | 0 | 0 | 0 | 309,571 |
| Direct stock reinvestment | | | | | | | | | |
| and purchase plan, net of | | | | | | | | | |
| expense of \$41 Employee stock purchase | 35 | 0 | 1,399 | 0 | 0 | 0 | 0 | 0 | 1,399 |
| plan Stock-based compensation | 81 | 1 | 3,270 | 0 | 0 | 0 | 0 | 0 | 3,271 |
| activity Subsidiary preferred stock | 1,017 | 10 | 23,973 | (416) | 0 | (132) | (5,043) | 0 | 18,524 |
| redemption Other comprehensive | 0 | 0 | 0 | 0 | 0 | 0 | 0 | (1,720) | (1,720) |
| income, net of tax | | | | | | | | | |
| of \$4,356 | 0 | 0 | 0 | 0 | 6,290 | 0 | 0 | 0 | 6,290 |
| Dividends | 0 | 0 | 0 | (149,391) | 0 | 0 | 0 | 0 | (149,391) |
| Balance at September 30, 2013 | 178,121 | \$1,781 | \$6,251,286 | \$(1,505,191) | \$(109,901) | (132) | \$(5,043) | \$ 0 | \$4,632,932 |

The accompanying notes are an integral part of these consolidated financial statements.

American Water Works Company, Inc. and Subsidiary Companies

Notes to Consolidated Financial Statements (Unaudited)

(In thousands, except per share data)

Note 1: Basis of Presentation

The accompanying Consolidated Balance Sheet of American Water Works Company, Inc. and Subsidiary Companies (the "Company") at September 30, 2014, the Consolidated Statements of Operations and Comprehensive Income for the three and nine months ended September 30, 2014 and 2013, the Consolidated Statements of Cash Flows for the nine months ended September 30, 2014 and 2013, and the Consolidated Statements of Changes in Stockholders' Equity for the nine months ended September 30, 2014 and 2013, are unaudited, but reflect all adjustments, which are, in the opinion of management, necessary to present fairly the consolidated financial position, the consolidated changes in stockholders' equity, the consolidated results of operations and comprehensive income, and the consolidated cash flows for the periods presented. All adjustments are of a normal, recurring nature, except as otherwise disclosed. Because they cover interim periods, the unaudited consolidated financial statements and related notes to the consolidated financial statements do not include all disclosures and notes normally provided in annual financial statements and, therefore, should be read in conjunction with the Company's Consolidated Financial Statements and related Notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the year, due primarily to the seasonality of the Company's operations.

The accompanying Notes to the Consolidated Financial Statements relate to continuing operations only unless otherwise indicated. Certain reclassifications have been made to previously reported data to conform to the current presentation. In 2014 the Company revised the 2013 balance sheet to classify \$18,609 of deferred income taxes as current rather than non-current. The change in classification was not material to the previously issued financial statements.

Note 2: New Accounting Pronouncements

The following recently issued accounting standards have been adopted by the Company and have been included in the consolidated results of operations, financial position or footnotes of the accompanying Consolidated Financial Statements:

Obligations Resulting from Joint and Several Liability Arrangements

In February 2013, the Financial Accounting Standards Board ("FASB") issued guidance for the recognition, measurement and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. Examples of obligations within the scope of the updated guidance include debt arrangements, other contractual obligations and settled litigation and judicial rulings. The update requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date as the sum of the following: (a) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and (b) any additional amount the reporting entity expects to pay on behalf of its co-obligors. The updated guidance also includes additional disclosures regarding the nature and amount of the obligation, as well as other information about those obligations. The update was effective on a retrospective basis for interim and annual periods beginning January 1, 2014. The adoption of this guidance did not have an impact on the Company's results of operations, financial position or cash flows.

Foreign Currency Matters

In June 2013, the FASB issued guidance for a parent's accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. The amendments resolve differing views in practice and apply to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or a business within a foreign entity. The update was effective prospectively for interim and annual periods beginning January 1, 2014. The adoption of this guidance did not have an impact on the Company's results of operations, financial position or cash flows.

The following recently issued accounting standards are not yet required to be adopted by the Company:

Service Concession Arrangements

In January 2014, the FASB issued guidance for an operating entity that enters into a service concession arrangement with a public sector grantor who controls or has the ability to modify or approve the services that the operating entity must provide with the infrastructure, to whom it must provide the services and at what price. The grantor also controls, through ownership or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement. The guidance specifies that an operating entity should not account for the service concession arrangement as a lease. The operating entity should refer instead to other accounting guidance to account for the various aspects of the arrangement. The guidance also specifies that the infrastructure used in the arrangement should not be recognized as property, plant and equipment of the operating entity. This update should be applied on a modified

retrospective basis to service concession arrangements that exist at the beginning of an entity's fiscal year of adoption. This requires the cumulative effect of applying the update to be recognized as an adjustment to the opening retained earnings balance for the annual period of adoption. The update is effective for interim and annual periods beginning January 1, 2015. Early adoption is permitted. The adoption of this updated guidance is not expected to have a material impact on results of operations, financial position or cash flows.

Reporting Discontinued Operations

In April 2014, the FASB issued guidance that changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. Under the updated guidance, a discontinued operation is defined as a component or group of components that is disposed of or is classified as held for sale and represents a strategic shift that has or will have a major effect on an entity's operations and financial results. A strategic shift could include a disposal of a major geographical area of operations, a major line of business, a major equity method investment or other major part of the entity. A component comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity including a reportable segment, an operating segment, a reporting unit, a subsidiary or an asset group. The update no longer precludes presentation as a discontinued operation if there are operations and cash flows of the component that have not been eliminated from the reporting entity's ongoing operations or if there is significant continuing involvement with a component after its disposal. The guidance is effective on a prospective basis for interim and annual periods beginning after January 1, 2015. In general, this guidance is likely to result in fewer disposals of assets qualifying as discontinued operations.

Revenue from Contracts with Customers

In May 2014, the FASB issued a comprehensive new revenue recognition standard that supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the new guidance is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The guidance is effective for annual and interim periods beginning January 1, 2017 and early adoption is not permitted. The new guidance allows for either full retrospective adoption, meaning the guidance is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements. The Company is evaluating the new guidance, the best transition method and the impact the new standard will have on its results of operations, financial position or cash flows.

Accounting for Stock-based Compensation with Performance Targets

In June 2014, the FASB issued guidance for the accounting for stock-based compensation tied to performance targets. The amendments clarify that a performance target that affects vesting of a share-based payment and that could be achieved after the requisite service period is a performance condition. As a result, the target is not reflected in the estimation of the award's grant date fair value and compensation cost would be recognized over the required service period, if it is probable that the performance condition will be achieved. The guidance is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. The Company is evaluating the impact the updated guidance will have on its results of operations, financial position or cash flows.

Disclosures of Uncertainties about an Entity's Ability to Continue as a Going Concern

In August 2014, the FASB issued guidance that explicitly requires an entity's management to assess the entity's ability to continue as a going concern. The new guidance requires an entity to evaluate, at each interim and annual period, whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date the financial statements are issued (or are available to be issued) and to provide

related disclosures, if applicable. The new guidance is effective for annual periods ending after December 15, 2016 and for interim and annual periods thereafter. Early adoption is permitted. The Company does not expect this new guidance to have a material impact on its results of operations, financial position or cash flows.

Note 3: Acquisitions and Divestitures

Acquisitions

During the nine-month period ended September 30, 2014, the Company closed on nine acquisitions: five regulated water systems, one regulated wastewater, and three regulated water and wastewater systems. The aggregate purchase price of these acquisitions totaled \$6,134. Assets acquired, principally plant, totaled \$13,119. Liabilities assumed totaled \$6,985, including contributions in aid of construction of \$4,231 and debt of \$1,683.

Divestitures

In the third quarter of 2014, the Company approved a plan to exit the Class B biosolids management business by selling Terratec Environmental Ltd (“Terratec”), and as a result, has included the results as discontinued operations for all periods presented. Terratec, which was previously included in the Market-Based Operations segment, is based in Canada and provides environmentally sustainable

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management and disposal of biosolids and wastewater by-products. The Company expects to complete the disposition during the fourth quarter of 2014.

Included in the loss on discontinued operations is an estimated loss on the disposal of Terratec in the amount of \$3,470. The provision for income taxes for 2014 includes the utilization of \$1,480 of tax attributes as a result of the expected sale. Charges recorded in connection with the discontinued operations include estimates that are subject to subsequent adjustment.

A summary of discontinued operations presented in the Consolidated Statements of Operations and Comprehensive Income follows:

| | Three Months Ended | | Nine Months Ended | |
|---|-----------------------|---------|-----------------------|----------|
| | September 30, 2014 | 2013 | September 30, 2014 | 2013 |
| Operating revenues | \$4,910 | \$7,006 | \$12,234 | \$16,904 |
| Total operating expenses, net | 7,973 | 6,297 | 17,657 | 17,430 |
| Income (loss) from discontinued operations before | | | | |
| income taxes | (3,063) | 709 | (5,423) | (526) |
| Provision (benefit) for income taxes | 1,360 | (47) | 865 | (374) |
| Income (loss) from discontinued operations | \$(4,423) | \$756 | \$(6,288) | \$(152) |

Assets and liabilities of discontinued operations in the accompanying Consolidated Balance Sheets include the following:

| | September 30, 2014 | December 31, 2013 |
|--|--------------------------|-------------------------|
| ASSETS | | |
| Total property, plant and equipment | \$ 2,168 | \$ 2,808 |
| Current assets | 4,088 | 4,953 |
| Total assets of discontinued operations | \$ 6,256 | \$ 7,761 |
| LIABILITIES | | |
| Current liabilities | \$ 1,667 | \$ 3,824 |
| Total liabilities of discontinued operations | \$ 1,667 | \$ 3,824 |

Note 4: Goodwill

The Company's annual goodwill impairment test is conducted at November 30 of each calendar year. Interim reviews are performed when the Company determines that a triggering event that would more likely than not reduce the fair value of a reporting unit below its carrying value has occurred. The Company has determined no such triggering event had occurred during the nine months ended September 30, 2014.

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The change in the Company's goodwill assets, as allocated between the reporting units is as follows:

| | Regulated Unit | | Market-Based Operations | | Consolidated | | Total Net |
|--|----------------|---------------------------|----------------------------|---------------------------|--------------|---------------------------|-------------|
| | Cost | Accumulated Impairment | Cost | Accumulated Impairment | Cost | Accumulated Impairment | |
| Balance at January 1, 2014 | \$3,412,063 | \$(2,332,670) | \$235,990 | \$(107,619) | \$3,648,053 | \$(2,440,289) | \$1,207,764 |
| Goodwill from acquisitions | 301 | 0 | 0 | 0 | 301 | 0 | 301 |
| Balance at September 30, 2014 | \$3,412,364 | \$(2,332,670) | \$235,990 | \$(107,619) | \$3,648,354 | \$(2,440,289) | \$1,208,065 |
| Balance at January 1, 2013 | \$3,411,549 | \$(2,332,670) | \$235,990 | \$(107,619) | \$3,647,539 | \$(2,440,289) | \$1,207,250 |
| Goodwill from acquisitions | 405 | 0 | 0 | 0 | 405 | 0 | 405 |
| Reclassifications and other activity | 86 | 0 | 0 | 0 | 86 | 0 | 86 |
| Balance at September 30, 2013 | \$3,412,040 | \$(2,332,670) | \$235,990 | \$(107,619) | \$3,648,030 | \$(2,440,289) | \$1,207,741 |

Note 5: Stockholders' Equity

Common Stock

Under American Water Stock Direct, a dividend reinvestment and direct stock purchase plan (the "DRIP"), stockholders may reinvest cash dividends and purchase additional Company common stock, up to certain limits, through the plan administrator without commission fees. The Company's plan administrator may buy newly issued shares directly from the Company or shares held in the Company's treasury. The plan administrator may also buy shares in the public markets or in privately negotiated transactions. Purchases generally will be made and credited to DRIP accounts once each week. As of September 30, 2014, there were 4,621 shares available for future issuance under the DRIP.

The following table summarizes information regarding issuances under the DRIP for the nine months ended September 30, 2014 and 2013:

| | 2014 | 2013 |
|-------------------------------|---------|---------|
| Shares of common stock issued | 34 | 35 |
| Cash proceeds received | \$1,590 | \$1,440 |

Cash dividend payments made during the three-month periods ended March 31, June 30 and September 30 were as follows:

| | 2014 | 2013 |
|---|----------|----------|
| Dividends per share, three months ended: | | |
| March 31 | \$0.28 | \$0.00 |
| June 30 | \$0.31 | \$0.28 |
| September 30 | \$0.31 | \$0.28 |
| Total dividends paid, three months ended: | | |
| March 31 | \$49,968 | \$0 |
| June 30 | \$55,422 | \$49,744 |
| September 30 | \$55,458 | \$49,810 |

On September 19, 2014, the Company declared a quarterly cash dividend of \$0.31 per share, payable on December 1, 2014 to shareholders of record as of November 10, 2014. As of September 30, 2014, the Company had accrued dividends totaling \$55,494 included in other current liabilities on the accompanying Consolidated Balance Sheet.

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Accumulated Other Comprehensive Income (Loss)

The following table presents changes in accumulated other comprehensive income (loss) by component, net of tax, for the nine months ended September 30, 2014 and 2013, respectively:

| | Defined Benefit Plans | | | | Loss | Total |
|--|-----------------------|--------------|--------------|-------------|----------|---------------|
| | Employee | Amortization | Amortization | Foreign | on | Accumulated |
| | Benefit | of Prior | of Actuarial | Currency | Cash | Other |
| | Plan | Service | (Gain) Loss | Translation | Flow | Comprehensive |
| | Funded | Cost | | | Hedge | Loss |
| | Status | | | | | |
| Beginning balance at January 1, 2014 | \$(69,711) | \$ 713 | \$ 31,150 | \$ 3,213 | \$ 0 | \$ (34,635) |
| Other comprehensive income (loss) before reclassifications | | | | | | |
| Amounts reclassified from accumulated | 0 | 0 | 0 | (594) | (825) | (1,419) |
| other comprehensive income (loss) | 0 | 124 | (22) | 0 | 10 | 112 |
| Net comprehensive income (loss) for the period | 0 | 124 | (22) | (594) | (815) | (1,307) |
| Ending balance at September 30, 2014 | \$(69,711) | \$ 837 | \$ 31,128 | \$ 2,619 | \$(815) | \$ (35,942) |
| Beginning balance at January 1, 2013 | \$(143,183) | \$ 539 | \$ 22,239 | \$ 4,214 | \$ 0 | \$ (116,191) |
| Other comprehensive income (loss) before reclassifications | | | | | | |
| Amounts reclassified from accumulated | 0 | 0 | 0 | (523) | 0 | (523) |
| other comprehensive income (loss) | 0 | 130 | 6,683 | 0 | 0 | 6,813 |
| Net comprehensive income (loss) for the period | 0 | 130 | 6,683 | (523) | 0 | 6,290 |
| Ending balance at September 30, 2013 | \$(143,183) | \$ 669 | \$ 28,922 | \$ 3,691 | \$ 0 | \$ (109,901) |

The Company does not reclassify the amortization of defined benefit pension cost components from accumulated other comprehensive income (loss) directly to net income in its entirety. These accumulated other comprehensive income components are included in the computation of net periodic pension cost. (See Note 9)

The amortization of the loss on cash flow hedge is included in interest, net in the accompanying Consolidated Statements of Operations and Comprehensive Income.

Stock-Based Compensation

The Company has granted stock option and restricted stock unit awards to non-employee directors, officers and other key employees of the Company pursuant to the terms of its 2007 Omnibus Equity Compensation Plan (the "Plan"). As of September 30, 2014, a total of 8,832 shares were available for grant under the Plan. Shares issued under the Plan may be authorized-but-unissued shares of Company stock or reacquired shares of Company stock, including shares purchased by the Company on the open market for purposes of the Plan.

The Company recognizes compensation expense for stock awards over the vesting period of the award. The following table presents stock-based compensation expense recorded in operation and maintenance expense in the accompanying Consolidated Statements of Operations and Comprehensive Income for the three and nine months ended September 30, 2014 and 2013:

| | Three Months Ended | | Nine Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2014 | September 30, 2013 | September 30, 2014 | September 30, 2013 |
| Stock options | \$632 | \$628 | \$1,989 | \$2,480 |
| Restricted stock units | 2,008 | 1,681 | 7,248 | 6,015 |
| Employee stock purchase plan | 148 | 145 | 433 | 421 |
| Stock-based compensation in operation and maintenance expense | 2,788 | 2,454 | 9,670 | 8,916 |
| Income tax benefit | (1,087) | (957) | (3,771) | (3,477) |
| After-tax stock-based compensation expense | \$1,701 | \$1,497 | \$5,899 | \$5,439 |

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There were no significant stock-based compensation costs capitalized during the nine months ended September 30, 2014 and 2013, respectively.

Stock Options

In the first nine months of 2014, the Company granted non-qualified stock options to certain employees under the Plan. The stock options vest ratably over the three-year service period beginning January 1, 2014. These awards have no performance vesting conditions and the grant date fair value is amortized through expense over the requisite service period using the straight-line method.

The following table presents the weighted-average assumptions used in the Black-Scholes option-pricing model and the resulting weighted-average grant date fair value per share of stock options granted through September 30, 2014:

| | |
|---------------------------------|---------|
| Dividend yield | 2.55 % |
| Expected volatility | 17.75 % |
| Risk-free interest rate | 1.06 % |
| Expected life (years) | 3.6 |
| Exercise price | \$44.29 |
| Grant date fair value per share | \$4.57 |

Stock options granted under the Plan have maximum terms of seven years, vest over periods ranging from one to three years, and are granted with exercise prices equal to the market value of the Company's common stock on the date of grant. As of September 30, 2014, \$2,241 of total unrecognized compensation cost related to the non-vested stock options is expected to be recognized over the weighted-average period of 1.2 years.

The table below summarizes stock option activity for the nine months ended September 30, 2014:

| | Shares | Weighted-Average Exercise Price (per share) | Weighted-Average Remaining Life (years) | Aggregate Intrinsic Value |
|---|--------|---|---|---------------------------------|
| Options outstanding at January 1, 2014 | 2,055 | \$ 28.80 | | |
| Granted | 491 | 44.29 | | |
| Forfeited or expired | (36) | 39.29 | | |
| Exercised | (427) | 25.36 | | |
| Options outstanding at September 30, 2014 | 2,083 | \$ 32.98 | 4.1 | \$ 31,773 |
| Exercisable at September 30, 2014 | 1,243 | \$ 27.42 | 3.0 | \$ 25,862 |

The following table summarizes additional information regarding stock options exercised during the nine months ended September 30, 2014 and 2013:

| | |
|------|------|
| 2014 | 2013 |
|------|------|

| | | |
|--------------------|---------|----------|
| Intrinsic value | \$8,775 | \$10,999 |
| Exercise proceeds | 10,831 | 15,499 |
| Income tax benefit | 2,634 | 3,138 |

Restricted Stock Units

During 2011, the Company granted selected employees 189 restricted stock units with internal performance measures and, separately, certain market thresholds. These awards vested in January 2014. The terms of the grants specified that if certain performance on internal measures and market thresholds was achieved, the restricted stock units would vest; if performance was surpassed, up to 175% of the target awards would be distributed; and if performance thresholds were not met, awards would be cancelled. In January 2014, an additional 113 restricted stock units were granted and distributed because performance thresholds were exceeded.

In the first nine months of 2014, the Company granted restricted stock units, both with and without performance conditions, to certain employees and non-employee directors under the Plan. The restricted stock units without performance conditions vest ratably over the three-year service period beginning January 1, 2014 and the restricted stock units with performance conditions vest ratably over the three-year performance period beginning January 1, 2014 (the "Performance Period"). Distribution of the performance shares is contingent upon the achievement of internal performance measures and, separately, certain market thresholds over the Performance

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Period. The restricted stock units granted with service-only conditions and those with internal performance measures are valued at the market value of the Company's common stock on the date of grant. The restricted stock units granted with market conditions are valued using a Monte Carlo model.

Weighted-average assumptions used in the Monte Carlo simulation are as follows for restricted stock units with market conditions granted through September 30, 2014:

| | |
|-------------------------|--------|
| Expected volatility | 17.78% |
| Risk-free interest rate | 0.75 % |
| Expected life (years) | 3 |

The grant date fair value of the restricted stock unit awards that vest ratably and have market and/or performance and service conditions is amortized through expense over the requisite service period using the graded-vesting method. Restricted stock units that have no performance conditions are amortized through expense over the requisite service period using the straight-line method. As of September 30, 2014, \$6,940 of total unrecognized compensation cost related to the non-vested restricted stock units is expected to be recognized over the weighted-average remaining life of 1.0 years.

The table below summarizes restricted stock unit activity for the nine months ended September 30, 2014:

| | Shares | Weighted-Average Grant Date Fair Value (per share) |
|--|--------|--|
| Non-vested total at January 1, 2014 | 539 | \$ 36.27 |
| Granted | 228 | 45.45 |
| Performance share adjustment | 113 | 30.34 |
| Vested | (325) | 31.77 |
| Forfeited | (16) | 41.24 |
| Non-vested total at September 30, 2014 | 539 | \$ 41.47 |

The following table summarizes additional information regarding restricted stock units distributed during the nine months ended September 30, 2014 and 2013:

| | 2014 | 2013 |
|--------------------|----------|----------|
| Intrinsic value | \$14,938 | \$13,983 |
| Income tax benefit | 1,592 | 2,049 |

If dividends are paid with respect to shares of the Company's common stock before the restricted stock units are distributed, the Company credits a liability for the value of the dividends that would have been paid if the restricted stock units were shares of Company common stock. When the restricted stock units are distributed, the Company pays

the participant a lump sum cash payment equal to the value of the dividend equivalents accrued. The Company accrued dividend equivalents totaling \$640 and \$416 to retained earnings during the nine months ended September 30, 2014 and 2013, respectively.

Employee Stock Purchase Plan

Under the Nonqualified Employee Stock Purchase Plan (the "ESPP"), employees can use payroll deductions to acquire Company stock at the lesser of 90% of the fair market value of (a) the beginning or (b) the end of each three-month purchase period. As of September 30, 2014, there were 1,288 shares of common stock reserved for issuance under the ESPP. During the nine months ended September 30, 2014, the Company issued 75 shares under the ESPP.

Note 6: Long-Term Debt

The Company primarily issues long-term debt to fund capital expenditures at the regulated subsidiaries. The components of long-term debt are as follows:

| | Rate | Weighted Average Rate | Maturity | September 30, 2014 | December 31, 2013 |
|--|-------------|-----------------------------|-----------|--------------------------|-------------------------|
| Long-term debt of American Water Capital Corp. | | | | | |
| ("AWCC") (a) | | | | | |
| Private activity bonds and government funded | | | | | |
| debt | | | | | |
| Fixed rate | 1.79%-6.25% | 5.42% | 2021-2040 | \$254,655 | \$330,732 |
| Senior notes | | | | | |
| Fixed rate | 3.40%-8.27% | 5.44% | 2016-2042 | 3,812,752 | 3,312,761 |
| Long-term debt of other subsidiaries | | | | | |
| Private activity bonds and government funded | | | | | |
| debt | | | | | |
| Fixed rate | 0.00%-6.20% | 4.67% | 2015-2041 | 814,025 | 863,716 |
| Mortgage bonds | | | | | |
| Fixed rate | 4.29%-9.71% | 7.41% | 2015-2039 | 676,500 | 676,500 |
| Mandatorily redeemable preferred stock | 8.47%-9.75% | 8.61% | 2019-2036 | 17,702 | 18,902 |
| Capital lease obligations | 12.17% | 12.17% | 2026 | 893 | 913 |
| Long-term debt | | | | 5,576,527 | 5,203,524 |
| Unamortized debt, net (b) | | | | 32,133 | 35,984 |
| Interest rate swap fair value adjustment | | | | 3,527 | 4,724 |
| Total long-term debt | | | | \$5,612,187 | \$5,244,232 |

(a) AWCC, which is a wholly-owned subsidiary of the Company, has a strong support agreement with its parent that, under certain circumstances, is the functional equivalent of a guarantee.

(b) Primarily fair value adjustments previously recognized in acquisition purchase accounting.

The Company issued the following long-term debt during 2014.

| Company | Type | Rate | Maturity | Amount |
|-----------------------------------|--|-------------|-----------|-----------|
| American Water Capital Corp. | Senior notes—fixed rate | 3.40%-4.30% | 2025-2042 | \$500,000 |
| Other subsidiaries ⁽¹⁾ | Private activity bonds and government funded debt—fixed rate | 0.00%-5.00% | 2031-2033 | 10,474 |
| Total issuances | | | | \$510,474 |

(1) Issuance includes \$9,977 which was initially kept in trust pending the Company's certification that it has incurred qualifying capital expenditures. This amount has been presented as non-cash in the accompanying Consolidated

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Statements of Cash Flows.

The Company also assumed debt of \$1,683 related to an acquisition in the second quarter of 2014.

The following long-term debt was retired through sinking fund payments and maturities during 2014:

| Company | Type | Rate | Maturity | Amount |
|-----------------------------------|--|-------------|-----------|-----------|
| American Water Capital Corp. | Private activity bonds and government | | | |
| | funded debt—fixed rate | 6.00%-6.75% | 2014-2031 | \$77,760 |
| American Water Capital Corp. | Senior notes—fixed rate | 6.00% | 2039 | 9 |
| Other subsidiaries ⁽¹⁾ | Private activity bonds and government | | | |
| | funded debt—fixed rate | 0.00%-5.25% | 2014-2041 | 60,165 |
| Other subsidiaries | Mandatorily redeemable preferred stock | 8.49% | 2036 | 1,200 |
| Other subsidiaries | Capital lease payments | | | 20 |
| Total retirements and redemptions | | | | \$139,154 |

(1)Includes \$1,215 of non-cash defeasance via the use of restricted funds

Interest income included in interest, net is summarized below:

| | Three Months Ended | | Nine Months Ended | |
|-----------------|-----------------------|---------|-----------------------|---------|
| | September 30, 2014 | 2013 | September 30, 2014 | 2013 |
| Interest income | \$3,527 | \$2,935 | \$9,030 | \$8,615 |

The Company has an interest rate swap to hedge \$100,000 of its 6.085% fixed-rate debt maturing 2017. The Company pays variable interest of six-month LIBOR plus 3.422%. The swap is accounted for as a fair-value hedge and matures with the fixed-rate debt in 2017.

The following table provides a summary of the derivative fair value balance recorded by the Company and the line item in the Consolidated Balance Sheets in which such amount is recorded:

| | September 30, | December 31, |
|---------------------------------------|------------------|-----------------|
| Balance sheet classification | 2014 | 2013 |
| Regulatory and other long-term assets | | |
| Other | \$ 3,515 | \$ 4,776 |
| Long-term debt | | |
| Long-term debt | 3,527 | 4,724 |

For derivative instruments that are designated and qualify as fair-value hedges, the gain or loss on the hedge instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current net income. The Company includes the gain or loss on the derivative instrument and the offsetting loss or gain on the hedged item in interest expense as follows:

| | Three Months Ended | | Nine Months Ended | |
|---------------------------------|-----------------------|-------|-----------------------|-----------|
| Income statement classification | September 30, 2014 | 2013 | September 30, 2014 | 2013 |
| Interest, net | | | | |
| Gain (loss) on swap | \$(1,058) | \$385 | \$(1,261) | \$(2,670) |
| Gain (loss) on borrowing | 945 | (247) | 1,198 | 2,434 |
| Hedge ineffectiveness | (113) | 138 | (63) | (236) |

Note 7: Short-Term Debt

Short-term debt consists of commercial paper borrowings totaling \$313,979 (net of discount of \$21) at September 30, 2014 and \$630,307 (net of discount of \$193) at December 31, 2013. During the first nine months of 2014, the Company borrowed \$35,000 with maturities greater than three months, and repaid \$35,000 and \$221,000 borrowed in 2014 and 2013, respectively, with maturities greater than three months.

Note 8: Income Taxes

The Company's estimated annual effective tax rate was 39.7% for the nine months ended September 30, 2014 and September 30, 2013, excluding various discrete items.

The Company's actual effective tax rates were as follows:

| | Three Months Ended | | Nine Months Ended | |
|---------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2014 | September 30, 2013 | September 30, 2014 | September 30, 2013 |
| Actual effective tax rate | 40.6% | 39.6% | 40.1% | 38.8% |

Included in 2013 are discrete items including \$3,274 of tax benefits recorded in the first quarter of 2013 associated with an entity reorganization within the Company's Market-Based Operations segment that allowed for the utilization of state net operating loss carryforwards and the release of a valuation allowance.

Current deferred tax assets increased in 2014 due to the expected utilization of certain tax attributes within the next 12 months.

Note 9: Pension and Other Postretirement Benefits

The following table provides the components of net periodic benefit costs:

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|--------------------|--------------------|--------------------|
| | September 30, 2014 | September 30, 2013 | September 30, 2014 | September 30, 2013 |
| Components of net periodic pension benefit cost | | | | |
| Service cost | \$7,943 | \$9,468 | \$23,830 | \$28,404 |
| Interest cost | 19,163 | 17,024 | 57,489 | 51,072 |
| Expected return on plan assets | (23,709) | (22,108) | (71,128) | (66,322) |
| Amortization of: | | | | |
| Prior service cost (credit) | 181 | 181 | 543 | 543 |
| Actuarial (gain) loss | (33) | 9,293 | (98) | 27,878 |
| Net periodic pension benefit cost | \$3,545 | \$13,858 | \$10,636 | \$41,575 |
| Components of net periodic other postretirement benefit cost | | | | |
| Service cost | \$2,764 | \$3,820 | \$8,293 | \$11,461 |
| Interest cost | 7,152 | 7,175 | 21,454 | 21,525 |
| Expected return on plan assets | (6,875) | (7,571) | (20,625) | (22,713) |
| Amortization of: | | | | |
| Prior service cost (credit) | (548) | (548) | (1,642) | (1,642) |
| Actuarial (gain) loss | (20) | 2,782 | (60) | 8,346 |
| Net periodic other postretirement benefit cost | \$2,473 | \$5,658 | \$7,420 | \$16,977 |

The Company contributed \$26,680 to its defined benefit pension plans in the first nine months of 2014 and expects to contribute \$10,785 during the balance of 2014. In addition, the Company contributed \$9,103 for the funding of its other postretirement plans in the first nine months of 2014 and expects to contribute \$3,034 during the balance of 2014.

Note 10: Commitments and Contingencies

The Company is routinely involved in legal actions incident to the normal conduct of its business. At September 30, 2014, the Company has accrued approximately \$3,200 as probable costs and it is reasonably possible that additional losses could range up to \$31,100 for these matters. For certain matters, the Company is unable to estimate possible losses. The Company believes that damages or settlements recovered by plaintiffs in such claims or actions, if any, will not have a material adverse effect on the Company's results of operations, financial position or cash flows, individually or in the aggregate.

The Company enters into agreements for the provision of services to water and wastewater facilities for the United States military, municipalities and other customers. The Company's military services agreements expire between 2051 and 2064 and have remaining performance commitments as measured by estimated remaining contract revenue of \$2,580,231 at September 30, 2014. The military contracts are subject to customary termination provisions held by the U.S. Federal Government prior to the agreed upon contract expiration. The Company's Operations and Maintenance agreements with municipalities and other customers expire between 2015 and 2048 and have remaining performance commitments as measured by estimated remaining contract revenue of \$882,176 at September 30, 2014. Some of the

Company's long-term contracts to operate and maintain a municipality's, federal government's or other party's water or wastewater treatment and delivery facilities include responsibility for certain maintenance for some of those facilities, in exchange for an annual fee. Unless specifically required to perform certain maintenance activities, the maintenance costs are recognized when the maintenance is performed.

On October 13, 2014, the Company and the Utility Workers Union of America AFL-CIO entered into a settlement agreement designed to resolve a dispute between the Company and most of the labor unions which represent employees in the Regulated Businesses (the "Unions") regarding the Company's national benefit agreements. Among other things, the settlement agreement provides for a new 2014-2018 National Benefits Agreement that will be in effect generally until July 31, 2018. In addition, the Company agreed to make a \$10 million lump-sum payment, to be distributed in accordance with procedures set forth in the settlement agreement among eligible employees represented by the Unions and affected by implementation of the Company's last, best and final offer effective January 1, 2011. The majority of the distributions are expected to be used to reimburse employees for medical claims which were incurred during the relevant period and will be funded by the Group Insurance Plan for American Water Works Company, Inc. and Its Designated Subsidiaries and Affiliates - Active Employees VEBA (the "VEBA Trust"), to which the Company previously has made contributions. Therefore, amounts funded out of the VEBA Trust will not have an impact on our results of operations. The Unions approved the settlement agreement on October 30, 2014 and National Labor Relations Board (the "NLRB") approved the

settlement agreement on October 31, 2014. The NLRB advised the Company that it will dismiss its petition for enforcement filed in the United States Court of Appeals for the Seventh Circuit and close the case after the Company has substantially complied with its obligations under the settlement agreement to make the lump sum payment and to post a notice to employees agreeable to the Company and acceptable to the NLRB.

Note 11: Environmental Matters

The Company's water and wastewater operations are subject to federal, state, local and foreign requirements relating to environmental protection, and as such, the Company periodically becomes subject to environmental claims in the normal course of business. Environmental expenditures that relate to current operations or provide a future benefit are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued, on an undiscounted basis, when it is probable that these costs will be incurred and can be reasonably estimated. Remediation costs accrued amounted to \$2,200 and \$3,300 at September 30, 2014 and December 31, 2013, respectively. The accrual relates to a conservation agreement entered into by a subsidiary of the Company with the National Oceanic and Atmospheric Administration ("NOAA") requiring the Company to, among other provisions, implement certain measures to protect the steelhead trout and its habitat in the Carmel River watershed in the state of California. The Company has agreed to pay \$1,100 annually from 2010 through 2016. The Company pursues recovery of incurred costs through all appropriate means, including regulatory recovery through customer rates. The Company's regulatory assets at September 30, 2014 and December 31, 2013 include \$7,791 and \$8,027, respectively, related to the NOAA agreement.

Note 12: Earnings per Common Share

Earnings per share is calculated using the two-class method. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security. The Company has participating securities related to restricted stock units, granted under the Company's 2007 Omnibus Equity Compensation Plan, that earn dividend equivalents on an equal basis with common shares. In applying the two-class method, undistributed earnings are allocated to both common shares and participating securities.

The following is a reconciliation of the Company's income from continuing operations, income (loss) from discontinued operations and net income and weighted-average common shares outstanding for calculating basic earnings per share:

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|---------------|-------------------|---------------|
| | September 30, | September 30, | September 30, | September 30, |
| | 2014 | 2013 | 2014 | 2013 |
| Basic | | | | |
| Income from continuing operations | \$ 156,608 | \$ 149,909 | \$ 335,895 | \$ 309,723 |
| Income (loss) from discontinued operations, net of tax | (4,423) | 756 | (6,288) | (152) |
| Net income | 152,185 | 150,665 | 329,607 | 309,571 |
| Less: Distributed earnings to common shareholders | 55,664 | 50,007 | 161,439 | 99,929 |
| Less: Distributed earnings to participating securities | 17 | 19 | 49 | 41 |
| Undistributed earnings | 96,504 | 100,639 | 168,119 | 209,601 |
| Undistributed earnings allocated to common shareholders | 96,478 | 100,598 | 168,070 | 209,520 |
| Undistributed earnings allocated to participating securities | 26 | 41 | 49 | 81 |
| Total income from continuing operations available to | | | | |
| common shareholders, basic | \$ 156,565 | \$ 149,849 | \$ 335,797 | \$ 309,601 |
| Total income available to common shareholders, basic | \$ 152,142 | \$ 150,605 | \$ 329,509 | \$ 309,449 |

| | | | | |
|--|-----------|---------|-----------|-----------|
| Weighted-average common shares outstanding, basic | 178,992 | 177,965 | 178,800 | 177,671 |
| Basic earnings per share: (a) | | | | |
| Income from continuing operations | \$0.87 | \$0.84 | \$1.88 | \$1.74 |
| Income (loss) from discontinued operations, net of tax | \$(0.02) | \$0.00 | \$(0.04) | \$(0.00) |
| Net income | \$0.85 | \$0.85 | \$1.84 | \$1.74 |

(a) Earnings per share amounts are computed independently for income from continuing operations, income (loss) from discontinued operations and net income. As a result, the sum of per-share amounts from continuing operations and discontinued operations may not equal the total per-share amount for net income.

Diluted earnings per common share is based on the weighted-average number of common shares outstanding adjusted for the dilutive effect of common stock equivalents related to the restricted stock units, stock options, and employee stock purchase plan. The dilutive effect of the common stock equivalents is calculated using the treasury stock method and expected proceeds on vesting of the restricted stock units, exercise of the stock options and purchases under the employee stock purchase plan.

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The following is a reconciliation of the Company's income from continuing operations, income (loss) from discontinued operations and net income and weighted-average common shares outstanding for calculating diluted earnings per share:

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|------------|-------------------|------------|
| | September 30, | | September 30, | |
| Diluted | 2014 | 2013 | 2014 | 2013 |
| Total income from continuing operations available to | | | | |
| common shareholders, basic | \$ 156,565 | \$ 149,849 | \$ 335,797 | \$ 309,601 |
| Income (loss) from discontinued operations, net of tax | (4,423) | 756 | (6,288) | (152) |
| Total income available to common shareholders, basic | 152,142 | 150,605 | 329,509 | 309,449 |
| Undistributed earnings for participating securities | 26 | 41 | 49 | 81 |
| Total income from continuing operations available to | | | | |
| common shareholders, diluted | \$ 156,591 | \$ 149,890 | \$ 335,846 | \$ 309,682 |
| Total income available to common shareholders, diluted | \$ 152,168 | \$ 150,646 | \$ 329,558 | \$ 309,530 |
| Weighted-average common shares outstanding, basic | 178,992 | 177,965 | 178,800 | 177,671 |
| Common stock equivalents: | | | | |
| Restricted stock units | 497 | 502 | 460 | 473 |
| Stock options | 458 | 685 | 462 | 760 |
| Employee stock purchase plan | 1 | 2 | 1 | 2 |
| Weighted-average common shares outstanding, diluted | 179,948 | 179,154 | 179,723 | 178,906 |
| Diluted earnings per share (a) | | | | |
| Income from continuing operations | \$0.87 | \$0.84 | \$1.87 | \$1.73 |
| Income (loss) from discontinued operations, net of tax | \$(0.02) | \$0.00 | \$(0.03) | \$(0.00) |
| Net income | \$0.85 | \$0.84 | \$1.83 | \$1.73 |

(a) Earnings per share amounts are computed independently for income from continuing operations, income (loss) from discontinued operations and net income. As a result, the sum of per-share amounts from continuing operations and discontinued operations may not equal the total per-share amount for net income.

The following potentially dilutive common stock equivalents were not included in the earnings per share calculations because they were anti-dilutive:

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|------|-------------------|------|
| | September 30, | | September 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| Stock options | 49 | 330 | 334 | 330 |
| Restricted stock units where certain performance | 53 | 88 | 53 | 89 |

conditions were not met

Note 13: Fair Value of Assets and Liabilities

Fair Value of Financial Instruments

The Company used the following methods and assumptions to estimate its fair value disclosures for financial instruments:

Current assets and current liabilities—The carrying amounts reported in the accompanying Consolidated Balance Sheets for current assets and current liabilities, including revolving credit debt, due to the short-term maturities and variable interest rates, approximate their fair values.

Preferred stock with mandatory redemption requirements and long-term debt—The fair values of preferred stock with mandatory redemption requirements and long-term debt are categorized within the fair value hierarchy based on the inputs that are used to value each instrument. The fair value of long-term debt classified as Level 1 is calculated using quoted prices in active markets. Level 2 instruments are valued using observable inputs and Level 3 instruments are valued using observable and unobservable inputs. The fair values of instruments classified as Level 2 and 3 are determined by a valuation model that is based on a conventional discounted cash flow methodology and utilizes assumptions of current market rates. As a majority of the Company's debts do not trade in active markets, the Company calculated a base yield curve using a risk-free rate (a U.S. Treasury securities yield curve) plus a credit spread that is based on the following two factors: an average of the Company's own publicly-traded debt securities and the current market rates for U.S. Utility A- debt securities. The Company used these yield curve assumptions to derive a base

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yield for the Level 2 and Level 3 securities. Additionally, the Company adjusted the base yield for specific features of the debt securities including call features, coupon tax treatment and collateral for the Level 3 instruments.

The carrying amounts (including fair value adjustments previously recognized in acquisition purchase accounting) and fair values of the financial instruments are as follows:

| Recurring Fair Value Measures | Carrying Amount | At Fair Value as of September 30, 2014 | | | |
|--|-----------------|--|-----------|-----------|-----------|
| | | Level 1 | Level 2 | Level 3 | Total |
| Preferred stock with mandatory redemption requirements | \$17,608 | \$0 | \$0 | \$22,255 | \$22,255 |
| Long-term debt (excluding capital lease obligations) | 5,611,294 | 2,901,707 | 1,479,866 | 2,096,293 | 6,477,866 |

| Recurring Fair Value Measures | Carrying Amount | At Fair Value as of December 31, 2013 | | | |
|--|-----------------|---------------------------------------|-----------|-----------|-----------|
| | | Level 1 | Level 2 | Level 3 | Total |
| Preferred stock with mandatory redemption requirements | \$18,827 | \$0 | \$0 | \$22,795 | \$22,795 |
| Long-term debt (excluding capital lease obligations) | 5,224,492 | 2,263,355 | 1,462,404 | 2,057,506 | 5,783,265 |

Included in the long-term debt carrying amount above is a fair value adjustment related to the Company's interest rate swap fair value hedge, which is classified as Level 2 within the fair value hierarchy.

Recurring Fair Value Measurements

The following table presents assets and liabilities measured and recorded at fair value on a recurring basis and their level within the fair value hierarchy as of September 30, 2014 and December 31, 2013, respectively:

| Recurring Fair Value Measures | At Fair Value as of September 30, 2014 | | | |
|-------------------------------------|--|-----------|---------|----------|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | |
| Restricted funds | \$37,283 | \$0 | \$0 | \$37,283 |
| Rabbi trust investments | 0 | 666 | 0 | 666 |
| Deposits | 1,318 | 0 | 0 | 1,318 |
| Mark-to-market derivative asset | 0 | 3,515 | 0 | 3,515 |
| Total assets | 38,601 | 4,181 | 0 | 42,782 |
| Liabilities | | | | |
| Deferred compensation obligation | 0 | 11,548 | 0 | 11,548 |
| Mark-to-market derivative liability | 0 | 1,068 | 0 | 1,068 |
| Total liabilities | 0 | 12,616 | 0 | 12,616 |
| Total net assets (liabilities) | \$38,601 | \$(8,435) | \$0 | \$30,166 |

| Recurring Fair Value Measures | At Fair Value as of December 31, 2013 | | | Total |
|---------------------------------------|--|------------------|-------------|-----------------|
| | Level 1 | Level 2 | Level 3 | |
| Assets | | | | |
| Restricted funds | \$29,259 | \$0 | \$ 0 | \$29,259 |
| Rabbi trust investments | 0 | 444 | 0 | 444 |
| Deposits | 1,901 | 0 | 0 | 1,901 |
| Mark-to-market derivative asset | 0 | 4,776 | 0 | 4,776 |
| Total assets | 31,160 | 5,220 | 0 | 36,380 |
| Liabilities | | | | |
| Deferred compensation obligation | 0 | 11,928 | 0 | 11,928 |
| Mark-to-market derivative liability | 0 | 1,276 | 0 | 1,276 |
| Total liabilities | 0 | 13,204 | 0 | 13,204 |
| Total net assets (liabilities) | \$31,160 | \$(7,984) | \$ 0 | \$23,176 |

Restricted funds—The Company’s restricted funds primarily represent proceeds received from financings for the construction and capital improvement of facilities and from customers for future services under operations and maintenance projects. The proceeds of these financings are held in escrow until the designated expenditures are incurred.

Rabbi trust investments—The Company’s rabbi trust investments consist primarily of fixed income investments from which supplemental executive retirement plan benefits are paid. The Company includes these assets in other long-term assets.

Deposits—Deposits include escrow funds and certain other deposits held in trust. The Company includes cash deposits in other current assets.

Deferred compensation obligations—The Company’s deferred compensation plans allow participants to defer certain cash compensation into notional investment accounts. The Company includes such plans in other long-term liabilities. The value of the Company’s deferred compensation obligations is based on the market value of the participants’ notional investment accounts. The notional investments are comprised primarily of mutual funds, which are based on observable market prices.

Mark-to-market derivative asset and liability—The Company utilizes fixed-to-floating interest-rate swaps, typically designated as fair-value hedges, to achieve a targeted level of variable-rate debt as a percentage of total debt. The Company also employs derivative financial instruments in the form of variable-to-fixed interest rate swaps, classified as economic hedges, in order to fix the interest cost on some of its variable-rate debt. The Company uses a calculation of future cash inflows and estimated future outflows, which are discounted, to determine the current fair value. Additional inputs to the present value calculation include the contract terms, counterparty credit risk, interest rates and market volatility.

Note 14: Segment Information

The Company has two operating segments that are also the Company’s two reportable segments, referred to as Regulated Businesses and Market-Based Operations. The following table includes the Company’s summarized segment information:

| | As of or for the Three Months Ended September 30, 2014 | | | |
|---|---|----------------------------|-----------|--------------|
| | Regulated Businesses | Market-Based Operations | Other | Consolidated |
| Net operating revenues | \$753,701 | \$ 96,980 | \$(4,512 |) \$846,169 |
| Depreciation and amortization | 99,120 | 1,447 | 6,222 | 106,789 |
| Total operating expenses, net | 434,912 | 79,915 | (5,943 |) 508,884 |
| Income from continuing operations before | | | | |
| income taxes | 258,539 | 17,634 | (12,360 |) 263,813 |
| Total assets | 14,161,472 | 309,935 | 1,244,240 | 15,715,647 |
| Assets of discontinued operations (included | | | | |
| in total assets above) | 0 | 6,256 | 0 | 6,256 |
| Capital expenditures | 261,241 | 1,849 | 0 | 263,090 |
| Capital expenditures of discontinued operations | 0 | 0 | 0 | 0 |

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(included in above)

| | As of or for the Three Months Ended September 30, 2013 | | | |
|---|---|----------------------------|-----------|--------------|
| | Regulated Businesses | Market-Based Operations | Other | Consolidated |
| Net operating revenues | \$743,091 | \$ 83,558 | \$(4,459) |) \$822,190 |
| Depreciation and amortization | 94,619 | 1,483 | 6,393 | 102,495 |
| Total operating expenses, net | 442,231 | 62,957 | (6,164) |) 499,024 |
| Income from continuing operations before | | | | |
| income taxes | 240,977 | 21,457 | (14,151) |) 248,283 |
| Total assets | 13,362,265 | 282,744 | 1,601,727 | 15,246,736 |
| Assets of discontinued operations (included | | | | |
| in total assets above) | 0 | 8,485 | 0 | 8,485 |
| Capital expenditures | 233,756 | 1,676 | 0 | 235,432 |
| Capital expenditures of discontinued operations | | | | |
| (included in above) | 0 | 108 | 0 | 108 |

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| | As of or for the Nine Months Ended September 30, 2014 | | | |
|--|--|----------------------------|-------------|--------------|
| | Regulated Businesses | Market-Based Operations | Other | Consolidated |
| Net operating revenues | \$2,039,446 | \$ 253,857 | \$(13,353) | \$2,279,950 |
| Depreciation and amortization | 296,084 | 4,354 | 17,960 | 318,398 |
| Total operating expenses, net | 1,302,298 | 212,075 | (13,938) | 1,500,435 |
| Income from continuing operations before income taxes | 555,985 | 43,593 | (38,910) | 560,668 |
| Total assets | 14,161,472 | 309,935 | 1,244,240 | 15,715,647 |
| Assets of discontinued operations (included in total assets above) | 0 | 6,256 | 0 | 6,256 |
| Capital expenditures | 660,805 | 4,066 | 0 | 664,871 |
| Capital expenditures of discontinued operations (included in above) | 0 | 12 | 0 | 12 |

| | As of or for the Nine Months Ended September 30, 2013 | | | |
|--|--|----------------------------|-------------|--------------|
| | Regulated Businesses | Market-Based Operations | Other | Consolidated |
| Net operating revenues | \$1,964,225 | \$ 221,751 | \$(13,282) | \$2,172,694 |
| Depreciation and amortization | 279,949 | 4,487 | 18,566 | 303,002 |
| Total operating expenses, net | 1,277,264 | 181,526 | (16,617) | 1,442,173 |
| Income from continuing operations before income taxes | 509,765 | 42,570 | (46,287) | 506,048 |
| Total assets | 13,362,265 | 282,744 | 1,601,727 | 15,246,736 |
| Assets of discontinued operations (included in total assets above) | 0 | 8,485 | 0 | 8,485 |
| Capital expenditures | 661,112 | 4,150 | 0 | 665,262 |
| Capital expenditures of discontinued operations (included in above) | 0 | 287 | 0 | 287 |

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements included in this Form 10-Q, other than statements of historical fact, may constitute forward-looking statements. Forward-looking statements can be identified by the use of words such as "may," "should," "will," "could," "estimates," "predicts," "potential," "continue," "anticipates," "believes," "plans," "expects," "future" and "intends" and similar expressions. Forward-looking statements may involve known and unknown risks, uncertainties and other factors that may cause the actual results or performance to differ from those projected in the forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. Factors that could cause or contribute to differences in results and outcomes from those in our forward-looking statements include, without limitation, those items discussed in the "Risk Factors" section or other sections in the Company's annual report on Form 10-K ("Form 10-K") for the year ended December 31, 2013 filed with the Securities and Exchange Commission ("SEC"). We undertake no obligation, other than as required by law, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

General

American Water Works Company, Inc. (herein referred to as "American Water" or the "Company") is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial, industrial and other customers. Our Regulated Businesses that provide these services are generally subject to economic regulation by state regulatory agencies ("PUCs") in the states in which they operate. We report the results of these businesses in our Regulated Businesses segment. We also provide services that are not subject to economic regulation by the PUCs. We report the results of these businesses in our Market-Based Operations segment. For further description of our businesses see Item 1, "Business," in our Form 10-K for the year ended December 31, 2013.

You should read the following discussion in conjunction with our Consolidated Financial Statements and related Notes included elsewhere in this Quarterly Report on Form 10-Q and in our Form 10-K for the year ended December 31, 2013.

Overview

Financial Results. For the three months ended September 30, 2014, we reported net income of \$152.2 million, or diluted earnings per share ("EPS") of \$0.85, compared to \$150.7 million, or diluted EPS of \$0.84, for the comparable period in 2013. Income from continuing operations was \$156.6 million, or \$0.87 per diluted share for the third quarter of 2014 compared to \$149.9 million, or \$0.84 per diluted share for the third quarter of 2013.

For the nine months ended September 30, 2014, we reported net income of \$329.6 million, or diluted EPS of \$1.83 compared to \$309.6 million, or diluted EPS of \$1.73, for the comparable period in 2013. Income from continuing operations was \$335.9 million, or \$1.87 per diluted share for the nine months ended September 30, 2014 compared to \$309.7 million, or \$1.73 per diluted share for the nine months ended September 30, 2013.

The increase in income from continuing operations for the three months ended September 30, 2014 compared to the same period in 2013 was due to favorable operating results from our Regulated Business segment due to higher revenues and lower operating expenses, partially offset by milder weather in the third quarter of 2014 compared to last

year and the 2013 impact of retroactive price redeterminations for one of our military contracts in the Market-Based Operations. The increase in income from continuing operations for the nine months ended September 30, 2014 compared to the same period in 2013 was the result of favorable operating results from our Regulated Business segment reflecting higher revenue and lower operations and maintenance (“O&M”) expenses partially offset by higher depreciation expenses and higher costs resulting from the Freedom Industries chemical spill in West Virginia. Also contributing to the overall increase in income from continuing operations was lower interest expense for the both the three and nine month periods ended September 30, 2014 compared to the same periods in the prior year.

During the third quarter of 2014, management was involved in discussions to sell our Terratec line of business, which is part of our Market-Based Operations segment. The sale is expected to close in the fourth quarter of 2014. The financial results of this entity have been reflected as discontinued operations for all periods presented. All financial information in this Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) reflects continuing operations, unless otherwise noted.

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For 2014, our goals include actively addressing regulatory lag and promoting constructive regulatory frameworks, continuing to improve our regulated operation and maintenance (“O&M”) efficiency ratio, making efficient use of our capital and expanding both our Regulated Businesses segment through focused acquisitions and/or organic growth and our Market-Based Operations segment through core growth, expanding markets and new offerings. In addition, we will continue to focus on our customer service by achieving established customer satisfaction and service quality targets. Regarding environmental sustainability, we are committed to maximizing our protection of the environment, reducing our carbon and waste footprints and water lost through leakage. The progress that we have made in the nine months of 2014 with respect to certain of these objectives is described below.

Promoting Constructive Regulatory Frameworks. On July 1, 2014, annualized revenues of \$7.4 million resulting from infrastructure charges in our New Jersey subsidiary became effective.

In July 2014, a settlement with the Office of Ratepayer Advocates and other interveners was reached in our general rate case in California. The settlement, if approved, would provide \$13.6 million in additional annualized revenues for 2015. The settlement also provides for escalation and attrition adjustments in 2016 and 2017 of \$5.0 million and \$6.3 million, respectively. The agreement is pending regulatory approval and is subject to change.

On September 2, 2014, our Missouri subsidiary filed for additional annualized revenues from infrastructure charges in the amount of \$8.5 million.

The table below provides further details of annualized revenues, assuming a constant volume, resulting from rate authorizations granted in 2014:

| | Annualized Rate Increases Granted For the three months ended September 30, 2014 (In millions) | |
|------------------------------|--|---|
| | For the three months ended September 30, 2014 | For the nine months ended September 30, 2014 |
| State | | |
| General Rate Cases | | |
| New York | \$— | \$ 1.2 |
| Iowa | — | 3.8 |
| Total General Rate cases | \$— | \$ 5.0 |
| Infrastructure charges | | |
| New York | \$— | \$ 1.8 |
| New Jersey | 7.4 | 17.5 |
| Missouri | — | 3.7 |
| Illinois | — | 2.1 |
| Tennessee | — | 0.5 |
| Total Infrastructure charges | \$7.4 | \$ 25.6 |

On October 29, 2014, our Tennessee subsidiary filed for additional annualized revenue from infrastructure charges in the amount of \$2.6 million.

As of October 31, 2014, we are awaiting final orders for general rate cases in Indiana and California, requesting additional annualized revenue of approximately \$44.5 million, adjusted for the potential California settlement discussed above. There is no assurance that all or any portion, of these requests will be granted.

On October 22, 2014, the New Jersey Board of Public Utilities issued an order on the Consolidated Tax Adjustment ("CTA") in New Jersey. Historically, the CTA allocated a portion of our consolidated losses since 1991 as a reduction to utility rate base. The order reaffirmed the continued use of a CTA as a deduction to utility rate base; however, it approved changes in methodology, two of which are significant for our New Jersey subsidiary. First, the "look-back" period was limited to the most recent five calendar years rather than to 1991. Second, the consolidated losses will be allocated 25% to customers and 75% to the company rather than customers receiving 100% allocation. The Order is subject to a 45 day appeal period.

Continuing Improvement in O&M Efficiency Ratio for our Regulated Businesses. Our O&M efficiency ratio (a non-GAAP measure) is calculated on our Regulated Businesses' operations and is defined as operation and maintenance expense divided by operating revenues where both O&M and operating revenues are adjusted to eliminate the impact of purchased water. We also exclude the allocable portion of non-O&M support services costs, mainly depreciation and general taxes that are reflected in the Regulated Businesses segment as O&M costs but for consolidated financial reporting purposes are categorized within other line items in the

Statement of Operations. Our O&M efficiency ratio was 32.6% for the three months ended September 30, 2014, compared to 35.3% for the three months ended September 30, 2013. Our O&M efficiency ratio was 36.9% for the nine months ended September 30, 2014, compared to 38.5% for the nine months ended September 30, 2013. The improvement in our 2014 O&M efficiency ratio for the three months ended September 30, 2014 was primarily attributable to an increase in Regulated Businesses' revenue and a decrease in our Regulated Businesses O&M compared to the same period in 2013. For the nine months ended September 30, 2014, the improvement was primarily attributable to the increase in our Regulated Businesses' revenue compared to the same period in 2013.

We evaluate our operating performance using this measure because management believes it is a direct measure of the efficiency of our Regulated Businesses' operations. This information is intended to enhance an investor's overall understanding of our operating performance. The O&M efficiency ratio is not a measure defined under GAAP and may not be comparable to other companies' operating measures and should not be used in place of the GAAP information provided elsewhere in this report. The following table provides a reconciliation that compares O&M and operating revenues, as determined in accordance with GAAP, to those amounts utilized in the calculation of our O&M efficiency ratio for the three and nine months ended September 30, 2014 as compared to the same periods in 2013:

Regulated O&M Efficiency Ratio (a Non-GAAP Measure):

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|--|---|-----------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| | (In thousands) | | | |
| Total O&M | \$341,348 | \$337,674 | \$1,004,377 | \$962,853 |
| Less: | | | | |
| O&M—Market-Based Operations | 77,401 | 59,682 | 204,460 | 172,684 |
| O&M—Other | (14,329) | (14,618) | (40,307) | (43,674) |
| Total Regulated O&M | 278,276 | 292,610 | 840,224 | 833,843 |
| Less: | | | | |
| Regulated purchased water expense | 33,674 | 33,956 | 93,332 | 84,759 |
| Allocation of internal O&M | 9,936 | 7,988 | 29,472 | 26,132 |
| Adjusted Regulated O&M (a) | \$234,666 | \$250,666 | \$717,420 | \$722,952 |
| | | | | |
| Total Operating Revenues | \$846,169 | \$822,190 | \$2,279,950 | \$2,172,694 |
| Less: | | | | |
| Operating revenues—Market-Based Operations | 96,980 | 83,558 | 253,857 | 221,751 |
| Operating revenues—Other | (4,512) | (4,459) | (13,353) | (13,282) |
| Total Regulated operating revenues | 753,701 | 743,091 | 2,039,446 | 1,964,225 |
| Less: Regulated purchased water expense* | 33,674 | 33,956 | 93,332 | 84,759 |
| Adjusted Regulated operating revenues (b) | \$720,027 | \$709,135 | \$1,946,114 | \$1,879,466 |
| Regulated O&M efficiency ratio (a)/(b) | 32.6 % | 35.3 % | 36.9 % | 38.5 % |

* Calculation assumes purchased water revenues are equal to purchased water expenses.

Making Efficient Use of Capital. We made capital investments of approximately \$313.7 million and \$701.6 million during the three months and nine months ended September 30, 2014, respectively. Of this total year-to-date investment, approximately \$695.4 million was for Company-funded capital improvements with the remaining \$6.2 million for the acquisition of regulated water and/or wastewater systems. For the full-year of 2014, we estimate our total capital plan to be \$1.0 billion, most of which will be allocated to upgrading our infrastructure and systems and

we estimate up to an additional \$15 million for acquisitions and strategic investment purposes.

Expanding Markets and Developing New Offerings. During the nine months ended September 30, 2014, our Regulated Businesses completed the purchase of five regulated water systems, one regulated wastewater system and three regulated water and wastewater systems. These acquisitions added approximately 2,100 water customers and 1,600 wastewater customers to our regulated operations. Also, as previously announced, in January 2014, our Military Services Group within our Market-Based Operations segment was awarded a contract for ownership, operation and maintenance of the water and wastewater systems at Hill Air Force Base in Utah. In August 2014, our Military Services Group was awarded a contract for ownership, operation and maintenance of the water and wastewater systems at Picatinny Arsenal in New Jersey. Additionally, during the nine months ended September 30, 2014, our Homeowner Services Group (“HOS”) expanded its water and sewer line protection programs into Arkansas, Louisiana, Maine, Minnesota, New Hampshire, Oklahoma, Vermont and Wyoming.

Other Matters.

West Virginia Freedom Industries Chemical Spill. As noted in the Form 10-K for the year ended December 31, 2013, on January 9, 2014, a chemical storage tank owned by Freedom Industries, Inc. leaked 4-methylcyclohexane methanol, or MCHM, and PPH/DiPHH, a mix of polyglycol ethers, into the Elk River near the West Virginia-American Water Company (“WVAWC”) treatment plant in Charleston, West Virginia. As a result of this event, income before income taxes was reduced by \$0.5 million and \$11.4 million for the three and nine months ended September 30, 2014, respectively.

See Part II, Item 1, “Legal Proceedings” in this report for information regarding litigation and an investigation by the Public Service Commission of West Virginia relating to the Freedom Industries chemical spill. The Company and WVAWC believe that WVAWC has responded appropriately to, and has no responsibility for, the Freedom Industries chemical spill, and the Company, WVAWC and other Company-affiliated entities named in any of the lawsuits have valid, meritorious defenses to the lawsuits. The Company, WVAWC and the other Company affiliates intend to vigorously contest the lawsuits. Nevertheless, an adverse outcome in one or more of the lawsuits could have a material adverse effect on the Company's financial condition, results of operations, cash flows, liquidity and reputation. Moreover, WVAWC and the Company are unable to predict the outcome of the ongoing government investigations or any legislative initiatives that might affect water utility operations.

Labor Dispute Regarding National Benefits Agreement. The Company’s Form 10-Q for the quarter ended June 30, 2014 describes a dispute between the Company and most of the labor unions representing employees in the Regulated Businesses (the “Unions”) regarding the Company’s national benefits agreement. On October 13, 2014, the Company and the Utility Workers Union of America AFL-CIO entered into a settlement agreement designed to resolve the dispute between the Company and the Unions. Among other things, the settlement agreement provides for a new 2014-2018 National Benefits Agreement that will be in effect generally until July 31, 2018. In addition, the Company agreed to make a \$10 million lump-sum payment, to be distributed in accordance with procedures set forth in the settlement agreement among eligible employees represented by the Unions and affected by implementation of the Company’s last, best and final offer effective January 1, 2011. The majority of the distributions are expected to be used to reimburse employees for medical claims arising during the relevant period and will be funded by the Group Insurance Plan for American Water Works Company, Inc. and Its Designated Subsidiaries and Affiliates - Active Employees VEBA (the “VEBA Trust”), to which the Company previously has made contributions. Therefore, amounts funded out of the VEBA Trust will not have an impact on earnings. The Unions approved the settlement agreement on October 30, 2014 and the National Labor Relations Board (the “NLRB”) approved the settlement agreement on October 31, 2014. The NLRB advised the Company that it will dismiss its petition for enforcement filed in the United States Court of Appeals for the Seventh Circuit and close the case after the Company has substantially complied with its obligations under the settlement agreement to make the lump sum payment and to post a notice to employees agreeable to the Company and acceptable to the NLRB.

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Consolidated Results of Operations and Changes from Prior Periods

| | Three Months Ended | | | Nine Months Ended | | |
|---|--|-----------|--------------------------------------|-------------------|-------------|--------------------------------------|
| | September 30, | | Favorable (Unfavorable) Change | September 30, | | Favorable (Unfavorable) Change |
| | 2014 | 2013 | | 2014 | 2013 | |
| | (Dollars in thousands, except per share amounts) | | | | | |
| Operating revenues | \$846,169 | \$822,190 | \$ 23,979 | \$2,279,950 | \$2,172,694 | \$ 107,256 |
| Operating expenses | | | | | | |
| Operation and maintenance | 341,348 | 337,674 | (3,674) | 1,004,377 | 962,853 | (41,524) |
| Depreciation and amortization | 106,789 | 102,495 | (4,294) | 318,398 | 303,002 | (15,396) |
| General taxes | 60,807 | 58,087 | (2,720) | 178,276 | 175,789 | (2,487) |
| (Gain) loss on asset dispositions and purchases | (60) | 768 | 828 | (616) | 529 | 1,145 |
| Total operating expenses, net | 508,884 | 499,024 | 9,860 | 1,500,435 | 1,442,173 | 58,262 |
| Operating income | 337,285 | 323,166 | 14,119 | 779,515 | 730,521 | 48,994 |
| Other income (expenses) | | | | | | |
| Interest, net | (75,445) | (77,389) | 1,944 | (222,673) | (233,260) | 10,587 |
| Allowance for other funds used during construction | 2,805 | 2,800 | 5 | 7,064 | 9,895 | (2,831) |
| Amortization of debt expense | 1,570 | 1,679 | (109) | 4,324 | 5,102 | (778) |
| Other, net | (733) | (449) | (284) | (2,591) | (1,481) | (1,110) |
| Total other income (expenses) | (73,472) | (74,883) | 1,411 | (218,847) | (224,473) | 5,626 |
| Income from continuing operations before income taxes | 263,813 | 248,283 | 15,530 | 560,668 | 506,048 | 54,620 |
| Provision for income taxes | 107,205 | 98,374 | (8,831) | 224,773 | 196,325 | (28,448) |
| Income from continuing operations, net of tax | (4,423) | 756 | (5,179) | (6,288) | (152) | (6,136) |
| Net income | \$152,185 | \$150,665 | \$ 1,520 | \$329,607 | \$309,571 | \$ 20,036 |
| Basic earnings per share: (a) | | | | | | |
| Income from continuing operations, net of tax | \$0.87 | \$0.84 | | \$1.88 | \$1.74 | |
| Loss from discontinued operations, net of tax | \$(0.02) | \$0.00 | | \$(0.04) | \$(0.00) | |
| Basic earnings per share | \$0.85 | \$0.85 | | \$1.84 | \$1.74 | |

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| | | | | |
|---|----------|----------|----------|------------|
| Diluted earnings per share: (a) | | | | |
| Income from continuing operations | \$0.87 | \$0.84 | \$1.87 | \$1.73 |
| Loss from discontinued operations, net | | | | |
| of tax | \$(0.02) |) \$0.00 | \$(0.03) |) \$(0.00) |
| Diluted earnings per share | \$0.85 | \$0.84 | \$1.83 | \$1.73 |
| Average common shares outstanding during the period: | | | | |
| Basic | 178,992 | 177,965 | 178,800 | 177,671 |
| Diluted | 179,948 | 179,154 | 179,723 | 178,906 |

(a) Amounts may not sum due to
rounding

The following is a discussion of the consolidated results of operations for the three and nine months ended September 30, 2014 compared to the three and nine months ended September 30, 2013:

Three Months Ended September 30, 2014 Compared to Three Months Ended September 30, 2013

Operating revenues. Consolidated operating revenues for the quarter increased \$24.0 million, or 2.9%, compared to the same quarter last year. The increase is the result of higher revenues in our Regulated Businesses segment of \$10.6 million, which is mainly attributable to rate increases, incremental revenues from surcharges, balancing accounts and acquisitions, partially offset by reduced consumption in 2014 compared to 2013, which we believe is the result of cooler and wetter weather conditions in 2014. Also, contributing to the higher revenues was a \$13.4 million increase in our Market-Based Operations segment primarily due to incremental revenue from our military contracts as a result of increased construction type projects at Fort Polk as well as contract growth in our HOS. For further information, see the respective “Operating Revenues” discussions within the “Segment Results.”

Operation and maintenance. Consolidated O&M increased by \$3.7 million, or 1.1%, compared to the same period in 2013. The increase is primarily due to higher O&M costs in our Market-Based Operations segment of \$17.7 million, principally due to increased activity under our military contracts, corresponding with the increased revenue. This increase was largely offset by a \$14.3 million decrease in O&M costs for our Regulated Businesses segment primarily due to lower production costs and lower employee-related costs. For further discussions on the changes in our Regulated and Market-Based segments’ O&M, see the respective “Operation and Maintenance” discussions within the “Segment Results.”

Depreciation and amortization. Depreciation and amortization expense increased by \$4.3 million, or 4.2%, principally as a result of additional utility plant placed in service, including our Customer Information and Enterprise Asset Management systems that went into service during the second and fourth quarters of 2013.

General Taxes: General taxes increased \$2.7 million or 4.7% due to higher property tax assessments in Pennsylvania and Kentucky.

Other income (expenses). Other expenses decreased by \$1.4 million, or 1.9%, compared to the same period in the prior year. The change is primarily due to a reduction in interest expense resulting from interest savings as a result of our 2013 refinancings.

Provision for income taxes. Our consolidated provision for income taxes increased \$8.8 million, or 9.0%, to \$107.2 million for the three months ended September 30, 2014. The effective tax rates for the three months ended September 30, 2014 and 2013 were 40.6% and 39.6%, respectively. Included in the three months ended September 30, 2014 were \$2.1 million of discrete tax items associated with uncertain tax positions.

Loss from discontinued operations, net of tax. As noted above, the financial results of our Terratec line of business within our Market-Based segment has been classified as discontinued operations for all periods presented. The increase in loss from discontinued operations, net of tax is primarily related to costs associated with the pending sale and an income tax valuation allowance and lower operating result for the quarter.

Nine Months Ended September 30, 2014 Compared to Nine Months Ended September 30, 2013

Operating revenues. Consolidated operating revenues increased \$107.3 million, or 4.9%. The increase is the result of higher revenues in our Regulated Businesses segment of \$75.2 million, mainly attributable to rate increases, incremental revenues from surcharges and balancing accounts, partially offset by reduced consumption in 2014, mainly due to the cooler and wetter weather in 2014 compared to 2013. Also contributing to the higher revenues was a \$32.1 million increase in our Market-Based Operations segment primarily due to incremental revenue from our military contracts as a result of increased construction type projects, with the largest increases at Forts Polk and

Leavenworth, and contract growth in our HOS. For further information, see the respective “Operating Revenues” discussions within the “Segment Results.”

Operation and maintenance. Consolidated O&M increased by \$41.5 million, or 4.3%. The increase is primarily due to higher O&M costs in our Regulated Businesses segment of \$6.4 million, principally due to increased production costs, uncollectible expense, maintenance expense and costs associated with the Freedom Industries chemical spill in West Virginia, partially offset by lower employee-related costs. The increase in our Market-Based Operations segment of \$31.8 million was mainly from incremental costs related to increased activity under our military contracts, corresponding with the increased revenue. For further discussions on the changes in our Regulated Businesses and Market-Based Operations segments’ O&M, see the respective “Operation and Maintenance” discussions within the “Segment Results.”

Depreciation and amortization. Depreciation and amortization expense increased by \$15.4 million, or 5.1%, principally as a result of additional utility plant placed in service, including our Customer Information and Enterprise Asset Management systems that were placed into service during the second and fourth quarters of 2013.

Other income (expenses). Other expenses decreased by \$5.6 million, or 2.5% . The change is primarily due to a reduction in interest expense resulting from interest savings as a result of our 2013 refinancings, offset by a reduction in AFUDC which is mainly attributable to our Customer Information and Enterprise Asset Management systems being placed into service in the second and fourth quarters of 2013.

Provision for income taxes. Our consolidated provision for income taxes increased \$28.4 million, or 14.5%. The effective tax rates for the nine months ended September 30, 2014 and 2013 were 40.1% and 38.8%, respectively. Included in the nine months ended September 30, 2014 were \$2.0 million of discrete tax items associated with uncertain tax positions. The 2013 rate included a \$3.3 million tax benefit associated with a legal structure reorganization in our Market-Based Operations segment. This strategic restructuring allowed us to utilize state net operating loss carryforwards prior to their expiration.

Loss from discontinued operations, net of tax. As noted above, the financial results of our Terratec line of business within our Market-Based segment has been classified as discontinued operations for all periods presented. The increase in loss from discontinued operations, net of tax is primarily related to costs associated with the pending sale and an income tax valuation allowance and lower operating results.

Segment Results

We have two operating segments that are also our reportable segments: the Regulated Businesses and the Market-Based Operations. We evaluate the performance of our segments and allocate resources based on several factors, with the primary measure being income before income taxes.

Regulated Businesses Segment

The following table summarizes certain financial information for our Regulated Businesses for the periods indicated:

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|--|---|-----------|------------------------|--|-------------|------------------------|
| | 2014 | 2013 | Increase (Decrease) | 2014 | 2013 | Increase (Decrease) |
| | (In thousands) | | | | | |
| Operating revenues | \$753,701 | \$743,091 | \$ 10,610 | \$2,039,446 | \$1,964,225 | \$ 75,221 |
| Operation and maintenance expense | 278,276 | 292,610 | (14,334) | 840,224 | 833,843 | 6,381 |
| Operating expenses, net | 434,912 | 442,231 | (7,319) | 1,302,298 | 1,277,264 | 25,034 |
| Income from continuing operations before income taxes | 258,539 | 240,977 | 17,562 | 555,985 | 509,765 | 46,220 |

Operating revenues. Our primary business involves the ownership of water and wastewater utilities that provide services to residential, commercial, industrial and other customers. This business generally is subject to PUC economic regulation, and our results of operations are impacted significantly by rates authorized by the PUCs in the states in which we operate.

Operating revenues increased by \$10.6 million, or 1.4%, for the quarter ended September 30, 2014, as compared to the same period in 2013. The increase in revenues is principally due to incremental revenues of approximately \$23.0 million of rate increases resulting from rate authorizations for a number of our operating companies. Additionally, revenue increased by \$1.8 million due to increased surcharges and balancing accounts and approximately \$3.7 million

of incremental revenues attributable to acquisitions. The most significant contributor to the increase in revenues from acquisitions was Dale Service Corporation (“Dale”), which was acquired by our Virginia subsidiary in the fourth quarter of 2013. Partially offsetting these increases was a decrease in revenues of approximately \$18.7 million as a result of lower demand, of which a large portion is believed to be the result of cooler and wetter weather this year compared to last year.

Operating revenues increased by \$75.2 million, or 3.8%, for the nine months ended September 30, 2014, as compared to the same period in 2013. The increase in revenues is principally due to incremental revenues of approximately \$63.7 million attributable to rate increases from rate authorizations for a number of our operating companies partially offset by a reduction in consumption levels of approximately \$11.5 million. As previously mentioned, we believe a large portion of this consumption decrease is the result of cooler and wetter weather this year compared to last year. Additionally, revenue increased by \$10.2 million due to increased surcharges and balancing accounts and approximately \$10.5 million as a result of 2013 acquisitions. The most significant contributor to the increase in revenues from acquisitions was Dale.

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The following table provides information regarding the Regulated Businesses' for the periods indicated:

| Customer Class | For the three months ended September 30, | | | | | Increase | | | | |
|------------------------------|--|-------------|------------|------------|------|---------------------------|------------|------------|------|----|
| | 2014 | 2013 | (Decrease) | Percentage | 2014 | 2013 | (Decrease) | Percentage | | |
| | Operating Revenues | | | | | Billed Water Sales Volume | | | | |
| | (dollars in thousands) | | | | | (gallons in millions) | | | | |
| Water service | | | | | | | | | | |
| Residential | \$431,906 | \$420,307 | \$ 11,599 | 2.8 | % | 53,523 | 55,905 | (2,382) | (4.3 | %) |
| Commercial | 155,761 | 152,640 | 3,121 | 2.0 | % | 23,758 | 24,789 | (1,031) | (4.2 | %) |
| Industrial | 35,349 | 33,026 | 2,323 | 7.0 | % | 10,405 | 10,081 | 324 | 3.2 | % |
| Public and other | 87,868 | 87,510 | 358 | 0.4 | % | 15,045 | 15,531 | (486) | (3.1 | %) |
| Other water revenues | 12,458 | 7,201 | 5,257 | 73.0 | % | — | — | — | — | |
| Billed water services | 723,342 | 700,684 | 22,658 | 3.2 | % | 102,731 | 106,306 | (3,575) | (3.4 | %) |
| Unbilled water services | (6,012) | 9,384 | (15,396) | (164.1 | %) | | | | | |
| Total water service revenues | 717,330 | 710,068 | 7,262 | 1.0 | % | | | | | |
| Wastewater service revenues | 23,059 | 20,720 | 2,339 | 11.3 | % | | | | | |
| Other revenues | 13,312 | 12,303 | 1,009 | 8.2 | % | | | | | |
| | \$753,701 | \$743,091 | \$ 10,610 | 1.4 | % | | | | | |
| | | | | | | | | | | |
| Customer Class | For the nine months ended September 30, | | | | | Increase | | | | |
| | 2014 | 2013 | (Decrease) | Percentage | 2014 | 2013 | (Decrease) | Percentage | | |
| | Operating Revenues | | | | | Billed Water Sales Volume | | | | |
| | (dollars in thousands) | | | | | (gallons in millions) | | | | |
| Water service | | | | | | | | | | |
| Residential | \$1,150,336 | \$1,100,767 | \$ 49,569 | 4.5 | % | 135,165 | 136,356 | (1,191) | (0.9 | %) |
| Commercial | 416,197 | 395,622 | 20,575 | 5.2 | % | 61,839 | 61,129 | 710 | 1.2 | % |
| Industrial | 100,337 | 90,044 | 10,293 | 11.4 | % | 29,811 | 27,235 | 2,576 | 9.5 | % |
| Public and other | 253,127 | 238,701 | 14,426 | 6.0 | % | 40,964 | 39,821 | 1,143 | 2.9 | % |
| Other water revenues | 21,057 | 16,187 | 4,870 | 30.1 | % | — | — | — | — | |
| Billed water services | 1,941,054 | 1,841,321 | 99,733 | 5.4 | % | 267,779 | 264,541 | 3,238 | 1.2 | % |
| Unbilled water services | (8,973) | 27,469 | (36,442) | (132.7 | %) | | | | | |
| Total water service revenues | 1,932,081 | 1,868,790 | 63,291 | 3.4 | % | | | | | |
| Wastewater service revenues | 69,721 | 60,955 | 8,766 | 14.4 | % | | | | | |

| | | | | | |
|----------------|-------------|-------------|----------|-----|---|
| Other revenues | 37,644 | 34,480 | 3,164 | 9.2 | % |
| | \$2,039,446 | \$1,964,225 | \$75,221 | 3.8 | % |

Water Services – Water service operating revenues for the three months ended September 30, 2014 totaled \$717.3 million, a \$7.3 million increase, or 1.0%, over the same period of 2013. For the nine months ended September 30, 2014, these revenues increased \$63.3 million, or 3.4%, compared to the nine months ended September 30, 2013. As described above, the increases for both the three and nine months ended September 30, 2014 are primarily due to rate increases, incremental revenues associated with surcharges and amortization of balancing accounts and recent acquisitions. Also, it should be noted that the mix between billed revenues and unbilled revenues for the three and nine months ended September 30, 2014, as compared to the same periods in 2013, has changed. This change is principally the result of the implementation of our Customer Information System (“CIS”) as part of Phase II of our business transformation project. At December 31, 2013, unbilled revenues were significantly higher than historical levels due to billing delays in certain accounts. During the first quarter of 2014, we addressed a majority of these delayed billings. Therefore, as a result, the change in unbilled water revenue for the three and nine-month periods ended September 30, 2014, compared to the same periods in 2013, decreased by \$15.4 million and \$36.4 million, respectively, with corresponding increases in billed revenues.

Wastewater services – Our subsidiaries provide wastewater services in eleven states. Revenues from these services increased \$2.3 million, or 11.3%, and \$8.8 million, or 14.4%, for the three and nine months ended September 30, 2014, respectively, compared to the same periods in 2013. The increase is primarily attributable to the Dale acquisition in the fourth quarter of 2013.

Other revenues – Other revenues, which include such items as reconnection charges, initial application service fees, certain rental revenues, revenue collection services for others and similar items, increased \$1.0 million, or 8.2%, and \$3.2 million, or 9.2%, for the three and nine months ended September 30, 2014, respectively. The increase for the three months ended September 30, 2014 is

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principally due to the additional surcharge revenues. The nine-month period increase is primarily due to \$2.4 million in insurance proceeds for business interruption as a result of Hurricane Sandy in addition to an increase in late payment fees.

Operation and maintenance expense. Operation and maintenance expense decreased \$14.3 million, or 4.9%, and increased \$6.4 million, or 0.8%, for the three and nine months ended September 30, 2014, respectively, compared to the same periods in 2013.

The following table provides information regarding operation and maintenance expense for the three and nine months ended September 30, 2014 and 2013, by major expense category:

| | For the three months ended September 30, | | | | For the nine months ended September 30, | | | |
|------------------------------------|--|-----------|------------|------------|---|-----------|------------|------------|
| | 2014 | 2013 | (Decrease) | Percentage | 2014 | 2013 | (Decrease) | Percentage |
| | Increase | | | | | | | |
| | Increase | | | | | | | |
| | (Dollars in thousands) | | | | | | | |
| Production costs | \$79,455 | \$82,093 | \$(2,638) | (3.2 %) | \$222,855 | \$207,698 | \$15,157 | 7.3 % |
| Employee-related costs | 106,672 | 114,127 | (7,455) | (6.5 %) | 321,452 | 342,611 | (21,159) | (6.2 %) |
| Operating supplies and services | 53,204 | 54,215 | (1,011) | (1.9 %) | 163,460 | 163,998 | (538) | (0.3 %) |
| Maintenance materials and supplies | 15,421 | 15,357 | 64 | 0.4 % | 53,581 | 47,733 | 5,848 | 12.3 % |
| Customer billing and accounting | 15,420 | 16,193 | (773) | (4.8 %) | 44,707 | 38,380 | 6,327 | 16.5 % |
| Other | 8,104 | 10,625 | (2,521) | (23.7 %) | 34,169 | 33,423 | 746 | 2.2 % |
| Total | \$278,276 | \$292,610 | \$(14,334) | (4.9 %) | \$840,224 | \$833,843 | \$6,381 | 0.8 % |

Production costs by major expense type were as follows:

| | For the three months ended September 30, | | | | For the nine months ended September 30, | | | |
|-----------------|--|----------|------------|------------|---|-----------|------------|------------|
| | 2014 | 2013 | (Decrease) | Percentage | 2014 | 2013 | (Decrease) | Percentage |
| | Increase | | | | | | | |
| | Increase | | | | | | | |
| | (Dollars in thousands) | | | | | | | |
| Purchased Water | \$33,674 | \$33,956 | \$(282) | (0.8 %) | \$93,332 | \$84,759 | \$8,573 | 10.1 % |
| Fuel and Power | 25,890 | 25,990 | (100) | (0.4 %) | 71,025 | 66,227 | 4,798 | 7.2 % |
| Chemicals | 12,521 | 15,063 | (2,542) | (16.9 %) | 35,316 | 36,997 | (1,681) | (4.5 %) |
| Waste Disposal | 7,370 | 7,084 | 286 | 4.0 % | 23,182 | 19,715 | 3,467 | 17.6 % |
| Total | \$79,455 | \$82,093 | \$(2,638) | (3.2 %) | \$222,855 | \$207,698 | \$15,157 | 7.3 % |

Production costs decreased by \$2.6 million, or 3.2%, for the three months ended September 30, 2014 and increased by \$15.1 million, or 7.3%, for the nine months ended September 30, 2014. The decrease for the three month period was primarily due to a \$1.8 million reversal of chemical expense resulting from a favorable litigation settlement. The

increase for the nine month period was primarily due to increases in purchased water, fuel and power costs and waste disposal. Partially offsetting these increases was a decrease in chemicals due to the credit discussed above. The purchased water increases principally reflect increased prices in our California subsidiary. Fuel and power costs increased due to increased customer demand and higher supplier prices in several of our operating facilities as well as incremental costs as a result of the Dale acquisition in the fourth quarter of 2013. The increase in waste disposal costs for both the three and nine month periods was principally due to an increase in the amount allowed by a cost recovery mechanism in one of our operating companies and the Dale acquisition. Also contributing to the nine month increase was incremental costs associated with the Freedom Industries chemical spill in West Virginia.

The following table provides information with respect to components of employee-related costs for the three and nine months ended September 30, 2014 and 2013:

| | For the three months ended September 30, Increase | | | | For the nine months ended September 30, Increase | | | |
|--------------------|--|-----------|-------------|------------|---|-----------|--------------|------------|
| | 2014 | 2013 | (Decrease) | Percentage | 2014 | 2013 | (Decrease) | Percentage |
| | (Dollars in thousands) | | | | | | | |
| Salaries and wages | \$81,456 | \$81,211 | \$ 245 | 0.3 % | \$245,107 | \$241,617 | \$ 3,490 | 1.4 % |
| Pensions | 6,648 | 11,976 | (5,328) | (44.5 %) | 20,268 | 36,604 | (16,336) | (44.6 %) |
| Group insurance | 13,759 | 16,636 | (2,877) | (17.3 %) | 41,889 | 50,283 | (8,394) | (16.7 %) |
| Other benefits | 4,809 | 4,304 | 505 | 11.7 % | 14,188 | 14,107 | 81 | 0.6 % |
| Total | \$106,672 | \$114,127 | \$ (7,455) | (6.5 %) | \$321,452 | \$342,611 | \$ (21,159) | (6.2 %) |

The overall decrease in employee-related costs for the three and nine months ended September 30, 2014, compared to the same periods in 2013, was primarily due to a reduction in pension costs and postretirement benefit costs (which is included in group insurance expenses). These decreases are principally due to the change in assumptions used for the discount rate, which in turn resulted in decreased contributions. The decrease in contributions occurred principally at those of our regulated operating companies whose costs are recovered based on our funding policy, which is to fund at least the minimum amount required by the Employee Retirement Income Security Act of 1974. Partially offsetting these decreases was an increase in salaries and wages expense for the three and nine months ended September 30, 2014, compared to the same periods in 2013. For the three month period, the increase is the result of annual wage and overtime expense increases offset by higher capitalization rates as a result of increased capital projects. For the nine month period, the increase is the result of annual wage increases and increased overtime expense attributable to an increased number of main breaks as a result of the harsh winter weather conditions, offset by a reduction in incentive compensation due to a lower than expected payout for the 2013 incentive period as well as higher capitalization rates as a result of increased capital projects.

Maintenance materials and supplies, which include preventive maintenance and emergency repair costs, remained relatively unchanged for the three months ended September 30, 2014 compared to the same period in 2013. The increase of \$5.8 million, or 12.3%, for the nine months ended September 30, 2014, compared to the same period in 2013, is primarily due to an increase in tank painting costs in one of our subsidiaries and increases in paving, backfilling and other repair costs, most of which are from the higher than normal main breaks in the first quarter of 2014 due to the abnormally harsh winter weather conditions experienced throughout our operating areas.

Customer billing and accounting expenses, which include uncollectible accounts expense, postage and other customer related expenses, decreased by \$0.8 million, or 4.8%, for the three months ended September 30, 2014 and increased by \$6.3 million, or 16.5%, for the nine months ended September 30, 2014. The increase for the nine-month period is primarily due to incremental uncollectible expense associated with an increase in customer accounts receivable attributable to the overall aging of receivables as well as rate increases. We believe the aging of our receivables is the result of temporary changes made in our collection process with the implementation of our new Customer Information System in 2013. As such we anticipate uncollectible expense will continue to be higher this year.

Other operation and maintenance expense includes casualty and liability insurance premiums and regulatory costs. The decrease in these costs for the three months ended September 30, 2014 compared to the prior year period was primarily driven by lower regulatory expenses as well as lower casualty insurance costs, as a result of historical claims experience, and retroactive premium adjustments. The increase for the nine-month period ended September 30, 2014 compared to the nine months ended September 30, 2013 was primarily due to an increase in our expected retroactive premiums, principally due to incremental claims associated with the Freedom Industries chemical spill in West Virginia, net of favorable forecasted experience for already existing claims. These retroactive premiums are based upon current facts and circumstances with respect to outstanding claims and are subject to change as the claims mature. The increase in insurance costs is partially offset by lower regulatory expenses in one of our operating subsidiaries compared to the same period in the prior year.

Operating expenses. The decrease in operating expenses, for the three and nine months ended September 30, 2014, is principally due to the decreases in operation and maintenance expense explained above and higher depreciation and amortization expense of \$4.5 million and \$16.1 million for the three and nine months ended September 30, 2014, respectively. The increase in depreciation and amortization is primarily due to additional utility plant placed in service, including CIS and our Enterprise Asset Management system.

Market-Based Operations

The following table provides financial information for our Market-Based Operations segment for the periods indicated:

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|---|---|----------|------------------------|--|-----------|------------------------|
| | 2014 | 2013 | Increase (Decrease) | 2014 | 2013 | Increase (Decrease) |
| | (In thousands) | | | | | |
| Operating revenues | \$96,980 | \$83,558 | \$ 13,422 | \$253,857 | \$221,751 | \$ 32,106 |
| Operation and maintenance expense | 77,401 | 59,682 | 17,719 | 204,460 | 172,684 | 31,776 |
| Operating expenses, net | 79,915 | 62,957 | 16,958 | 212,075 | 181,526 | 30,549 |
| Income from continuing operations before income taxes | 17,634 | 21,457 | (3,823) | 43,593 | 42,570 | 1,023 |

Operating revenues. Revenues for the three and nine months ended September 30, 2014 increased \$13.4 million and \$32.1 million, respectively, compared to the same periods in 2013, as a result of incremental revenues in our Contract Operations Group (“ConOp”) and HOS lines of business. For the three and nine months ended September 30, 2014, our ConOp revenue increased \$9.9

million and \$19.8 million, respectively. These increases are primarily related to additional revenues from capital project activities associated with our military contracts. Partially offsetting these incremental revenues were the effects of retroactive price redeterminations for several of our military contracts which increased revenues by \$3.4 million and \$5.7 million for the three and nine months ended September 30, 2013, respectively. Other decreases in revenues in the 2014 periods compared to the prior year periods include terminated municipal and industrial operations and maintenance contracts. HOS revenues increased \$3.5 million and \$12.6 million for the three and nine months ended September 30, 2014, respectively. These increases were principally the result of contract growth, mainly through our New York City contracts, as well as expansion into other geographic areas and price increases for certain existing customers.

Operation and maintenance. Operation and maintenance expense increased \$17.7 million, or 29.7%, and \$31.8 million, or 18.4% for the three and nine months ended September 30, 2014, respectively.

The following table provides information regarding categories of operation and maintenance expense for the periods indicated:

| | For the three months ended September 30, | | | | For the nine months ended September 30, | | | | | |
|------------------------------------|--|----------|------------------------|------------|---|-----------|------------------------|------------|--|--|
| | 2014 | 2013 | Increase (Decrease) | Percentage | 2014 | 2013 | Increase (Decrease) | Percentage | | |
| | (Dollars in thousands) | | | | | | | | | |
| Production costs | \$8,511 | \$9,333 | \$ (822) | (8.8 %) | \$26,372 | \$27,803 | \$ (1,431) | (5.1 %) | | |
| Employee-related costs | 15,993 | 14,673 | 1,320 | 9.0 % | 45,069 | 44,162 | 907 | 2.1 % | | |
| Operating supplies and services | 38,836 | 24,757 | 14,079 | 56.9 % | 93,518 | 67,611 | 25,907 | 38.3 % | | |
| Maintenance materials and supplies | 12,443 | 9,778 | 2,665 | 27.3 % | 34,753 | 30,161 | 4,592 | 15.2 % | | |
| Other | 1,618 | 1,141 | 477 | 41.8 % | 4,748 | 2,947 | 1,801 | 61.1 % | | |
| Total | \$77,401 | \$59,682 | \$ 17,719 | 29.7 % | \$204,460 | \$172,684 | \$ 31,776 | 18.4 % | | |

As noted in the table above, the primary factor contributing to the overall increase was an increase in operating supplies and services. This increase is mainly attributable to the increase in construction project activities under our military contracts and corresponds with the incremental revenues. Additionally, included in the three and nine months ended September 30, 2013 was the release of \$3.8 million in loss contract reserves due to the resolution of certain outstanding issues and uncertainties. The increase in maintenance materials and supplies increased primarily due to higher HOS repair costs, which is attributable to new contracts.

Operating expense. The changes in operating expenses for the three and nine months ended September 30, 2014, compared to the same periods in 2013, are primarily due to the variances in the operation and maintenance expense explained above.

Liquidity and Capital Resources

For a general overview of our sources and uses of capital resources, see the introductory discussion under “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources,” contained in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2013.

We rely on our revolving credit facility, the capital markets and our cash flows from operations to fulfill our short-term liquidity needs, to issue letters of credit and to support our commercial paper program. We fund liquidity needs for capital investment, working capital and other financial commitments through cash flows from operations, public and private debt offerings, commercial paper markets and, to the extent necessary, our revolving credit facility. We regularly evaluate the capital markets and closely monitor the financial condition of the financial institutions with contractual commitments in the revolving credit facility.

In order to meet our short-term liquidity needs, we, through AWCC, our financing subsidiary, issue commercial paper, which is supported by the revolving credit facility. The revolving credit facility is also used, to a limited extent, to support our issuance of letters of credit and, from time to time, for direct borrowings. As of September 30, 2014, AWCC had no outstanding borrowings and \$39.7 million of outstanding letters of credit under the revolving credit facility. As of September 30, 2014, AWCC had \$1.2 billion available under the credit facility that we can use to fulfill our short-term liquidity needs, to issue letters of credit and support our \$314.0 million outstanding commercial paper. We can provide no assurances that our lenders will meet their existing commitments or that we will be able to access the commercial paper or loan markets in the future on terms acceptable to us or at all.

Cash Flows from Operating Activities

Cash flows from operating activities primarily result from the sale of water and wastewater services and, due to the seasonality of demand, are generally greater during the third quarter of each fiscal year. Cash flows from continuing operating activities for the

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nine months ended September 30, 2014 were \$840.9 million compared to \$688.5 million for the nine months ended September 30, 2013.

The following table provides a summary of the major items affecting our cash flows from continuing operating activities for the nine months ended September 30, 2014 and 2013:

| | Nine Months Ended | |
|---|-------------------|---------------|
| | September 30, | September 30, |
| | 2014 | 2013 |
| | (In thousands) | |
| Net income | \$329,607 | \$309,571 |
| Add (subtract): | | |
| Non-cash activities (1) | 576,381 | 561,285 |
| Changes in working capital (2) | (29,303) | (104,643) |
| Pension and postretirement healthcare contributions | (35,783) | (77,664) |
| Net cash flows provided by continuing operations | \$840,902 | \$688,549 |

(1) Includes depreciation and amortization, provision for deferred income taxes, amortization of deferred investment tax credits, provision for losses on accounts receivable, allowance for other funds used during construction, (gain) loss on asset dispositions and purchases, pension and non-pension postretirement benefits expense, stock-based compensation expense and other non-cash items. Details of each component can be found in the Consolidated Statements of Cash Flows.

(2) Changes in working capital include changes to receivables and unbilled revenue, taxes receivable (including income taxes), other current assets, accounts payable, taxes accrued (including income taxes), interest accrued, change in book overdraft and other current liabilities.

The increase in cash flows from operating activities during the nine months ended September 30, 2014 as compared to the same period in 2013 reflects higher net income adjusted for non-cash activities, changes in working capital and a reduction in pension and postretirement benefit contributions. The increase in working capital for the nine months ended September 30, 2014 compared to the same period in the prior year is principally the result of increased processing of payments, accounts payable and accrued expenses in the first quarter of 2013, which was attributed to delays in payment of vendor invoices in the latter portion of 2012 as a result of the implementation of Phase I of our business transformation project.

Our working capital needs are primarily limited to funding the increase in our customer accounts receivable and unbilled revenues which is mainly associated with the revenue increase as a result of rate increases in our Regulated Businesses segment. We address this timing issue through the aforementioned liquidity funding mechanisms. Our cash collections for our Regulated Businesses' accounts receivable, some of which were unbilled as December 31, 2013, has showed improvement during 2014 compared to the second half of 2013. In the second half of 2013, the rate of cash collections, particularly in those states in which we implemented CIS in the second quarter of 2013, were slower than historical payment patterns. We believe this degradation in cash collections to be a result of certain process decisions, made as part of the CIS implementation, including the manual validation of bills prior to mailing to customers and decreased collection efforts. Therefore, we believe this situation to be only temporary in nature. Although cash collections increased during the first nine months of 2014, there are no assurances that the rate of cash collections will continue or be consistent with previous historical collection patterns.

Cash Flows from Investing Activities

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The following table provides information regarding cash flows used in investing activities of continuing operations for the periods indicated:

| | Nine Months Ended | |
|--|-------------------|---------------|
| | September 30, | September 30, |
| | 2014 | 2013 |
| | (In thousands) | |
| Net capital expenditures | \$(664,859) | \$(664,975) |
| Proceeds from sale of assets and securities | 804 | 749 |
| Acquisitions | (6,053) | (16,554) |
| Other investing activities, net (1) | (51,221) | (38,300) |
| Net cash flows used in investing activities of continuing operations | \$(721,329) | \$(719,080) |

(1) Includes removal costs from property, plant and equipment retirements, net and net funds released.

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Cash Flows from Financing Activities

Our financing activities, primarily focused on funding construction expenditures, include the issuance of long-term and short-term debt, primarily through AWCC. We intend to access the capital markets on a regular basis, subject to market conditions. In addition, new infrastructure may be financed with customer advances (net of refunds) and contributions in aid of construction (net of refunds).

As previously noted, AWCC is a wholly-owned finance subsidiary of American Water Works Company, Inc. (the “parent company”). Based on the needs of our regulated subsidiaries and the parent company, AWCC borrows in the capital markets and then, through intercompany loans, provides proceeds of those borrowings to the regulated subsidiaries and the parent company. The regulated subsidiaries and the parent company are obligated to pay to AWCC their respective portion of principal and interest in the amount required to enable AWCC to meet its debt service obligations. Because the parent company borrowings are not a source of capital for the Company’s regulated subsidiaries, the Company is not able to recover the interest charges on parent company debt through regulated water and wastewater rates.

We intend to utilize commercial paper for short-term liquidity, as commercial paper borrowings have historically been a more flexible and lower cost option. However, if necessary, we utilize our credit facility to complement our borrowings in the commercial paper market. In the event of disruptions in the money market sector of the debt capital markets, borrowings under our revolving credit facility may be more efficient and a lower cost alternative to commercial paper.

The following table provides information on long-term debt that was issued during the first nine months of 2014:

| Company | Type | Rate | Maturity | Amount (In thousands) |
|---|--|-------------|-----------|--------------------------|
| American Water Capital Corp. ⁽¹⁾ | Senior notes—fixed rate | 3.40%-4.30% | 2025-2042 | \$ 500,000 |
| Other subsidiaries ⁽²⁾ | Private activity bonds and government funded debt—fixed rate | 0.00%-5.00% | 2031-2033 | 10,474 |
| Total issuances | | | | \$ 510,474 |

(1) On August 14, 2014, AWCC closed on senior fixed rate notes. Proceeds used to refinance commercial paper borrowings and to finance redemptions of long-term debt.

(2) Proceeds from the above issuance, which were initially kept in trust, were received from New Jersey Environmental Infrastructure Trust and will be used to fund certain specific projects. The proceeds are held in trust pending our certification that we have incurred qualifying expenditures. These issuances have been presented as non-cash in the accompanying Consolidated Statements of Cash Flows. Subsequent releases of the funds will be reflected as net funds released in the cash flows from investing activities section of the Consolidated Statements of Cash Flows.

In addition to the above issuance, we also assumed \$1.7 million of debt as a result of an acquisition.

The following long-term debt was retired through sinking fund provisions or payment at maturity during the first nine months of 2014:

| Company | Type | Rate | Maturity | Amount (In thousands) |
|-----------------------------------|--|-------------|-----------|--------------------------|
| American Water Capital Corp. | Private activity bonds and government | | | |
| | funded debt—fixed rate | 6.00%-6.75% | 2014-2031 | \$ 77,760 |
| American Water Capital Corp. | Senior notes—fixed rate | 6.00% | 2039 | 9 |
| Other subsidiaries ⁽¹⁾ | Private activity bonds and government | | | |
| | funded debt—fixed rate | 0.00%-5.25% | 2014-2041 | 60,165 |
| Other subsidiaries | Mandatorily redeemable preferred stock | 8.49% | 2036 | 1,200 |
| Other subsidiaries | Capital lease payments | | | 20 |
| Total retirements and redemptions | | | | \$ 139,154 |

(1) Includes \$1.2 million of non-cash defeasance via the use of restricted funds.

In September 2014, AWCC issued a notice of redemption for \$23.3 million of outstanding 6.25% Senior Notes with an original maturity of 2032. These notes will be retired on November 1, 2014. Also, in September, our New York subsidiary issued a notice of redemption for 4.9% notes with an original maturity of 2034. These notes were retired on October 1, 2014. Lastly, on October 9, 2014, we issued a notice of redemption for \$59.6 million of outstanding 6.00% Senior Notes with an original maturity date of 2039. These notes will be retired on December 1, 2014.

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From time to time, and as market conditions warrant, we may engage in additional long-term debt retirements via tender offers, open market repurchases or other transactions.

Credit Facilities and Short-Term Debt

Short-term debt balance, consisting of commercial paper, net of discount, amounted to \$314.0 million at September 30, 2014.

The following table provides information as of September 30, 2014 regarding letters of credit sub-limits under our revolving credit facility and available funds under the revolving credit facility, as well as outstanding amounts of commercial paper and borrowings under our revolving credit facility.

| | Available Credit Facility Commitment (In thousands) | Available Credit Facility Capacity | Letter of Credit Sub-limit | Available Letter of Credit Capacity | Outstanding Commercial Paper (Net of Discount) | Credit Line Borrowings |
|--------------------|--|--|-------------------------------|---|---|---------------------------|
| September 30, 2014 | \$ 1,250,000 | \$ 1,210,337 | \$ 150,000 | \$ 110,337 | \$ 313,979 | \$ — |

The weighted-average interest rate on short-term borrowings for the three months ended September 30, 2014 and 2013 was approximately 0.29% and 0.33%, respectively, and 0.29% and 0.36% for the nine months ended September 30, 2014 and 2013, respectively.

Capital Structure

The following table provides information regarding our capital structure for the periods presented:

| | At September 30, 2014 | At December 31, 2013 | | |
|---|--------------------------------|-------------------------------|---|---|
| Total common stockholders' equity | 45 | 45 | % | % |
| Long-term debt and redeemable preferred stock at redemption value | 51 | 49 | % | % |
| Short-term debt and current portion of long-term debt | 4 | 6 | % | % |
| | 100 | 100 | % | % |

Debt Covenants

Our debt agreements contain financial and non-financial covenants. To the extent that we are not in compliance, we, or our subsidiaries, may be restricted in the ability to pay dividends, issue new debt or access our revolving credit facility. For two of our smaller operating companies, we have informed our counterparties that we will provide only unaudited financial information at the subsidiary level, which resulted in technical non-compliance with certain of their reporting requirements. We do not believe this change will materially impact us. Our failure to comply with restrictive covenants under our credit facility could accelerate repayment obligations. Our long-term debt indentures contain a number of covenants that, among other things, limit the Company from issuing debt secured by the

Company's assets, subject to certain exceptions.

Certain long-term notes and the revolving credit facility require us to maintain a ratio of consolidated debt to consolidated capitalization (as defined in the relevant documents) of not more than 0.70 to 1.00. As of September 30, 2014, our ratio was 0.55 to 1.00 and therefore we were in compliance with the covenant.

Security Ratings

Our access to the capital markets, including the commercial paper market, and respective financing costs in those markets, is directly affected by securities ratings of the entity that is accessing the capital markets. We primarily access the capital markets, including the commercial paper market, through AWCC. However, we have also issued debt through our regulated subsidiaries, primarily in the form of tax exempt securities or borrowings under state revolving funds, to lower our overall cost of debt.

The following table shows the Company's securities ratings as of September 30, 2014:

| Securities | Moody's Investors Service | Standard & Poor's Ratings Service |
|-----------------------|---------------------------|-----------------------------------|
| Senior unsecured debt | Baa1 | A |
| Commercial paper | P2 | A2 |

A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating agency, and each rating should be evaluated independently of any other rating. Security ratings are highly dependent upon our ability to generate cash flows in an amount sufficient to service our debt and meet our investment plans. We can provide no assurances that our ability to generate cash flows is sufficient to maintain our existing ratings. None of our borrowings are subject to default or prepayment if a downgrading of these security ratings, although such a downgrading could increase fees and interest charges under our credit facility.

As part of the normal course of business, we routinely enter into contracts for the purchase and sale of water, energy, fuels and other services. These contracts either contain express provisions or otherwise permit us and our counterparties to demand adequate assurance of future performance when there are reasonable grounds for doing so. In accordance with the contracts and applicable contract law, if our debt is downgraded by a credit rating agency, especially if such downgrade is to a level below investment grade, it is possible that a counterparty would attempt to reference such a downgrade as a basis for making a demand for adequate assurance of future performance, which could include a demand that we provide collateral to secure our obligations. We do not expect that our posting of collateral would have a material adverse impact on our results of operations, financial position or cash flows.

Dividends

Our board of directors' practice has been to distribute to our shareholders a portion of our net cash provided by operating activities as regular quarterly dividends, rather than retaining that cash for other purposes. Since the dividends on our common stock are not cumulative, only declared dividends will be paid.

On March 3, 2014, we made a cash dividend payment of \$0.28 per share to all shareholders of record as of February 3, 2014. On June 2, 2014 and September 2, 2014, we made quarterly cash dividend payments of \$0.31 per share to all shareholders of record as of May 12, 2014 and August 11, 2014, respectively.

To permit our shareholders to take advantage of 2012 tax rates, the cash dividend payment that would have historically been paid in March 2013 was paid in December 2012. On June 3, 2013 and September 3, 2013, we made cash dividend payments of \$0.28 per share to all shareholders of record as of May 24, 2013 and August 19, 2013, respectively.

On September 19, 2014 our board of directors declared a quarterly cash dividend payment of \$0.31 per share payable on December 1, 2014 to all shareholders of record as of November 10, 2014.

Market Risk

There have been no significant changes to our market risk since December 31, 2013. For a discussion of our exposure to market risk, refer to Part II, Item 7A. "Quantitative and Qualitative Disclosures about Market Risk," contained in our Form 10-K for the year ended December 31, 2013.

Application of Critical Accounting Policies and Estimates

Our financial condition, results of operations and cash flows are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Estimates," in our Form 10-K for the year ended December 31, 2013 for a discussion of our critical accounting policies.

Recent Accounting Pronouncements

See Part I, Item 1 – Financial Statements (Unaudited) – Note 2 – New Accounting Pronouncements in this Quarterly Report on Form 10-Q for a discussion of new accounting standards recently adopted or pending adoption.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to market risks in the normal course of business, including changes in interest rates and equity prices. For further discussion of market risks see “Market Risk” in Part I, Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

American Water Works Company, Inc. maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in its reports filed or submitted under the Securities Exchange Act of 1934 (“the Exchange Act”) is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

Our management, including the Chief Executive Officer and the Chief Financial Officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) of the Exchange Act) as of September 30, 2014 pursuant to 15d-15(e) under the Exchange Act.

Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2014, our disclosure controls and procedures were effective at a reasonable level of assurance. Our disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the three months ended September 30, 2014, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The following information updates and amends the information provided in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 (the "Form 10-K") in Part I, Item 3, "Legal Proceedings," and in the Forms 10-Q for the quarters ended March 31, 2014 (the "First Quarter 2014 Form 10-Q") and June 30, 2014 (the "Second Quarter 2014 Form 10-Q"), in each case in Part II, Item 1, "Legal Proceedings."

Alternative Water Supply in Lieu of Carmel River Diversions

The Form 10-K describes the Complaint for Declaratory Relief filed by California-American Water Company ("CAWC") against the Marina Coast Water District ("MCWD") and the Monterey County Water Resources Agency ("MCWRA"), which, following a transfer of the case, continued before the San Francisco County Superior Court. The Complaint for Declaratory Relief seeks a determination by the Court as to whether certain agreements related to the now-abandoned Regional Desalination Project (the "RDP Agreements") are void as a result of the alleged conflict of interest of a former director of MCWRA (described in the Form 10-K), or remained valid. As noted in the First Quarter 2014 Form 10-Q, the former director entered a plea of no contest to, among other things, a felony violation of California Government Code section 1090 ("Section 1090"), which precludes public officials from being financially interested in any contract made by them in their official capacity. As also described in the First Quarter 2014 Form 10-Q, the Court ruled that CAWC's action was barred by the statute of limitations, but that MCWRA was subject to a longer statute of limitations under California Government Code section 1092(b), which invalidates contracts made in violation of Section 1090. As further described in the First Quarter 2014 Form 10-Q, MCWRA filed a Cross-Complaint against MCWD, contending that the RDP Agreements were void as a result of the former director's conduct and financial interest in the agreements.

On August 8, 2014, MCWRA filed a motion for summary judgment against MCWD with regard to both MCWRA's Cross-Complaint and the causes of action in MCWD's Cross-Complaint, which was filed on November 21, 2012 and was described in the Form 10-K. On November 3, 2014, the Court denied MCWRA's motion with regard to MCWRA's Cross-Complaint, and granted the motion with regard to all but two counts in MCWD's Cross-Complaint. The remaining issues in MCWD's Cross-Complaint to be addressed by the Court pertain to the question of whether certain of the agreements involve financing obligations and, therefore, are subject to a 60 day statute of limitations that would preclude MCWRA's Section 1090 action with regard to those agreements; the Court indicated that its earlier rulings in this matter did not address the contracts separately and, therefore, did not address these issues. A trial on the matter is scheduled for December 1-5, 2014.

The Form 10-K also describes CAWC's application with the California Public Utilities Commission ("CPUC") for approval of the Monterey Peninsula Water Supply Project (the "New Project"). The New Project includes a desalination plant north of the City of Marina with slant wells and related infrastructure proposed to be located on property owned by Lonestar California, Inc., Cemex, Inc., Cemex Construction Materials Pacific, LLC, RMC Pacific Materials LLC and/or affiliated entities (collectively, "Cemex").

A preliminary step to building the desalination plant is the installation by CAWC of a temporary test well to confirm the suitability of the property on which permanent intake wells will be located to draw water from under Monterey Bay. In CAWC's settlement agreements with 15 other parties that have intervened in the CPUC proceedings related to the New Project (described in the Form 10-K), the parties agreed that the preferred location to build a temporary test well is the Cemex property. Accordingly, beginning in 2012, CAWC commenced negotiations with Cemex to enable CAWC's purchase of a temporary easement for a test well and an option for a permanent easement for production wells if they were determined to be feasible. However, on September 4, 2014, the City of Marina denied CAWC's application for a coastal development permit to complete the test well. CAWC has appealed the City of Marina's decision to the California Coastal Commission (the "Coastal Commission") to secure approval to complete the test well. Nevertheless, Cemex has advised CAWC that it will no longer negotiate with regard to the easements unless and until CAWC secures approvals from the Coastal Commission. In response, on September 19, 2014, CAWC

commenced litigation in the Monterey County Superior Court against Cemex. The litigation currently relates to CAWC's Complaint in Eminent Domain (the "Compliant"), seeking a condemnation of temporary easement that will enable CAWC to construct a temporary test well; CAWC's Ex Parte Application for Order Granting Prejudgment Possession (the "Application"), which would enable CAWC to possess a temporary easement prior to adjudication of the Complaint in Eminent Domain and CAWC's Verified Petition for Immediate Order Permitting Entry Onto Property Pursuant to Code of Civil Procedure Section 1245.010 (the "Petition") (essentially, an alternative action to the Complaint in Eminent Domain and the Application). Among other things, CAWC asserts that as a result of protocol agreed to with the U.S. Fish and Wildlife Service to protect the federally endangered snowy plover, and based on the birds' migratory habits, drilling for a test well must occur between October and February, and failure to timely obtain possession of the test well site will delay the New Project by a year. In addition, CAWC asserted that in order to obtain a coastal development permit from the Coastal Commission, it must demonstrate that it has a legal interest (i.e., the temporary easement) in the Cemex property.

In response to CAWC's filings, Cemex and, by virtue of its filing of a Motion for Leave to Intervene, MCWD made several filings in opposition to the Complaint, the Application and the Petition. In addition to the allegations of Cemex and MCWD described below, each of Cemex and MCWD also made additional allegations, including some allegations similar to those made by the other.

Cemex has asserted a number of affirmative defenses to the Complaint, including an allegation that CAWC has failed to meaningfully investigate alternative public and private sites for the intake wells for the proposed desalination plant; the construction and operation of the test well will result in unnecessary and reasonable interference with Cemex's sand mining operations; and CAWC has not obtained certain required government approvals to construct the test well. In its opposition to the Application, Cemex's assertions include a claim that an emergency justifying an ex parte order does not exist because CAWC does not have the legal right to begin construction in 2014 even it were to gain a temporary easement. With regard to the Petition, Cemex has asserted, among other things, that CAWC seeks an order that is not permissible under the relevant California statutes, which Cemex claims permits only brief and innocuous rights of entry and not what it alleges is a taking of property by CAWC.

As noted above, MCWD has filed a Motion for Leave to Intervene in the actions related to the Cemex property. In the motion and other related filings, MCWD asserts that it supplies water to residents in the Marina and Ord Community service areas and pumps all of its water supply from groundwater wells situated in the Salinas Valley Groundwater Basin, which includes the Cemex property. MCWD further alleges that CAWC's pumping from the proposed test well will impact MCWD's water rights and its ability to serve its customers. In addition, MCWD alleges that a portion of the Cemex property is subject to an agreement, to which MCWD is a party, that limits groundwater extraction from the property and that CAWC has failed to prove that the proposed use of the Cemex property is a compatible or more necessary use than MCWD's use of the property.

CAWC has filed an opposition to MCWD's Motion for Leave to Intervene asserting, among other things, that CAWC is not seeking to use the Cemex property to pump any potable groundwater from the Salinas Valley Groundwater Basin; a primary purpose of the test well is to confirm that CAWC will draw over 96 percent seawater, and that any incidental amounts of highly salt-contaminated, "brackish" (non-potable) water will not have a material impact on any currently used water sources; the agreement relied on by MCWD has nothing to do with the easement sought by CAWC nor with the seawater CAWC seeks to pump from under the basin; MCWD has no property interest in the specific property sought to be taken, does not meet the statutory standards for permissive intervention, and has no direct interest in the easement CAWC seeks to condemn. In other responsive pleadings, CAWC challenged assertions made by Cemex and MCWD, while also characterizing them as collateral attacks that are not relevant to applicable eminent domain law; CAWC argued that the sole issue before the Court is whether CAWC has satisfied the procedural requirements of applicable eminent domain law to acquire a temporary easement over the Cemex property, which CAWC asserts it has done. A hearing on MCWD's Motion for Leave to Intervene and on CAWC's Application and Petition is scheduled for November 7, 2014.

The Form 10-K also references settlement agreements with a number of intervenors in CPUC proceedings with respect to the New Project. As noted in the Form 10-K, the settlement agreements will not take effect until, among other things, the CPUC certifies an environmental impact report for the proposed New Project and approves the settlement agreements. The report is now expected to be issued in the third quarter of 2015.

Water Treatment Residuals Disposal Matters

The Form 10-K describes CAWC's determination and self-reporting to the Sacramento County Environmental Management Department ("SCEMD") that it may have improperly disposed of water treatment residuals that are viewed as hazardous under California law from its Isleton treatment plant before July 2013.

After CAWC self-reported the possible violations, SCEMD conducted an extensive series of facility inspections during the third and fourth quarters of 2013. On September 19, 2014, SCEMD issued an Administrative Enforcement

Order to CAWC, which, following negotiations between CAWC and SCEMD, was amended on October 21, 2014. The Amended Administrative Enforcement Order cited 14 violations of the California Health and Safety Code at CAWC's Isleton and Parksite (Sacramento) treatment plants. With regard to the Isleton plant, SCEMD found that CAWC failed to properly characterize some water treatment residuals, and consequentially improperly disposed of those materials and failed to comply with various other requirements that would have been triggered if the waste was properly characterized. With respect to the Parksite plant, SCEMD cited miscellaneous violations related to improper characterization, storage and handling of waste, as well as administrative deficiencies related to training and record keeping.

On October 24, 2014, CAWC and SCEMD entered into an Amended Stipulation and Order (the "Order"), which constitutes settlement of the violations cited by SCEMD. Under the Order, CAWC agreed to pay a penalty of \$461,000 within 10 business days following the parties' execution of the Order and to submit current and/or corrected Hazardous Materials Business Plans within 30 days following the parties' execution of the Order for all CAWC sites in Sacramento County for which a current and/or corrected Hazardous Materials Business Plan was not on file with SCEMD.

West Virginia Elk River Chemical Spill

The Form 10-K and Forms 10-Q address, among other things, litigation relating to leakage of two substances from a chemical storage tank owned by Freedom Industries, Inc. into the Elk River near the West Virginia-American Water Company ("WVAWC") treatment plant intake in Charleston, West Virginia (the "Elk River Chemical Spill"). Among the actions described in the Second Quarter 2014 Form 10-Q is the consolidated class action complaint filed in the United States District Court for the Southern District of West Virginia against multiple individuals and corporate entities, including WVAWC, American Water Works Service Company, Inc. and the Company (collectively, the "American Water Defendants"). On September 5, 2014 and October 27, 2014, the Court entered scheduling orders, setting a schedule for discovery and class certification motions, culminating in a class certification hearing to be held on September 25, 2015. A trial date has not yet been set.

The Court has not yet acted upon the American Water Defendants' motions to dismiss.

As also described in the Second Quarter 2014 Form 10-Q, on May 21, 2014, the Public Service Commission of West Virginia (the "PSC") issued an Order initiating a General Investigation into certain issues relating to WVAWC's response to the Elk River Chemical Spill. Three parties have intervened in the proceeding, including the Consumer Advocate Division of the PSC and two attorney-sponsored groups, including one sponsored by some of the plaintiffs' counsel involved in the civil litigation described above. WVAWC is subject to discovery from PSC staff and the intervenors as part of the General Investigation. Several disputes have arisen between the WVAWC and the intervenors regarding, among other things, the scope of the discovery and the maintenance of confidentiality with regard to certain WVAWC emergency planning documents. In order to address these disputes, the PSC extended the final hearing date to February 10-12, 2015.

Labor Dispute Regarding National Benefits Agreement

The Company's Form 10-Q for the quarter ended June 30, 2014 describes a dispute between the Company and most of the labor unions which represent employees in the Regulated Businesses (the "Unions") regarding the Company's national benefits agreement. On October 13, 2014, the Company and the Utility Workers Union of America AFL-CIO entered into a settlement agreement designed to resolve the dispute between the Company and the Unions. Among other things, the settlement agreement provides for a new 2014-2018 National Benefits Agreement that will be in effect generally until July 31, 2018. In addition, the Company agreed to make a \$10 million lump-sum payment, to be distributed in accordance with procedures set forth in the settlement agreement among eligible employees represented by the Unions and affected by implementation of the Company's last, best and final offer effective January 1, 2011. The majority of the distributions are expected to be used to reimburse employees for medical claims which were incurred during the relevant period and will be funded by the Group Insurance Plan for American Water Works Company, Inc. and Its Designated Subsidiaries and Affiliates - Active Employees VEBA (the "VEBA Trust"), to which the Company previously has made contributions. Therefore, amounts funded out of the VEBA Trust will not have an impact on earnings. The Unions approved the settlement agreement on October 30, 2014 and the National Labor Relations Board (the "NLRB") approved the settlement agreement on October 31, 2014. The NLRB advised the Company that it will dismiss its petition for enforcement filed in the United States Court of Appeals for the Seventh Circuit and close the case after the Company has substantially complied with its obligations under the settlement agreement to make the lump sum payment and to post a notice to employees agreeable to the Company and acceptable to the NLRB.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in the "Risk Factors" in the Company's Form 10-K for the year ended December 31, 2013, and our other public filings, which could materially affect our business, financial condition or future results. There have been no material changes from

risk factors previously disclosed in “Risk Factors” in the Company’s Form 10-K for the year ended December 31, 2013.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. MINE SAFETY DISCLOSURES

None

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ITEM 5. OTHER INFORMATION

None

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ITEM 6. EXHIBITS

| Exhibit Number | Exhibit Description |
|-------------------|--|
| *31.1 | Certification of Susan N. Story, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act |
| *31.2 | Certification of Linda G. Sullivan, Senior Vice President and Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act |
| *32.1 | Certification of Susan N. Story, President and Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act |
| *32.2 | Certification of Linda G. Sullivan, Senior Vice President and Chief Financial Officer, pursuant to |

Section 906 of
the
Sarbanes-Oxley
Act

101 The following
financial
statements from
American Water
Works
Company, Inc.'s
Quarterly
Report on Form
10-Q for the
quarterly period
ended
September 30,
2014, filed with
the Securities
and Exchange
Commission on
November 5,
2014, formatted
in XBRL
(eXtensible
Business
Reporting
Language): (i)
the
Consolidated
Balance Sheets;
(ii) the
Consolidated
Statements of
Operations and
Comprehensive
Income; (iii) the
Consolidated
Statements of
Cash Flows; (iv)
the
Consolidated
Statements of
Changes in
Stockholders'
Equity; and (v)
the Notes to
Consolidated
Financial
Statements.

* filed herewith.

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 5th day of November, 2014.

AMERICAN WATER WORKS COMPANY, INC.

(REGISTRANT)

/S/ Susan N. Story
Susan N. Story

President and Chief Executive Officer

Principal Executive Officer

/S/ Linda G. Sullivan
Linda G. Sullivan

Senior Vice President and Chief Financial Officer

Principal Financial Officer

/S/ Mark Chesla
Mark Chesla

Vice President and Controller

Principal Accounting Officer

EXHIBIT INDEX

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- 101 The following financial statements from American Water Works Company, Inc.'s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2014, filed with the Securities and Exchange Commission on November 5, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations and Comprehensive Income; (iii) the Consolidated Statements of Cash Flows; (iv) the Consolidated Statements of Changes in Stockholders' Equity; and (v) the Notes to Consolidated Financial Statements.

* filed herewith.