American Water Capital Corp.
Form 424B4
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*(Prospectus)*

# American Water Capital Corp.

## $75,000,000

## 8.25% Senior Monthly Notes due 2038

This is an offering by American Water Capital Corp., which we refer to as AWCC or the issuer, of its 8.25% Senior Monthly Notes due 2038, which we refer to as the notes. We will pay interest on the notes on the first day of each month, beginning on March 1, 2009. The notes will mature on December 1, 2038. However, we can redeem the notes, in whole or in part from time to time, on or after December 1, 2013 at 100% of the principal amount thereof plus any accrued interest thereon. In addition, we will be required to redeem the notes at the option of the representative of any deceased beneficial owner (subject to limitations and conditions specified herein) at 100% of the principal amount thereof plus any accrued interest thereon. If we experience certain change of control triggering events, we must offer to purchase the notes at 101% of their aggregate principal amount, plus accrued interest. Notes will be issued only in registered form and in denominations of $1,000 and integral multiples of $1,000 in excess thereof.

The notes will be unsecured, will rank equally with the issuer s existing and future senior debt and will rank senior to the issuer s future subordinated debt. The notes will be effectively subordinated to the issuer s existing and future secured debt to the extent of the collateral securing that debt. The notes will have the benefit of a support agreement from American Water Works Company, Inc., AWCC s parent company. The notes will not be guaranteed by any of our subsidiaries. AWCC is a finance subsidiary whose activities are limited to borrowing funds through the issuance of debt securities and lending those funds under loan agreements with our operating subsidiaries.

***Investing in these notes involves risks. See*** ***Risk Factors beginning on page 12*** ***to read about factors you should consider before buying these notes.***

**Neither the Securities and Exchange Commission, any state securities commission nor any other regulatory body has approved or disapproved of these securities or passed on the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.**

The underwriter proposes to offer the notes from time to time for sale in negotiated transactions, or otherwise, at varying prices to be determined at the time of each sale. The underwriter has agreed to purchase the notes from the issuer at 96.85% of their principal amount (approximately $72.6 million net proceeds to the issuer before expenses), subject to the terms and conditions in the underwriting agreement.

The underwriter expects to deliver the notes against payment therefor in New York, New York on February 4, 2009.

**EdwardJones**

Prospectus dated January 30, 2009.

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## PROSPECTUS SUMMARY

*This summary highlights information contained elsewhere in this prospectus. It may not contain all the information that is important to you. You should carefully read this entire prospectus, including the section captioned Risk Factors and the consolidated financial statements and notes to the consolidated financial statements, before making an investment decision. For the definition of certain terms used in this prospectus, please refer to the definitions set forth in the section entitled Glossary.*

**Our Company**

Founded in 1886, American Water Works Company, Inc., which we refer to, together with its subsidiaries, as American Water, the Company or the support provider, is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our approximately 7,000 employees provide approximately 15 million people with drinking water, wastewater and other water-related services in 32 states and Ontario, Canada.

Our primary business involves the ownership of regulated water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers, treating and delivering over one billion gallons of water per day. Our subsidiaries that provide these services are generally subject to economic regulation by state Public Utility Commissions, which we refer to as state PUCs, in the states in which they operate. In 2007, we generated $2,214.2 million in total operating revenue, representing approximately four times the operating revenue of the next largest investor-owned company in the United States water and wastewater business, $15.1 million in operating income, which includes $509.3 million of impairment charges relating to continuing operations, and a net loss of $342.8 million. For the nine months ended September 30, 2008 we generated $1,768.4 million in total operating revenue, $315.9 million in operating loss, which includes $750.0 million of impairment charges, and a net loss of $598.8 million. Our Regulated Businesses, operating in 20 states in the United States, generated 89.8% and 89.3% of our total operating revenue in 2007 and for the nine months ended September 30, 2008, respectively.

We also provide services that are not subject to economic regulation by state PUCs. Our Non-Regulated Businesses include our Contract Operations Group, our Applied Water Management Group and our Homeowner Services Group. In 2007 and for the nine months ended September 30, 2008, our Non-Regulated Businesses generated $242.7 million and $202.1 million, respectively, in operating revenue, prior to inter-segment eliminations.

**Our Industry**

The United States water and wastewater industry has two main segments: (i) utility, which involves supplying water and wastewater services to customers, and (ii) general services, which involves providing water and wastewater-related services, including engineering, consulting and sales of water infrastructure and distribution products, such as pipes, to water and wastewater utilities and other consumers on a fee-for-service contract basis.

The utility segment includes municipal systems, which are owned and operated by local governments, and investor-owned systems. Government-owned systems make up the vast majority of the United States water and wastewater utility segment, accounting for approximately 84% of all United States community water systems and approximately 98% of all United States community wastewater systems.

The utility segment is characterized by high barriers to entry, including high capital spending requirements. Investor-owned water and wastewater utilities also face regulatory approval processes in order to do business, which may involve obtaining relevant operating approvals, including certificates of public convenience and necessity (or similar authorizations), pursuant to which state PUCs grant investor-owned utilities the right to

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provide service within an authorized service area. The utility segment of the United States water and wastewater industry is highly fragmented, with approximately 52,000 community water systems and approximately 16,000 community wastewater facilities, according to the United States Environmental Protection Agency, or EPA, and therefore presents opportunities for consolidation. Larger utilities, such as ours, that have greater access to capital are generally more capable of making mandated and other necessary infrastructure upgrades to water and wastewater systems.

**Our Strengths**

We believe that we are distinguished by the following key competitive strengths:

***Market leader with broad national footprint and strong local presence.*** We are the largest and most geographically diversified investor-owned water and wastewater utility company in the United States. Our scale provides us with a competitive advantage in procuring goods and services reliably and economically. Our geographic scope enables us to capitalize effectively on growth opportunities across our service areas, while helping to insulate us from adverse conditions relating to regulatory environments, weather and economic conditions in any one geographic area. Also, our active community involvement supports customer satisfaction.

***Regulated Businesses provide financial stability*****.** Our Regulated Businesses provide a high degree of financial stability because (i) high barriers to entry insulate us from competitive pressures, (ii) economic regulation promotes predictability in financial planning and long-term performance through the rate-setting process and (iii) our largely residential customer base promotes consistent operating results.

***Experience in securing appropriate rates of return and promoting constructive regulatory frameworks.*** We seek appropriate rates of return on our investment and a return of our investment and recovery of prudently incurred operating expenses from state PUCs in the form of rate increases, which we refer to as rate relief. We have a strong track record of providing reliable service at cost-effective rates, which has generally allowed us to maintain positive relations with regulators. We have generally been granted rate relief in a timely manner after application.

***Significant growth opportunities with a low risk business profile.*** We believe we are well positioned to benefit from favorable industry dynamics in the water and wastewater sectors, which provide significant opportunities for future growth in both our Regulated Businesses and complementary Non-Regulated Businesses.

- We intend to invest capital prudently to enable us to continue to provide essential services to our customers in the water and wastewater utility industry and to municipalities in meeting the capital challenges of making substantial required infrastructure upgrades.

- Our Regulated Businesses provide a large platform on which to grow both organically and through consolidation from among the numerous water and wastewater systems in the United States.

- Our national footprint increases our ability to make opportunistic investments in non-regulated businesses that are complementary to our Regulated Businesses.

***Experienced senior management team***. Our four most senior executives, Donald L. Correll, President and Chief Executive Officer, Ellen C. Wolf, Senior Vice President and Chief Financial Officer, John S. Young, President, American Water Services, and Walter J. Lynch, President, Regulated Operations, have an average of over 20 years of experience in the utilities industry. Our 14 state presidents have an average of 25 years of experience in the utilities industry.

***Industry leader in water quality, testing and research.*** We are experts in water quality testing, compliance and treatment and have established and own industry-leading water testing facilities. Our technologically advanced quality control and testing laboratory in Belleville, Illinois is certified in 23 states and Puerto Rico.

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**Our Strategy**

Our goal is to consistently provide customers with safe, high quality drinking water and reliable water and wastewater services. Our business strategies include:

- continuing to invest prudently in regulated water and wastewater infrastructure projects;
- earning an appropriate rate of return on our investments from state PUCs;
- growing our Regulated Businesses through acquisitions; and
- continuing to pursue public/private partnerships, including O&M and military contracts and services, and other non-regulated businesses that are complementary to our Regulated Businesses.

**The Transactions**

American Water is currently an indirect majority-owned subsidiary of RWE Aktiengesellschaft, which we refer to as RWE, a stock corporation incorporated in the Federal Republic of Germany whose shares are publicly listed on the Frankfurt and Düsseldorf stock exchanges and other German stock exchanges as well as on the Zurich stock exchange. RWE is one of Europe s leading electricity and gas companies and supplies 20 million customers with electricity and 10 million customers with gas in Germany, the United Kingdom and Central and Eastern Europe. On November 4, 2005, RWE announced its intention to exit its water activities in the United States and the United Kingdom in order to focus on its core European electricity and gas business and has since then completed the divestiture of its water business in the United Kingdom. As a part of this strategy, RWE sold approximately 63.2 million shares in the initial public offering of American Water s common stock in April 2008. Of the approximately 63.2 million shares sold, approximately 5.2 million were sold pursuant to the partial exercise of the underwriters over-allotment option on May 27, 2008. RWE intends to fully divest its remaining ownership of American Water through the consummation of additional public offerings of common stock of American Water as soon as reasonably practicable, subject to market conditions, which, together with RWE s sale of shares in the initial public offering, we refer to as the RWE Divestiture. As of September 30, 2008, RWE owned approximately 60% of American Water s outstanding shares of common stock.

On September 28, 2007, Thames Water Aqua US Holdings, Inc., which we refer to as Thames US Holdings, at the time an indirect wholly-owned subsidiary of RWE, was merged with and into American Water with American Water being the surviving entity, which we refer to as the Merger.

On September 20, 2007, AWCC, our wholly-owned financing subsidiary, issued $1,750.0 million of debt to RWE, which we refer to as the RWE redemption notes, which was used to fund the early redemption of $1,750.0 million of preferred stock held by RWE. In addition, on October 22, 2007 we used the net proceeds from the issuance of $1,500.0 million aggregate principal amount of senior notes of AWCC, which we refer to as the new senior notes, to fund the repayment of $1,286.0 million aggregate principal amount of RWE redemption notes and $206.0 million (including after tax gains of $2.2 million, net of $1.4 million of tax) aggregate principal amount of other debt owed to RWE, which we refer to as the RWE notes. The new senior notes were not registered under, and were offered in reliance on an exemption from the registration requirements of, the Securities Act of 1933, as amended, which we refer to as the Securities Act.

On November 7, 2007, we effected a 160,000-for-1 stock split.

In December 2007, we used the net proceeds from the issuance of approximately $415.0 million of commercial paper and $49.0 million of excess cash to fund the repayment of approximately $464.0 million of RWE redemption notes.

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These financing transactions, together with the non-cash equity contribution to the Company by RWE of $100.0 million of debt of our subsidiaries held by RWE on March 29, 2007, the $550.0 million cash equity contribution to the Company by RWE on March 29, 2007, which was used to pay down $232.5 million of short-term debt and the remainder used for general working capital purposes and the cash equity contribution to the Company by RWE of $266.0 million on December 21, 2007, which was used to pay down $266.0 million of commercial paper, are collectively referred to as the Refinancing.

On May 13, 2008, RWE made a cash equity contribution of $245.0 million to us, which we refer to as the Equity Contribution, in order to ensure compliance with relevant state PUC capital structure requirements. On November 26, 2008, AWCC issued $75.0 million of 10% Senior Monthly Notes due 2038, which we refer to as the existing senior monthly notes, to fund the repayment of $72.0 million of short-term debt. The Equity Contribution, the Refinancing, the 160,000-for-1 split of common stock, the Merger, the initial public offering, the issuance of the existing senior monthly notes and the issuance and sale of notes by us in this offering and our application of our proceeds therefrom are collectively referred to in this prospectus as the Transactions.

**Recent Developments**

On December 8, 2008, the New Jersey Board of Public Utilities approved new rates for New Jersey-American Water Company, our subsidiary. The increase is expected to generate additional annualized revenues of $72.1 million.

In November 2008, the Missouri Public Service Commission approved new rates for Missouri American Water Company, our subsidiary. The increase is expected to generate additional annualized revenues of $34.5 million.

In September 2008, our Contracts Operation Group was awarded two United States military contracts for operation and maintenance of the water and wastewater systems at Fort Polk and Fort Hood Army Installations. The estimated gross revenues we will receive from these 50-year fixed price contracts which are subject to modification as described below will be approximately $348 million and $329 million for Fort Polk and Fort Hood, respectively. All of the contracts with the U.S. government may be terminated, in whole or in part, prior to the end of the 50-year term for convenience of the U.S. government or as a result of a default or non-performance by the subsidiary performing the contract. In either event, we are entitled to recover the remaining amount of our capital investment pursuant to the terms of a termination settlement with the U.S. government at the time of termination as provided in each of the contracts. The contract price for each of these contracts is subject to redetermination two years after commencement of operations and every three years thereafter. Price redetermination is a contract mechanism to periodically adjust the service fee in the next period to reflect changes in contract obligations and anticipated market conditions.

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**Organizational Structure**

American Water is currently a direct majority-owned subsidiary of RWE Aqua Holdings GmbH, a limited liability company organized under the laws of the Federal Republic of Germany and a direct wholly-owned subsidiary of RWE. The following chart sets forth our organizational structure:

**Our Executive Offices**

We are a corporation incorporated under the laws of Delaware. Our principal executive offices are located at 1025 Laurel Oak Road, Voorhees, NJ 08043. Our telephone number is (856) 346-8200. Our internet address is www.amwater.com. **The information contained on or accessible from our website does not constitute a part of this prospectus and is not incorporated by reference herein.**

American Water and its logos are our trademarks. Other service marks, trademarks and trade names referred to in this prospectus are the property of their respective owners.

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**THE OFFERING**

| | |
|---|---|
| Issuer | American Water Capital Corp. |
| Securities Offered | $75,000,000 aggregate principal amount of 8.25% Senior Monthly Notes due 2038. |
| Maturity Date | The notes will mature on December 1, 2038. |
| Interest Payment Dates | We will pay interest on the notes on the first day of each month, beginning on March 1, 2009, to the holders of the notes as of the day that is 15 calendar days (whether or not a business day) prior to the relevant interest payment date and, if applicable, upon redemption. |
| Support Agreement | The notes will have the benefit of a support agreement from American Water, pursuant to which American Water has agreed to pay to any debt investor or lender any principal or interest owed by the issuer to such debt investor or lender that the issuer fails to pay on a timely basis, referred to herein as the support agreement. |
| Optional Redemption | We will have the right to redeem the notes in whole at any time or in part from time to time, on or after December 1, 2013 at 100% of the principal amount to be redeemed plus any accrued and unpaid interest thereon to the date of redemption. |
| Redemption Option of a Deceased Beneficial Owner s Representative | We will be required to redeem the notes at the option of the representative of any deceased beneficial owner of notes on a quarterly basis at 100% of the principal amount to be redeemed plus any accrued and unpaid interest thereon to the date of redemption, subject to the limitations and conditions that, during the period from the original issue date of the notes through December 1, 2009 and during each twelve-month period after December 1, 2009, the maximum principal amount we are required to redeem is $25,000 per deceased beneficial owner and an aggregate of $1,500,000 (2% of the aggregate principal amount of the notes sold in this offering) for all deceased beneficial owners. For a complete description, see Description of the Notes Limited Right of Redemption Upon Death of Beneficial Owner. |
| Repurchase Right of Holders Upon a Change in Control | Upon the occurrence of both (i) a change of control of American Water and (ii) a downgrade of the notes below an investment grade rating by each of Moody s Investors Service, Inc. and Standard & Poor s Ratings Services within a specified period, you will have the right to require us to repurchase the notes at a price equal to 101% of the aggregate principal amount of notes repurchased plus accrued and unpaid interest, if any, on the notes repurchased, to the date of purchase. See Description of the Notes Change of Control. |

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Ranking

The notes will be the issuer s unsecured senior obligations and will:

- rank equal in right of payment to all of the issuer s existing and future unsecured obligations that are not, by their terms, expressly subordinated in right of payment to the notes;
- rank senior in right of payment to all of the issuer s future obligations that are, by their terms, expressly subordinated in right of payment to the notes; and
- rank effectively junior in right of payment to all of our future secured indebtedness to the extent of the value of the assets securing such indebtedness.

Similarly, the obligations of American Water under the support agreement will be unsecured senior obligations of the support provider and will:

- rank equal in right of payment to all existing and future unsecured obligations of American Water that are not, by their terms, expressly subordinated in right of payment to such obligations;
- rank senior in right of payment to any future obligations of American Water that are, by their terms, expressly subordinated in right of payment to such obligations; and
- rank (i) effectively junior in right of payment to any future secured indebtedness of American Water to the extent of the value of the assets securing such indebtedness and (ii) structurally junior in right of payment to any liabilities of the applicable American Water subsidiaries.

As of September 30, 2008, on a pro forma basis after giving effect to this offering and the issuance of the existing senior monthly notes:

- The issuer would have had $3,304.0 million of senior indebtedness, including (i) $2,959.0 million of currently outstanding senior notes, (ii) $75.0 million of notes offered hereby, (iii) $86.9 million of other senior indebtedness and (iv) $183.1 million of short-term debt and no subordinated indebtedness;
- the support provider would have had no indebtedness other than its obligations under the support agreement with respect to the issuer s indebtedness; and
- the subsidiaries of the support provider (other than the issuer) would have had approximately $1,818.7 million of indebtedness and other liabilities.

Certain Covenants

The indenture governing the notes contains certain covenants that, among other things, limit our ability to:

- create or assume liens; and

- enter into sale and leaseback transactions.

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These limitations are subject to a number of significant exceptions. See Description of the Notes Certain Covenants.

| | |
|---|---|
| Use of Proceeds | We estimate that the proceeds from this offering, net of discounts and expenses, will be approximately $72.1 million. We intend to use the proceeds from this offering to fund the repayment of short-term debt. |
| Risk Factors | Investing in the notes involves risk. See the section entitled Risk Factors in this prospectus for a description of certain of the risks you should consider before investing in the notes. |
| Governing Law | The indenture and the notes are governed by, and construed in accordance with, the laws of the state of New York. |

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## SUMMARY HISTORICAL CONSOLIDATED AND UNAUDITED PRO FORMA FINANCIAL DATA

The following table presents our summary historical consolidated financial data and summary unaudited pro forma consolidated financial data at the dates and for the periods indicated. The historical data as of December 31, 2006 and 2007 and for the years ended December 31, 2005, 2006 and 2007 have been derived from our audited historical consolidated financial statements and the notes to those statements included elsewhere in this prospectus. The historical data as of September 30, 2008 and for the nine months ended September 30, 2007 and 2008 have been derived from our unaudited historical consolidated financial statements and the notes to those statements included elsewhere in this prospectus, which have been prepared on a basis consistent with our annual consolidated financial statements. In the opinion of management, such unaudited financial data reflect all adjustments, consisting only of normal and recurring adjustments, necessary for fair presentation of the results for those periods. The results of operations for the nine months ended September 30, 2008 are not necessarily indicative of the results to be expected for the full year or any future period. See footnote 1 to the table below.

The summary unaudited pro forma financial data have been derived from our historical financial statements and adjusted as described below. The summary unaudited pro forma financial data have been prepared to give effect to the Transactions as if they had occurred on January 1, 2007, in the case of the summary unaudited pro forma statement of operations data, and have been prepared to give effect to this offering as if it had occurred on September 30, 2008, in the case of the summary unaudited pro forma balance sheet data. The pro forma adjustments are based upon available information and certain assumptions that we believe are reasonable. The summary unaudited pro forma financial data are for informational purposes only and do not purport to represent what our results of operations or financial position actually would have been if the Transactions had occurred at any date, and such data do not purport to project the results of operations for any future period. See Unaudited Pro Forma Condensed Consolidated Financial Information.

Our historical financial data are not necessarily indicative of our future performance or what our financial position and results of operations would have been if we had operated as a separate, stand-alone entity during the periods shown. Because the data in this table is only a summary and does not provide all of the data contained in our financial statements, the information should be read in conjunction with Use of Proceeds, Capitalization, Unaudited Pro Forma Condensed Consolidated Financial Information, Selected Historical Consolidated Financial Data, Management s Discussion and Analysis of Financial Condition and Results of Operations and the financial statements and related notes thereto appearing elsewhere in this prospectus.

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| | For the Years Ended December 31, | | | For the Nine Months Ended September 30, | | Pro Forma For the Year Ended December 31, 2007 (unaudited) | Pro Forma For the Nine Months Ended September 30, 2008 (unaudited) |
|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2007 (unaudited) | 2008 (unaudited) | | |
| | (in thousands, except per share data) | | | | | | |
| **Statement of operations data(1):** | | | | | | | |
| Operating revenues | $ 2,136,746 | $ 2,093,067 | $ 2,214,215 | $ 1,660,394 | $ 1,768,377 | $ 2,214,215 | $ 1,768,377 |
| Operating expenses | | | | | | | |
| Operation and maintenance | 1,201,566 | 1,174,544 | 1,246,479 | 910,304 | 984,063 | 1,248,920 | 982,498 |
| Depreciation and amortization | 261,364 | 259,181 | 267,335 | 202,463 | 199,599 | 267,335 | 199,599 |
| General taxes | 183,324 | 185,065 | 183,253 | 140,910 | 151,074 | 183,253 | 151,074 |
| Loss (gain) on sale of assets(2) | (6,517) | 79 | (7,326) | (6,821) | (413) | (7,326) | (413) |
| Impairment charges | 385,434 | 221,685 | 509,345 | 243,345 | 750,000 | 509,345 | 750,000 |
| Total operating expenses, net | 2,025,171 | 1,840,554 | 2,199,086 | 1,490,201 | 2,084,323 | 2,201,527 | 2,082,758 |
| Operating income (loss) | 111,575 | 252,513 | 15,129 | 170,193 | (315,946) | 12,688 | (314,381) |
| Other income (deductions) | | | | | | | |
| Interest, net | (345,257) | (365,970) | (283,165) | (211,709) | (212,718) | (274,995) | (219,418) |
| Amortization of debt expense | (4,367) | (5,062) | (4,867) | (3,624) | (4,360) | (5,608) | (4,508) |
| Other, net(3) | 13,898 | 9,581 | 17,384 | 11,532 | 17,808 | 17,384 | 17,808 |
| Total other income (deductions) | (335,726) | (361,451) | (270,648) | (203,801) | (199,270) | (263,219) | (206,118) |
| Income (loss) from continuing operations before income taxes | (224,151) | (108,938) | (255,519) | (33,608) | (515,216) | (250,531) | (520,499) |
| Provision for income taxes | 50,979 | 46,912 | 86,756 | 74,095 | 83,612 | 88,729 | 81,522 |
| Income (loss) from continuing operations | $ (275,130) | $ (155,850) | $ (342,275) | $ (107,703) | $ (598,828) | $ (339,260) | $ (602,021) |
| Income (loss) from continuing operations per basic common share(4)(5) | $ (1.72) | $ (0.97) | $ (2.14) | $ (0.67) | $ (3.74) | $ (2.12) | $ (3.76) |
| Income (loss) from continuing operations per diluted common share(4)(5) | $ (1.72) | $ (0.97) | $ (2.14) | $ (0.67) | $ (3.74) | $ (2.12) | $ (3.76) |
| Basic weighted average common shares | 160,000 | 160,000 | 160,000 | 160,000 | 159,960 | 160,000 | 159,960 |
| Diluted weighted average common shares | 160,000 | 160,000 | 160,000 | 160,000 | 159,960 | 160,000 | 159,960 |
| **Other data(1):** | | | | | | | |
| Cash flows provided by (used in): | | | | | | | |
| Operating activities | $ 525,435 | $ 323,748 | $ 473,712 | $ 329,913 | $ 392,913 | | |
| Investing activities | (530,165) | (691,438) | (746,578) | (482,950) | (723,574) | | |
| Financing activities | (9,049) | 332,367 | 256,593 | 274,542 | 323,869 | | |
| Construction expenditures | (558,446) | (688,843) | (758,569) | (507,237) | (714,559) | | |

| Ratio of Earnings to Fixed Charges(6) |
| --- |

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| | As of December 31, 2006 | As of December 31, 2007 | As of September 30, 2008 (unaudited) | Pro Forma as of September 30, 2008 (unaudited) |
|---|---|---|---|---|
| | (in thousands) | | | |
| **Balance sheet data(1):** | | | | |
| Cash and cash equivalents | $ 29,754 | $ 13,481 | $ 6,689 | $ 6,689 |
| Utility plant at original cost, net of accumulated depreciation | 8,605,341 | 9,199,909 | 9,742,671 | 9,742,671 |
| Goodwill | 2,962,493 | 2,456,952 | 1,704,310 | 1,704,310 |
| Total assets | 12,783,059 | 12,934,072 | 12,780,732 | 12,785,845 |
| Redeemable preferred stock at redemption value(7) | 1,774,475 | 24,296 | 24,217 | 24,217 |
| Other long-term debt | 3,096,404 | 4,674,837 | 4,669,502 | 4,819,502 |
| Other short-term and current portion of long-term debt(8) | 1,007,128 | 316,969 | 423,021 | 278,922 |
| Total debt | 5,878,007 | 5,016,102 | 5,116,740 | 5,122,641 |
| Common stockholders equity | 3,817,397 | 4,542,046 | 4,162,357 | 4,162,357 |
| Preferred stock without mandatory redemption requirements(7) | 4,568 | 4,568 | 4,557 | 4,557 |

(1) On September 28, 2007, Thames US Holdings was merged with and into American Water, with American Water as the surviving entity. Prior to the initial public offering in April 2008, American Water was an indirect wholly-owned subsidiary of RWE. The historical consolidated financial statements of American Water represent the consolidated results of the Company, formerly issued under the name Thames Water Aqua US Holdings, Inc. and Subsidiary Companies.

(2) Represents primarily losses (gains) on sales of publicly traded securities and dispositions of assets not needed in utility operations.

(3) Includes allowance for other funds used during construction, allowance for borrowed funds used during construction and preferred dividends of subsidiaries.

(4) The number of common shares used to compute loss from continuing operations per basic common share and loss from continuing operations per diluted common share for the fiscal years ended December 31, 2005, 2006 and 2007 and for the nine months ended September 30, 2007 and 2008 is 160.0 million, after giving effect to the 160,000-for-1 stock split on November 7, 2007. The same number of shares of common stock is used to compute both loss from continuing operations per basic common share and loss from continuing operations per diluted common share, as no potentially dilutive instruments were outstanding prior to April 2008 and subsequently all potentially dilutive instruments are anti-dilutive.

(5) The number of common shares used to compute loss from continuing operations per basic common share is 160.0 million, which gives effect to the 160,000-for-1 stock split effected on November 7, 2007. Pro forma loss from continuing operations per diluted common share considers the effect of all potentially dilutive instruments, which include restricted shares, restricted stock units and stock options granted under our 2007 Omnibus Equity Compensation Plan to certain of our employees upon the consummation of our initial public offering. However, there are no dilutive incremental common shares included in pro forma diluted earnings per share as all potentially dilutive instruments would be antidilutive.

(6) For the years ended December 31, 2005, 2006 and 2007 and for the nine months ended September 30, 2008, earnings were insufficient to cover fixed charges and there were deficiencies of $224.3 million, $109.1 million, $255.7 million and $515.4 million, respectively. On a pro forma basis after giving effect to this offering and the offering of existing senior monthly notes, earnings would have been insufficient to cover fixed charges and there would have been a deficiency of $250.7 million and $520.6 million for the year ended December 31, 2007 and for the nine months ended September 30, 2008, respectively.

(7) Includes preferred stock held by RWE and other preferred stock issued by subsidiaries of the Company.

(8) Includes the current portion of redeemable preferred stock and the unamortized debt discount attributable to preferred stock of $0.6 million and $0.4 million as of December 31, 2006 and 2007, and $0.3 million as of September 30, 2008, respectively.

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## RISK FACTORS

*An investment in the notes involves risk. Before you decide to purchase the notes, you should carefully consider these risk factors together with all of the other information included in this prospectus, including the information contained in the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the notes thereto. If any of the following risks actually occurs, our business, financial condition, operating results and prospects could be adversely affected, which in turn could adversely affect the value of the notes.*

### Risks Related to Our Industry and Business

***Our utility operations are heavily regulated. Decisions by state PUCs and other regulatory agencies can significantly affect our business and results of operations.***

Our Regulated Businesses provide water and wastewater services to our customers through subsidiaries economically regulated by state PUCs. Economic regulation affects the rates we charge our customers and has a significant effect on our business and results of operations. Generally, the state PUCs authorize us to charge rates that they determine are sufficient to recover our prudently incurred operating expenses, to enable us to finance the addition of new, or the replacement of existing, water and wastewater infrastructure and to allow us the opportunity to earn what they determine to be an appropriate rate of return on our invested capital and a return of our invested capital.

Our ability to meet our financial objectives depends upon the rates authorized by the various state PUCs. We periodically file rate increase applications with state PUCs. The ensuing administrative process may be lengthy and costly. We can provide no assurances that our rate increase requests will be granted. Even if approved, there is no guarantee that approval will be given in a timely manner or at a sufficient level to cover our expenses, the recovery of our investment and/or provide us an opportunity to earn an appropriate rate of return on our investment and a return of our investment. If the authorized rates are insufficient to cover operating expenses, to allow for the recovery of our investment and to provide an appropriate return on invested capital, or if the rate increase decisions are delayed, our financial condition, results of operations, cash flow and liquidity may be adversely affected. Even if rates are sufficient, we face the risk that we will not achieve the rates of return on our invested capital and a return of our invested capital that are permitted by the state PUC.

***Our operations and the quality of water we supply are subject to extensive environmental laws and regulations. Our operating costs have increased, and are expected to continue to increase, as a result of complying with environmental laws and regulations. We also could incur substantial costs as a result of violations of or liabilities under such laws and regulations.***

Our water and wastewater operations are subject to extensive United States Federal, state and local and, in the case of our Canadian operations, Canadian, laws and regulations, that govern the protection of the environment, health and safety, the quality of the water we deliver to our customers, water allocation rights, and the manner in which we collect, treat, discharge and dispose of wastewater. These requirements include the United States Clean Water Act of 1972, which we refer to as the Clean Water Act, and the United States Safe Drinking Water Act of 1974, which we refer to as the Safe Drinking Water Act, and similar state and Canadian laws and regulations. We are also required to obtain various environmental permits from regulatory agencies for our operations. State PUCs also set conditions and standards for the water and wastewater services we deliver. If we deliver water or wastewater services to our customers that do not comply with regulatory standards, or otherwise violate environmental laws, regulations or permits, or other health and safety and water quality regulations, we could incur substantial fines, penalties or other sanctions or costs or damage to our reputation. In the most serious cases, regulators could force us to discontinue operations and sell our operating assets to another utility or municipality. Given the nature of our business which, in part, involves supplying water for human consumption, any potential non-compliance with, or violation of, environmental laws or regulations would likely pose a more significant risk to us than to an issuer not similarly involved in the water and wastewater industry.

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We incur substantial operating and capital costs on an ongoing basis to comply with environmental laws and regulations and other health and safety and water quality regulations. These laws and regulations, and their enforcement, have tended to become more stringent over time, and new or stricter requirements could increase our costs. Although we may seek to recover ongoing compliance costs in our rates, there can be no guarantee that the various state PUCs or similar regulatory bodies that govern our Regulated Businesses would approve rate increases to recover such costs or that such costs will not adversely and materially affect our financial condition, results of operations, cash flow and liquidity.

We may also incur liabilities under environmental laws and regulations requiring us to investigate and clean up environmental contamination at our properties or at off-site locations where we have disposed of waste or caused adverse environmental impacts. The discovery of previously unknown conditions, or the imposition of cleanup obligations in the future, could result in significant costs, and could adversely affect our financial condition, results of operations, cash flow and liquidity. Such remediation losses may not be covered by our insurance policies and may make it difficult for us to secure insurance in the future at acceptable rates.

***Changes in laws and regulations over which we have no control can significantly affect our business and results of operations.***

Any governmental entity that regulates our operations may enact new legislation or adopt new regulations or policies at any time, and new judicial decisions may change the interpretation of existing legislation or regulations at any time. The individuals who serve as regulators are elected or are political appointees. Therefore, elections which result in a change of political administration or new appointments may also result in changes in the individuals who serve as regulators and the policies of the regulatory agencies that they serve. New laws or regulations, new interpretations of existing laws or regulations, or changes in agency policy, including as a response to shifts in public opinion, or conditions imposed during the regulatory hearing process may affect our business in a number of ways, including the following:

- making it more difficult for us to raise our rates and, as a consequence, to recover our costs or earn our expected rates of return;
- changing the determination of the costs, or the amount of costs, that would be considered recoverable in rate cases;
- changing water quality or delivery service standards or wastewater collection, treatment, discharge and disposal standards with which we must comply;
- restricting our ability to terminate our services to customers who owe us money for services previously provided;
- requiring us to provide water services at reduced rates to certain customers;
- restricting our ability to sell assets or issue securities;
- changing regulatory benefits that we expected to receive when we began offering services in a particular area;
- changing or placing additional limitations on change in control requirements relating to any concentration of ownership of our common stock;
- making it easier for governmental entities to convert our assets to public ownership via eminent domain;
- restricting or prohibiting our extraction of water from rivers, streams, reservoirs or aquifers; and

- revoking or altering the terms of the certificates of public convenience and necessity (or similar authorizations) issued to us by state PUCs.

Any of these changes or any other changes in laws, regulations, judicial decisions or agency policies applicable to us may have an adverse effect on our business, financial condition, results of operations, cash flow and liquidity.

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***Weather conditions, natural hazards, availability of water supplies and competing uses may interfere with our sources of water, demand for water services and our ability to supply water to customers.***

Our ability to meet the existing and future water demands of our customers depends on an adequate supply of water. As a general rule, sources of public water supply, including rivers, lakes, streams and groundwater aquifers are held in the public trust and are not owned by private interests. As such, we typically do not own the water that we use in our operations, and the availability of our water supply is established through allocation rights and passing-flow requirements set by governmental entities. Passing-flow requirements set minimum volumes of water that must pass through specified water sources, such as rivers and streams, in order to maintain environmental habitats and meet water allocation rights of downstream users. Allocation rights are imposed to ensure sustainability of major water sources and passing flow requirements are most often imposed on source waters from smaller rivers, lakes and streams. These requirements can change from time to time and adversely impact our water supply. Drought, overuse of sources of water, the protection of threatened species or habitats or other factors may limit the availability of ground and surface water.

Governmental restrictions on water use may also result in decreased use of water services, even if our water supplies are sufficient to serve our customers, which may adversely affect our financial condition and results of operations. Seasonal drought conditions that would impact our water services are possible across all of our service areas, and drought conditions currently exist in several areas of the United States. However, these conditions are more prevalent in the Northeast and West where supply capacity is limited and per capita water demand is high. If a regional drought were to occur affecting our service areas and adjacent systems, governmental restrictions may be imposed on all systems within a region independent of the supply adequacy of any individual system. There have been no mandatory water use restriction orders to date in 2008, although voluntary conservation efforts or water use restrictions were implemented during certain periods in parts of New Jersey, New Mexico, New York and California. Following drought conditions, water demand may not return to pre-drought levels even after restrictions are lifted. Cool and wet weather may also reduce demand for water, thereby adversely affecting our financial condition, results of operations, cash flow and liquidity.

Service interruptions due to severe weather events are possible across all our service areas. These include winter storms and freezing conditions in our colder climate service areas, high wind conditions in our service areas known to experience tornados, earthquakes in our service areas known to experience seismic activity, high water conditions for our facilities located in or near designated flood plains, hurricanes in our coastal service areas and severe electrical storms which are possible across all of our service areas. These weather events may affect the condition or operability of our facilities, limiting or preventing us from delivering water or wastewater services to our customers, or requiring us to make substantial capital expenditures to repair any damage. Any interruption in our ability to supply water or to collect, treat and properly dispose of wastewater, or any costs associated with restoring service, could adversely affect our financial condition and results of operations. Furthermore, losses from business interruptions or damage to our facilities might not be covered by our insurance policies and such losses may make it difficult for us to secure insurance in the future at acceptable rates.

***Declining residential per customer water usage may reduce our long-term revenues, financial condition and results of operations.***

Increased water conservation, including through the use of more efficient household fixtures and appliances among residential consumers, combined with declining household sizes in the United States, has contributed to a trend of declining residential per customer water usage. Our Regulated Businesses are heavily dependent upon revenue generated from rates we charge to our residential customers for the volume of water they use. The rate we charge for our water is regulated by state PUCs, and we may not unilaterally adjust our rates to reflect demand. Declining usage will have a negative impact on our long-term operating revenues if we are unable to secure rate increases or to grow our residential customer base to the extent necessary to offset the residential usage decline.

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***Risks associated with the collection, treatment and disposal of wastewater may impose significant costs.***

The wastewater collection, treatment and disposal operations of our subsidiaries are subject to substantial regulation and involve significant environmental risks. If collection or sewage systems fail, overflow or do not operate properly, untreated wastewater or other contaminants could spill onto nearby properties or into nearby streams and rivers, causing damage to persons or property, injury to aquatic life and economic damages, which may not be recoverable in rates. This risk is most acute during periods of substantial rainfall or flooding, which are the main causes of sewer overflow and system failure. Liabilities resulting from such damage could adversely and materially affect our business, results of operations and financial condition. Moreover, in the event that we are deemed liable for any damage caused by overflow, our losses might not be covered by insurance policies, and such losses may make it difficult for us to secure insurance in the future at acceptable rates.

***Our Regulated Businesses require significant capital expenditures to maintain infrastructure and expand our rate base and may suffer if we fail to secure appropriate funding to make investments, or if we suffer delays in completing major capital expenditure projects.***

The water and wastewater utility business is capital intensive. In addition to our acquisition strategy, we invest significant amounts of capital to add, replace and maintain property, plant and equipment. In 2007, we invested $758.6 million in net Company-funded capital improvements. We invested approximately $1.0 billion in net capital improvements in 2008. We expect the level of capital expenditures necessary to maintain the integrity of our systems to increase in the future. We fund these projects from cash generated from operations, borrowings under our revolving credit facility and commercial paper programs and the issuance of long-term debt and equity securities. We can provide no assurances that we will be able to access the debt and equity capital markets on favorable terms or at all.

RWE has certain registration rights with respect to future issuances of our equity securities and intends to fully divest its remaining ownership of American Water as soon as reasonably practicable, subject to market conditions. The registration rights agreement entered into with RWE imposes certain restrictions on our ability to issue equity securities in amounts beyond specified thresholds without RWE s consent. Sales of our common stock by RWE as well as the restrictions in the registration rights agreement, may make it more difficult or costly for us to raise additional equity in the future. Furthermore, if we are unable to raise sufficient equity, we can provide no assurances that we will be able to access the debt capital markets on favorable terms or at all.

In addition, we believe that our dividend policy, which, subject to applicable law and the discretion of our board of directors, is to pay cash dividends of approximately $0.20 per share per quarter, could limit, but not preclude, our ability to pursue growth. In particular, this limitation could be significant, for example, with respect to large acquisitions and growth opportunities that require cash investments in amounts greater than our operating subsidiaries available cash or external financing resources. In order to fund construction expenditures, acquisitions (including tuck-in acquisitions) and principal and interest payments on our indebtedness, and pay dividends at the level currently anticipated under our dividend policy, we expect that we will need additional financing. However, we intend to retain sufficient cash from operating activities after the distribution of dividends to fund a portion of our capital expenditures. For further discussion of our acquisition strategy, see Business Our Regulated Businesses Acquisitions.

If we are unable to obtain sufficient capital, we may fail to maintain our existing property, plant and equipment, realize our capital investment strategies, meet our growth targets and successfully expand the rate base upon which we are able to earn future returns on our investment and a return of our investment. Even if we have adequate resources to make required capital expenditures, we face the additional risk that we will not complete our major capital expenditures on time, as a result of construction delays or other obstacles. Each of these outcomes could adversely affect our financial condition and results of operations. We also face the risk that after we make substantial capital expenditures, the rate increases granted to us by state PUCs may not be sufficient to recover our prudently incurred operating expenses and to allow us the opportunity to earn an appropriate rate of return on our invested capital and a return of our invested capital.

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***Market disruptions could affect our ability to meet our liquidity needs.***

We rely on our revolving credit facility and the capital markets to satisfy our liquidity needs. Disruptions in the credit markets may discourage lenders from meeting their existing lending commitments, extending the terms of such commitments or agreeing to new commitments. Market disruptions may also limit our ability to issue debt securities in the capital markets. On September 15, 2008, we sought to issue commercial paper but were unable to consummate the issuance due to adverse market conditions. In order to meet our short-term liquidity needs we are borrowing under our existing $840 million revolving credit facility, which was scheduled to expire on September 15, 2012. On September 15, 2008, a majority of our lenders agreed to extend $685.0 million of commitments under this revolving credit facility to September 15, 2013. AWCC had $437.0 million of outstanding borrowings and $43.7 million of outstanding letters of credit under this credit facility as of January 15, 2009. AWCC had $81.0 million of outstanding overnight commercial paper as of January 15, 2009. 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.

***The failure of, or the requirement to repair, upgrade or dismantle, any of our dams may adversely affect our financial condition and results of operations.***

We own a total of 99 dams. A failure of any of those dams could result in injuries and property damage downstream for which we may be liable. The failure of a dam would also adversely affect our ability to supply water in sufficient quantities to our customers and could adversely affect our financial condition and results of operations. Any losses or liabilities incurred due to a failure of one of our dams might not be covered by insurance policies or be recoverable in rates, and such losses may make it difficult for us to secure insurance in the future at acceptable rates.

We also are required from time to time to repair or upgrade the dams that we own. The cost of such repairs can be and has been material. We might not be able to recover such costs through rates. The inability to recover these higher costs or regulatory lag in the recovery of such costs can affect our financial condition, results of operations, cash flow and liquidity.

The federal and state agencies that regulate our operations may adopt rules and regulations requiring us to dismantle our dams. Federal and state agencies are currently considering rules and regulations that could require us to strengthen or dismantle one of our dams on the Carmel River in California due to safety concerns related to seismic activity. Any requirement to strengthen or dismantle this dam could result in substantial costs that may adversely affect our financial condition and results of operations. We are currently engaged in negotiations with federal and state agencies and local stakeholders on a plan to maintain our existing Carmel River dams or to share the costs of dismantling one of them with those federal and state agencies and local stakeholders. These negotiations could be delayed or abandoned.

***Any failure of our network of water and wastewater pipes and water reservoirs could result in losses and damages that may affect our financial condition and reputation.***

Our operating subsidiaries distribute water and wastewater through an extensive network of pipes and store water in reservoirs located across the United States. A failure of major pipes or reservoirs could result in injuries and property damage for which we may be liable. The failure of major pipes and reservoirs may also result in the need to shut down some facilities or parts of our network in order to conduct repairs. Such failures and shutdowns may limit our ability to supply water in sufficient quantities to our customers and to meet the water and wastewater delivery requirements prescribed by governmental regulators, including state PUCs with jurisdiction over our operations, and adversely affect our financial condition, results of operations, cash flow, liquidity and reputation. Any business interruption or other losses might not be covered by insurance policies or be recoverable in rates, and such losses may make it difficult for us to secure insurance in the future at acceptable rates.

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***Contamination of our sources of water could result in service interruptions and human exposure to hazardous substances and subject our subsidiaries to civil or criminal enforcement actions, private litigation and cleanup obligations.***

Our water supplies are subject to contamination, including contamination from naturally-occurring compounds, chemicals in groundwater systems, pollution resulting from man-made sources, such as perchlorate and methyl tertiary butyl ether (MTBE), and possible terrorist attacks. In the event that our water supply is contaminated, we may have to interrupt the use of that water supply until we are able to substitute the supply of water from another water source, including, in some cases, through the purchase of water from a third-party supplier. In addition, we may incur significant costs in order to treat the contaminated source through expansion of our current treatment facilities, or development of new treatment methods. If we are unable to substitute water supply in a cost-effective manner, our financial condition, results of operations, cash flow, liquidity and reputation may be adversely affected. We might not be able to recover costs associated with treating or decontaminating water supplies through rates, or such recovery may not occur in a timely manner. Moreover, we could be held liable for environmental damage as well as damages arising from toxic tort or other lawsuits or criminal enforcement actions or other consequences arising out of human exposure to hazardous substances in our drinking water supplies.

***Our liquidity and earnings could be adversely affected by increases in our production costs, including the cost of chemicals, electricity, fuel or other significant materials used in the water and wastewater treatment process.***

We incur significant production costs in connection with the delivery of our water and wastewater services. Our production costs are driven by inputs such as chemicals used to treat water and wastewater as well as electricity and fuel, which are used to operate pumps and other equipment used in water treatment and delivery and wastewater collection, treatment and disposal. We also incur production costs for waste disposal. For 2007, production costs accounted for 12.6% of our total operating costs. These costs can and do increase unexpectedly and in substantial amounts, as occurred in California during 2001 and Illinois during 2007, when the cost of electricity rose substantially.

Our Regulated Businesses might not be able to recover increases in the costs of chemicals, electricity, fuel, other significant inputs or waste disposal through rates, or such recovery may not occur in a timely manner. Our Non-Regulated Businesses may not be able to recover these costs in contract prices or other terms. The inability to recover these higher costs can affect our financial condition, results of operations, cash flow and liquidity.

***Our reliance on third-party suppliers poses significant risks to our business and prospects.***

We contract with third parties for goods and services that are essential to our operations, such as maintenance services, pipes, chemicals, electricity, water, gasoline, diesel and other materials. We are subject to substantial risks because of our reliance on these suppliers. For example:

- our suppliers may not provide raw materials that meet our specifications in sufficient quantities;
- our suppliers may provide us with water that does not meet applicable quality standards or is contaminated;
- our suppliers may face production delays due to natural disasters or strikes, lock-outs or other such actions;
- one or more suppliers could make strategic changes in the lines of products and services they offer; and
- some of our suppliers are small companies which are more likely to experience financial and operational difficulties than larger, well-established companies, because of their limited financial and other resources.

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As a result of any of these factors, we may be required to find alternative suppliers for the raw materials and services on which we rely. Accordingly, we may experience delays in obtaining appropriate raw materials and services on a timely basis and in sufficient quantities from such alternative suppliers at a reasonable price, which could interrupt services to our customers and adversely affect our revenues, financial condition, results of operations, cash flow and liquidity.

***Risks associated with potential acquisitions or investments may adversely affect us.***

We will continue to seek to acquire or invest in additional regulated water or wastewater systems, including by acquiring systems in markets in the United States where we do not currently operate our Regulated Businesses, and through tuck-ins. We will also continue to seek to enter into public/private partnerships, including O&M, military and design, build and operate, which we refer to as DBO, contracts and services that complement our businesses. These transactions may result in:

- incurrence of debt and contingent liabilities;
- failure to have or to maintain effective internal control over financial reporting;
- fluctuations in quarterly results;
- exposure to unknown risk and liabilities, such as environmental liabilities; and
- other acquisition-related expenses.

We may also experience difficulty in obtaining required regulatory approvals for acquisitions, and any regulatory approvals we obtain may require us to agree to costly and restrictive conditions imposed by regulators. Sales of our common stock by RWE as well as the restrictions in the registration rights agreement between us and RWE, may make it more difficult or costly for us to raise additional equity to fund an acquisition or to issue shares as consideration in connection with an acquisition. We may not identify all significant risks when conducting due diligence for a transaction, and we could be exposed to potential liabilities for which we will not be indemnified. There may be difficulties integrating new businesses, including bringing newly acquired businesses up to the necessary level of regulatory compliance, retaining and integrating key personnel, achieving strategic objectives and integrating acquired assets and technological systems. The demands of identifying and transitioning newly acquired businesses or pursuing investment opportunities may also divert management s attention from other business concerns and otherwise disrupt our business. Any of these risks may adversely affect our financial condition, results of operations and cash flows.

***We have recorded a significant amount of goodwill, and we may never realize the full value of our intangible assets, causing us to record impairments that may negatively affect our results of operations or require us to effect additional dilutive equity issuances.***

Our total assets include substantial goodwill. At September 30, 2008, our goodwill totaled $1,704.3 million. The goodwill is primarily associated with the acquisition of American Water by an affiliate of RWE in 2003 and the acquisition of E Town Corporation in 2001. Goodwill represents the excess of the purchase price the purchaser paid over the fair value of the net tangible and intangible assets acquired. Goodwill is recorded at fair value on the date of an acquisition and, in accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, which we refer to as SFAS No. 142, is reviewed annually or more frequently if changes in circumstances indicate the carrying value may not be recoverable. Annual impairment reviews are performed at November 30 of each year and interim reviews are performed when management determines that a triggering event has occurred. We have been required to reflect, as required by SFAS No. 142 and other applicable accounting rules, a non-cash charge to operating results for goodwill impairment in the amounts of $396.3 million, $227.8 million, and $509.3 million for the years ended December 31, 2005, 2006 and 2007, respectively. These amounts include impairments relating to discontinued operations. Also, for the three months ended March 31, 2008 we recorded a goodwill impairment in the amount of $750.0 million.

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There can be no assurances that the Company will not be required to recognize an impairment of goodwill in the future due to market conditions or other factors related to the Company s performance. These market events could include a decline over a period of time of the Company s stock price, a decline over a period of time in valuation multiples of comparable water utilities, the lack of an increase in the Company s market price consistent with its peer companies, or decreases in control premiums and the overhang effect. A decline in the forecasted results in our business plan, such as changes in rate case results or capital investment budgets or changes in our interest rates, could also result in an impairment charge. Recognition of impairments of a significant portion of goodwill would negatively affect the Company s reported results of operations and total capitalization, the effect of which could be material and could make it more difficult to secure financing on attractive terms, maintain compliance with debt covenants and meet expectations of our regulators. As a result, we may be required to issue and sell additional shares of common stock at market prices, which could be dilutive to existing holders of our common stock. For further discussion, see Management s Discussion and Analysis of Financial Condition and Results of Operations Factors Affecting our Results of Operations Goodwill Impairment.

While our annual goodwill impairment test is conducted at November 30, we have processes to monitor for interim triggering events. As of March 31, 2008, in light of the initial public offering price and trading levels in our common stock subsequent to the date of the initial public offering, the Company performed an interim impairment test and, on May 9, 2008, management concluded that the carrying value of the Company s goodwill was impaired. The Company believed that the initial public offering price was indicative of the value of the Company at March 31, 2008, and accordingly, based on those factors recorded an impairment charge to the goodwill of its Regulated reporting unit in the amount of $750.0 million as of March 31, 2008. The impairment charge was primarily attributed to the market price of the Company s common stock (both the initial public offering price and the price during subsequent trading) being less than the estimate of the initial public offering price used during the 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company s debt (due to increased market interest rates). As a result of the impairment charge, RWE Aqua Holdings GmbH (a wholly-owned subsidiary of RWE) transferred $245.0 million to the Company on May 13, 2008. This cash was used to reduce short-term debt. RWE is not obligated to make any additional capital contributions.

During the third quarter of 2007, as a result of the Company s debt being placed on review for a possible downgrade and the proposed sale of a portion of the Company in the initial public offering, management determined at that time it was appropriate to update its valuation analysis before the next scheduled annual test. Based on this assessment, the Company performed an interim impairment test and recorded an impairment charge to goodwill related to its Regulated reporting unit in the amount of $243.3 million as of September 30, 2007. The decline was primarily due to a slightly lower long-term earnings forecast caused by updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery.

The Company completed its scheduled annual impairment test in the fourth quarter of 2007 and determined that an impairment had occurred based upon information regarding the Company s market value in connection with the initial public offering. Management determined that the indicative fair value of the Company based on estimates of the initial public offering price range was the best evidence of the Company s market value and incorporated this indicated market value into the Company s valuation methodology, which also considered other items, such as peer multiples, discounted cash flows and a control premium. Based on the results of the impairment test, an impairment of $266.0 million to the Company s carrying value was recognized as of December 31, 2007.

***Our Regulated Businesses compete with governmental entities, other regulated utilities, as well as strategic and financial buyers, for acquisition opportunities, which may hinder our ability to grow our business.***

We compete with governmental entities, other regulated utilities, as well as strategic and financial buyers, for acquisition opportunities, including tuck-ins. Our competitors may impede our growth by purchasing water utilities near our existing operations, thereby preventing us from acquiring them. Competing governmental

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entities, utilities and strategic and financial buyers have challenged, and may in the future challenge, our applications for new service territories. Our growth could be hindered if we are not able to compete effectively for new territories with other companies or strategic and financial buyers that have lower costs of operations or that can submit more attractive bids.

***The assets of our Regulated Businesses are subject to condemnation through eminent domain.***

Municipalities and other government subdivisions have historically been involved in the provision of water and wastewater services in the United States, and organized movements may arise from time to time in one or more of the service areas in which our Regulated Businesses operate to convert our assets to public ownership and operation through the governmental power of eminent domain. Should a municipality or other government subdivision seek to acquire our assets through eminent domain, we may resist the acquisition. Contesting an exercise of condemnation through eminent domain may result in costly legal proceedings and may divert the attention of the affected Regulated Business s management from the operation of its business.

On September 5, 2008, under threat of condemnation, California American Water sold the assets of our Felton, California water system, which served approximately 1,330 customers, to the San Lorenzo Valley Water District, which we refer to as SLVWD. The most recent prior sale of our water and wastewater systems under threat of condemnation occurred in 2003. If a municipality or other government subdivision succeeds in acquiring the assets of one or more of our Regulated Businesses through eminent domain, there is a risk that we will not receive adequate compensation for the business, that we will not be able to keep the compensation, or that we will not be able to divest the business without incurring significant one-time charges.

***In order to consummate the proposed RWE Divestiture, we and RWE were required to obtain approvals from thirteen state PUCs. There can be no guarantee that some state PUC approvals already granted to us will not be appealed, withdrawn, modified or stayed.***

To consummate the proposed RWE Divestiture, we and RWE obtained regulatory approvals from state PUCs in 13 states. The state PUC approval in Illinois has been appealed, and there can be no guarantee that the state PUC approval in Illinois will not be overturned. Moreover, some of our existing state PUC approvals may be withdrawn or altered in the future by the state PUCs because they retain authority to withdraw or modify their prior decisions. There also can be no guarantee that, in conjunction with an appeal or otherwise, a stay or other form of injunctive relief will not be granted by a state PUC or reviewing court.

In addition, two of the regulatory approvals that we and RWE obtained expire on April 22, 2010 and another approval expires on April 22, 2011. If RWE does not fully divest its remaining ownership of American Water by such dates, then we and RWE may be required to seek an extension of such approvals, as applicable, which process may result in delays, costs and the imposition of additional conditions on us or on RWE.

***In order to obtain the state PUC approvals to consummate the proposed RWE Divestiture we were required to accept certain conditions and restrictions that could increase our costs.***

Some of the regulatory approvals contain conditions and restrictions, including reporting obligations, obligations to maintain appropriate creditworthiness, restrictions on changes of control, prohibitions on the pass- through of our initial Sarbanes-Oxley Act compliance costs, prohibitions on the pass-through of certain costs of the Transactions, service quality and staffing level requirements and the maintenance of specific collective bargaining agreements and retirement and certain other post-employment benefit programs. These conditions and restrictions could increase our costs and adversely affect our business.

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***Our Non-Regulated Businesses, through American Water (excluding our regulated subsidiaries), provide performance guarantees and other forms of financial security to our public-sector clients that could be claimed by our clients or potential clients if we do not meet certain obligations.***

Under the terms of some of our indebtedness and some of our agreements for the provision of services to water and wastewater facilities with municipalities, other governmental entities and other customers, American Water (excluding its regulated subsidiaries) provides guarantees of the performance of our Non-Regulated Businesses, including financial guarantees or deposits, to ensure performance of certain obligations. At September 30, 2008, we had remaining performance commitments as measured by remaining contract revenue totaling approximately $1,680.2 million, and this amount is likely to increase if our Non-Regulated Businesses grow. The presence of these commitments may adversely affect our financial condition and make it more difficult for us to secure financing on attractive terms. In addition, if the obligor on the instrument fails to perform certain obligations to the satisfaction of the party that holds the performance commitments that party may seek to enforce the performance commitments against us or proceed against the deposit. In that event, our financial condition, results of operations, cash flow and liquidity could be adversely affected.

***We operate a number of water and wastewater systems under O&M contracts and face the risk that the owners of those systems may fail to maintain those systems, which will negatively affect us as the operators of the systems.***

We operate a number of water and wastewater systems under O&M contracts. Pursuant to these contracts, we operate the system according to the standards set forth in the applicable contract, and it is generally the responsibility of the owner to undertake capital improvements. In some cases, we may not be able to convince the owner to make needed improvements in order to maintain compliance with applicable regulations. Although violations and fines incurred by water and wastewater systems may be the responsibility of the owner of the system under these contracts, those non-compliance events may reflect poorly on us as the operator of the system and damage our reputation, and in some cases, may result in liability to the same extent as if we were the owner.

***Our Non-Regulated Businesses are party to long-term contracts to operate and maintain water and wastewater systems under which we may incur costs in excess of payments received.***

Some of our Non-Regulated Businesses enter into long-term contracts pursuant to which they agree to operate and maintain a municipality s, Federal government s or other party s water or wastewater treatment and delivery facilities, which includes responsibility for certain major maintenance for some of those facilities, in exchange for an annual fee. Our Non-Regulated Businesses are generally subject to the risk that costs associated with operating and maintaining the facilities may exceed the fees received from the municipality or other contracting party. In addition, directly or through our non-regulated subsidiaries, we often guarantee our Non-Regulated Businesses obligations under those contracts. Losses under these contracts or guarantees may adversely affect our financial condition, results of operations, cash flow and liquidity.

***We rely on our IT systems to assist with the management of our business and customer and supplier relationships, and a disruption of these systems could adversely affect our business.***

Our IT systems are an integral part of our business, and a serious disruption of our IT systems could significantly limit our ability to manage and operate our business efficiently, which in turn could cause our business and competitive position to suffer and cause our results of operations to be reduced. We depend on our IT systems to bill customers, process orders, provide customer service, manage construction projects, manage our financial records, track assets, remotely monitor certain of our plants and facilities and manage human resources, inventory and accounts receivable collections. Our IT systems also allow us to purchase products from our suppliers and bill customers on a timely basis, maintain cost-effective operations and provide service to our customers. Our IT systems are vulnerable to damage or interruption from:

- power loss, computer systems failures and internet, telecommunications or data network failures;

- operator negligence or improper operation by, or supervision of, employees;

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- physical and electronic loss of customer data or security breaches, misappropriation and similar events;
- computer viruses;
- intentional acts of vandalism and similar events; and
- hurricanes, fires, floods, earthquakes and other natural disasters.

Such damages or interruptions may result in physical and electronic loss of customer or financial data, security breaches, misappropriation and similar events. In addition, the lack of redundancy for certain of our IT systems, including billing systems, could exacerbate the impact on the Company of any of the foregoing events.

In addition, we may not be successful in developing or acquiring technology that is competitive and responsive to the needs of our business and we might lack sufficient resources to make the necessary investments in technology to allow us to continue to operate at our current level of efficiency.

***Our indebtedness could affect our business adversely and limit our ability to plan for or respond to changes in our business, and we may be unable to generate sufficient cash flow to satisfy our liquidity needs.***

As of September 30, 2008, after giving effect to this offering and the issuance of the existing senior monthly notes, our pro forma indebtedness (including preferred stock with mandatory redemption requirements) was $5,122.6 million, and our working capital, defined as current assets less current liabilities, was in a deficit position. Our indebtedness could have important consequences, including:

- limiting our ability to obtain additional financing to fund future working capital or capital expenditures;
- exposing us to interest rate risk with respect to the portion of our indebtedness that bears interest at a variable rate;
- limiting our ability to pay dividends on our common stock or make payments in connection with our other obligations;
- likely requiring that a portion of our cash flow from operations be dedicated to the payment of the principal of and interest on our debt, thereby reducing funds available for future operations, acquisitions, dividends on our common stock or capital expenditures;
- limiting our ability to take advantage of significant business opportunities, such as acquisition opportunities, and to react to changes in market or industry conditions; and
- placing us at a competitive disadvantage compared to those of our competitors that have less debt.

In order to meet our capital expenditure needs, we may be required to make additional borrowings under our credit facilities or be required to issue new debt securities in the capital markets. We can provide no assurances that we will be able to access the debt capital markets or do so on favorable terms. If new debt is added to our current debt levels, the related risks we now face could intensify, limiting our ability to refinance existing debt on favorable terms.

We will depend primarily on operations to fund our expenses and to pay the principal and interest on our outstanding debt. Our ability to meet our expenses thus depends on our future performance, which will be affected by financial, business, economic, competitive, legislative, regulatory and other factors beyond our control. If we do not have enough money to pay the principal and interest on our outstanding debt, we

may be required to refinance all or part of our existing debt, sell assets, borrow additional funds or sell additional equity. If our business does not generate sufficient cash flow from operations or if we are unable to incur indebtedness sufficient to enable us to fund our liquidity needs, we may be unable to plan for or respond to changes in our business that would prevent us from maintaining or increasing our business and cause our operating results and prospects to be affected adversely.

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***Our failure to comply with restrictive covenants under our credit facilities could trigger prepayment obligations.***

Our failure to comply with the restrictive covenants under our credit facilities could result in an event of default, which, if not cured or waived, could result in us being required to repay or refinance (on less favorable terms) these borrowings before their due date. If we are forced to repay or refinance (on less favorable terms) these borrowings, our results of operations and financial condition could be adversely affected by increased costs and rates. In 2007, we were not in compliance with reporting covenants contained in some of the debt agreements of our subsidiaries. Such defaults under the reporting covenants were caused by our delay in producing our quarterly and audited annual consolidated financial statements. We have obtained all necessary waivers under the agreements. We can provide no assurance that we will comply in the future with all our reporting covenants and will not face an event of default under our debt agreements, or that such default will be cured or waived.

***Work stoppages and other labor relations matters could adversely affect our results of operations.***

Currently, approximately 3,700 of our employees, or approximately 51% of our total workforce, are unionized and represented by 20 different unions. Approximately one-fourth of our 76 union collective bargaining agreements expire annually, with 18 agreements covering 982 employees scheduled to expire before the end of 2009. We might not be able to renegotiate labor contracts on terms that are favorable to us and negotiations or dispute resolutions undertaken in connection with our labor contracts could be delayed or become subject to the risk of labor actions or work stoppages. Labor actions, work stoppages or the threat of work stoppages and our failure to obtain favorable labor contract terms during renegotiations may all adversely affect our financial condition, results of operations, cash flow and liquidity.

***We currently have material weaknesses in internal control over financial reporting. If we fail to remedy our material weaknesses or otherwise maintain effective internal control over financial reporting, we may not be able to report our financial results accurately or on a timely basis. Any inability to report and file our financial results in an accurate and timely manner could harm our business and adversely impact the trading price of our common stock.***

As a public company, we are required to comply with the Sarbanes-Oxley Act and other rules and regulations that govern public companies. In particular, we will be required to certify our compliance with Section 404 of the Sarbanes-Oxley Act for the year ended December 31, 2009, which will require us to perform system and process evaluation and testing of our internal control over financial reporting to allow management and our registered public accounting firm to report on the effectiveness of our internal control over financial reporting. Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. However, from 2003 until the completion of our initial public offering in April 2008, we were an indirect wholly-owned subsidiary of RWE, a stock corporation incorporated in the Federal Republic of Germany, and were not required to maintain a system of effective internal controls in compliance with the requirements of the SEC and the Sarbanes-Oxley Act, nor to prepare our own consolidated financial statements. As a public reporting company, we are required, among other things, to maintain a system of effective internal control over financial reporting suitable to prepare our publicly reported financial statements in a timely and accurate manner, and also to evaluate and report on such system of internal control.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company s annual or interim financial statements will not be prevented or detected on a timely basis. In connection with the preparation of our consolidated financial statements as of December 31, 2006, we and our independent registered public accountants have identified the following material weaknesses in our internal control over financial reporting:

- inadequate internal staffing and skills;

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- inadequate controls over financial reporting processes;
- inadequate controls over month-end closing processes, including account reconciliations;
- inadequate controls over maintenance of contracts and agreements;
- inadequate controls over segregation of duties and restriction of access to key accounting applications; and
- inadequate controls over tax accounting and accruals.

We have initiated a remediation plan with respect to our material weaknesses, but there can be no assurances that our remediation plan will be effective. For further discussion, see Management s Discussion and Analysis of Financial Condition and Results of Operations Our Internal Control and Remediation Initiatives.

Each of these weaknesses could result in a material misstatement of our annual or interim consolidated financial statements. Moreover, we cannot assure you that we have identified all, or that we will not in the future have additional, material weaknesses, any of which may subject us to additional regulatory scrutiny, and cause future delays in filing our financial statements and periodic reports with the SEC. Any such delays in the filing of our financial statements and periodic reports may result in a loss of public confidence in the reliability of our financial statements and sanctions imposed on us by the SEC. We believe that such misstatements or delays could negatively impact our liquidity, access to capital markets, financial condition and the market value of our common stock or cause a downgrade in the credit ratings of American Water or AWCC. These material weaknesses contributed to our inability to comply with reporting covenants in our debt agreements and those of our subsidiaries in 2005 and 2006, and could hinder our ability to comply with such covenants in the future if we are not successful in remediating such weaknesses.

**Risks Related to this Offering**

***The notes are structurally subordinated to all the obligations of our subsidiaries other than the issuer. The issuer s ability to service its debt is dependent on the performance of our other subsidiaries.***

The notes have been issued by American Water Capital Corp., our finance subsidiary. American Water has signed a support agreement with the issuer. The notes are not guaranteed by any of our subsidiaries and are the obligations only of the issuer and American Water, by virtue of the support agreement. Accordingly, the notes are structurally subordinated to the liabilities, including trade payables, lease commitments and moneys borrowed, of American Water s subsidiaries other than the issuer. American Water has no material assets or operations other than equity interests in its subsidiaries, and the issuer has no material assets or operations except for its limited operations as a finance vehicle for our businesses. We expect that payments of interest and principal that the issuer makes on the notes (or that American Water makes pursuant to the support agreement) will be made only to the extent that our operating subsidiaries can distribute cash or other property to American Water and, through American Water, to the issuer.

***The notes do not restrict our ability to incur additional indebtedness, which could adversely affect our ability to pay our obligations under the notes.***

Although the terms of the notes restrict our ability and the ability of our subsidiaries to incur certain liens and to enter into certain sale and leaseback transactions, the incurrence of other indebtedness or other liabilities by any of our subsidiaries is not prohibited in connection with the notes and could adversely affect our ability to pay our obligations on the notes. As of September 30, 2008, total liabilities of our subsidiaries other than the issuer were $5,203.5 million. As of September 30, 2008, the indebtedness of our subsidiaries other than the issuer, excluding intercompany liabilities and obligations of a type not required to be reflected on a balance sheet in accordance with generally accepted accounting principles, that would effectively have been senior to the notes, was approximately $1,766.8 million. We anticipate that from time to time our subsidiaries will incur additional debt and other liabilities. Any debt incurred by our subsidiaries other than the issuer will be structurally senior to the notes.

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We have not agreed to any financial covenants in connection with the notes. Consequently, we are not required in connection with the notes to meet any financial tests, such as those that measure our working capital, interest coverage, fixed charge or net worth, in order to maintain compliance with the terms of the notes.

***Our ability to service our obligations under the notes depends on our ability to receive cash distributions from our operating subsidiaries. There can be no assurance that we will continue to receive such distributions or, if they are received, that they will be in amounts similar to past distributions.***

The issuer is our finance subsidiary and has no substantial assets. We have entered into a support agreement with the issuer pursuant to which we have agreed to pay to any debt investor or lenders of the issuer any principal or interest amounts owed by the issuer to such debt investor or lender that the issuer fails to pay on a timely basis. Because substantially all of our operations are conducted through our subsidiaries other than the issuer, the issuer will not be able to make interest and principal payments on the notes (and we will not be able to fulfill our obligations under the support agreement) unless we receive sufficient cash distributions from our operating subsidiaries and contribute such distributions to the issuer. The distributions received from our operating subsidiaries might not permit the issuer or us to make required payments of interest and principal under the notes or pursuant to the support agreement, as applicable, on a timely basis, or at all.

***If an active trading market does not develop for the notes you may not be able to resell them.***

Currently, there is no public market for the notes. If no active trading market develops, you may not be able to resell the notes at their fair market value or at all.

The liquidity of any market for the notes will depend upon various factors, including:

- the number of holders of the notes;
- the interest of securities dealers in making a market for the notes;
- our financial performance or prospects; and
- the prospects for companies in our industry generally.

Accordingly, we cannot assure you that a market or liquidity will develop for the notes.

***Our principal stockholder is in a position to affect our ongoing operations, corporate transactions and other matters, and its interests may conflict with or differ from your interests as a noteholder.***

RWE owns approximately 60% of our common stock. As a result, RWE is able to control the outcome on virtually all matters submitted to a vote of our stockholders, including the election of directors. So long as RWE continues to own a significant portion of the outstanding shares of our common stock, it will continue to be able to significantly influence the election of our directors, subject to compliance with applicable NYSE requirements, our decisions, policies, management and affairs and corporate actions requiring stockholder approval, including the approval of transactions involving a change in control. The interests of RWE and its affiliates may not coincide with the interests of our other stockholders or with your interests as a noteholder.

***We may not be able to repurchase the notes upon a change of control.***

Upon the occurrence of a change of control triggering event, the issuer will be required to offer to repurchase all outstanding notes at 101% of their principal amount plus accrued and unpaid interest. The source of funds for any such purchase of the notes will be available cash, cash generated from our operating subsidiaries (other than the issuer) or other sources, including borrowings, sales of assets or sales of equity. The sources of cash may not be adequate to permit the issuer (or us, pursuant to our obligations under the support agreement) to repurchase the notes upon a change of control triggering event. The issuer s failure to offer to repurchase the notes, or to repurchase notes tendered following a change

of control triggering event, will result in a default under the indenture governing the notes, which could lead to a cross-default under the terms of our existing and future indebtedness. For further information, see Description of the Notes.

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***The right of a deceased beneficial owner s representative to redeem notes may be limited in amount.***

The representative of a deceased beneficial owner of notes will have the right at any time to request redemption of all or part of such notes. We will have a discretionary right, however, to limit the aggregate principal amount of notes subject to redemption by the representative of any individual deceased beneficial owner of notes to $25,000 for the period prior to December 1, 2009 and each 12-month period thereafter while the notes remain outstanding. We will also have a discretionary right to limit the aggregate principal amount of notes we will redeem pursuant to such requests from all representatives of deceased beneficial owners of notes to $1,500,000 (2% of the aggregate principal amount of the notes sold in this offering) during each such period. Accordingly, we cannot assure you that a redemption request submitted by a representative of a deceased beneficial owner of notes will be permitted for the desired amount during any single period during which these limitations are calculated. In addition, any such redemptions will be effected on a quarterly basis and the right of a representative of a deceased beneficial owner of notes to request redemption of notes is subject to other conditions as described under Description of the Notes Limited Right of Redemption Upon Death of Beneficial Owner.

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## FORWARD-LOOKING STATEMENTS

We have made statements under the captions Summary, Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations, Business and in other sections of this prospectus that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and the Private Securities Litigation Reform Act of 1995. In some cases, these forward-looking statements can be identified by words with prospective meanings such as intend, plan, estimate, believe, anticipate, expect, predict, project, forecast, future, potential, continue, may, can, should and could and similar expressions. Forward-looking statements may relate to, among other things, our future financial performance, our growth strategies, our ability to repay debt, our ability to finance current operations and growth initiatives, trends in our industry, regulatory or legal developments or rate adjustments.

Forward-looking statements are predictions based on our current expectations and assumptions regarding future events. They are not guarantees of any outcomes, financial results or levels of performance, and you are cautioned not to place undue reliance upon them. These forward-looking statements are subject to a number of risks and uncertainties, and new risks and uncertainties of which we are not currently aware or which we do not currently perceive may arise in the future from time to time. Should any of these risks or uncertainties materialize, or should any of our expectations or assumptions prove incorrect, then our results may vary materially from those discussed in the forward-looking statements herein. Factors that could cause actual results to differ from those discussed in forward-looking statements include, but are not limited to, the factors discussed under the caption Risk Factors and the following factors:

- weather conditions, patterns or events, including drought or abnormally high rainfall;
- changes in general economic, business and financial market conditions;
- changes in laws, governmental regulations and policies, including environmental, health and water quality and public utility regulations and policies;
- the decisions of governmental and regulatory bodies, including decisions to raise or lower rates;
- the timeliness of regulatory commissions actions concerning rates;
- migration into or out of our service territories;
- our ability to obtain permits for expansion projects;
- changes in customer demand for, and patterns of use of, water, such as may result from conservation efforts;
- the availability of adequate and cost-effective supplies of chemicals, electricity, fuel, water and other raw materials that are needed for our operations;
- our ability to successfully acquire and integrate water and wastewater systems that are complementary to our operations and the growth of our business;

our ability to manage the expansion of our business;

our ability to control operating expenses and to achieve efficiencies in our operations;

access to sufficient capital on satisfactory terms;

fluctuations in interest rates;

restrictive covenants in or changes to the credit ratings on our current or future debt that could increase our financing costs or affect our ability to borrow, make payments on debt or pay dividends;

changes in our credit rating;

changes in capital requirements;

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- the incurrence of impairment charges;
- difficulty in obtaining insurance at acceptable rates and on acceptable terms and conditions;
- ability to retain and attract qualified employees;
- cost overruns relating to improvements or the expansion of our operations; and
- civil disturbance or terrorist threats or acts or public apprehension about future disturbances or terrorist threats or acts.

Any forward-looking statements we make speak only as of the date of this prospectus. Except as required by law, we do not have any obligation, and we specifically disclaim any undertaking or intention, to update any forward-looking statements, whether as a result of new information, future events or otherwise.

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## INDUSTRY AND MARKET DATA

Unless otherwise indicated, information contained in this prospectus concerning the water and wastewater industry, its segments and related markets and our general expectations concerning such industry and its segments and related markets are based on management estimates. Such estimates are derived from publicly available information released by third-party sources, as well as data from our internal research and on assumptions made by us based on such data and our knowledge of such industry and markets, which we believe to be reasonable. We have estimated the number of people served by our water and wastewater systems (i) by multiplying the number of residential water and wastewater connections by average people per household based on 2000 United States Census data by state (average people per household varies by state but is generally between 2.4 to 3.0 individuals per household); (ii) by adjusting for weather fluctuations, for some other customer classes, including commercial customers, and for bulk water sales and (iii) by reconciling drinking water and wastewater connections to avoid double counting population served where the same user has both drinking water and wastewater service. In some instances, population estimates for our Non-Regulated Businesses are based on either (i) specific population estimates from the client or (ii) population estimates based on the average volume of water processed by the applicable facilities. While we are not aware of any misstatements regarding the industry or similar data presented herein, such data involve risks and uncertainties and are subject to change based on various factors, including those discussed under the heading Risk Factors in this prospectus.

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## USE OF PROCEEDS

We estimate that we will receive net proceeds of approximately $72.1 million from this offering after deducting underwriting discounts and commissions and estimated offering expenses.

We intend to use the net proceeds to us from this offering to redeem $72.1 million of short-term debt, which includes borrowings under AWCC s $840 million unsecured revolving credit facility and overnight commercial paper. The credit facility is scheduled to terminate on September 15, 2012 for $155 million of commitments and on September 15, 2013 for $685 million of commitments. As of January 15, 2009, the average interest rate on our overnight commercial paper was 1.3%, and the average interest rate on short term borrowings under the credit facility was 0.7%. AWCC had $437.0 million of outstanding borrowings and $43.7 million of outstanding letters of credit under this credit facility as of January 15, 2009. For more details about the terms of this credit facility, see Description of Other Indebtedness Revolving Credit Facility.

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## CAPITALIZATION

The following table sets forth our cash and cash equivalents and capitalization as of September 30, 2008 on an actual basis and on an as adjusted basis to give effect to this offering, the issuance of $75.0 million of existing senior monthly notes and the use of the proceeds to us as if they had occurred on September 30, 2008.

You should read this table in conjunction with, and this table is qualified in its entirety by reference to, the sections in this prospectus entitled Summary Historical Consolidated and Unaudited Pro Forma Financial Data, Use of Proceeds, Unaudited Pro Forma Condensed Consolidated Financial Information, Selected Historical Consolidated Financial Data, Management s Discussion and Analysis of Financial Condition and Results of Operations, and our consolidated financial statements and the notes thereto included elsewhere in this prospectus.

| | As of September 30, 2008 (in thousands) | |
|---|---|---|
| | Historical (unaudited) | As Adjusted (unaudited) |
| Cash and cash equivalents | $ 6,689 | $ 6,689 |
| Short-term debt | | |
| Short-term debt | 327,185 | 183,086 |
| Total short-term debt | 327,185 | 183,086 |
| Long-term debt of AWCC including current portion | | |
| Private activity bonds and government funded debt | 86,860 | 86,860 |
| Senior notes | 2,884,000 | 2,884,000 |
| 10% existing senior monthly notes | | 75,000 |
| Notes offered hereby | | 75,000 |
| Long-term debt of other subsidiaries including current portion | | |
| Private activity bonds and government funded debt | 969,186 | 969,186 |
| Mortgage bonds | 715,800 | 715,800 |
| Senior notes | 40,705 | 40,705 |
| Redeemable preferred stock at redemption value(1) | 24,503 | 24,503 |
| Notes payable and other | 2,993 | 2,993 |
| Unamortized debt discount, net | 65,508 | 65,508 |
| Total long-term debt | 4,789,555 | 4,939,555 |
| Total debt | 5,116,740 | 5,122,641 |
| Equity | | |
| Common stockholders equity | 4,162,357 | 4,162,357 |
| Preferred stock without mandatory redemption requirements | 4,557 | 4,557 |
| Total equity | 4,166,914 | 4,166,914 |
| Total capitalization including short-term debt and current portion of long-term debt | $ 9,283,654 | $ 9,289,555 |

(1) Includes current portion of redeemable preferred stock and the unamortized debt discount attributable to preferred stock of $0.3 million.

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## RATIO OF EARNINGS TO FIXED CHARGES

American Water s and the issuer s ratio of earnings to fixed charges for each of the periods indicated is as follows:

For purposes of calculating the ratio of earnings to fixed charges, earnings consists of income (loss) from continuing operations before income taxes including the effect of allowance for funds used during construction, which we refer to as AFUDC, plus fixed charges. Fixed charges consist of interest expense, amortization of debt issuance costs, and a portion of rent expense that management believes is representative of the interest component of rental expense. Fixed charges have not been reduced for the effect of AFUDC.

The ratio of earnings to fixed charges was less than 1.00x for the periods indicated in the table below.

| | For the Year Ended December 31, | | | | | For the nine months ended September 30, |
|---|---|---|---|---|---|---|
| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
| **American Water** | | | | | | |
| Ratio of Earnings to Fixed Charges (1) | 1.35 | 1.38 | | | | |
| Pro Forma Ratio of Earnings to Fixed Charges (2) | | | | | | |
| **American Water Capital Corp.** | | | | | | |
| Ratio of Earnings to Fixed Charges | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Pro Forma Ratio of Earnings to Fixed Charges | | | | | 1.00 | 1.00 |

(1) For the years ended December 31, 2005, 2006 and 2007 and for the nine months ended September 30, 2008, earnings were insufficient to cover fixed charges and there were deficiencies of $224.3 million, $109.1 million, $255.7 million and $515.4 million, respectively.

(2) On a pro forma basis after giving effect to the offering of notes and the issuance of $75.0 million of existing senior monthly notes, earnings would have been insufficient to cover fixed charges and there would have been a deficiency of $250.7 million and $520.6 million for the year ended December 31, 2007 and for the nine months ended September 30, 2008, respectively.

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## UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL INFORMATION

The following unaudited pro forma condensed consolidated financial information has been developed by applying pro forma adjustments to the historical consolidated financial statements of American Water appearing elsewhere in this prospectus. See the explanatory note to the unaudited pro forma condensed consolidated financial statements. The unaudited pro forma condensed consolidated statements of operations give effect to the Transactions as if they had occurred on January 1, 2007. The unaudited pro forma condensed consolidated balance sheet gives effect to this offering as if it had occurred on September 30, 2008. No pro forma adjustments to the balance sheet are made for transactions that occurred prior to September 30, 2008. The Transactions consist of the following:

- The Merger, comprising:
  - the merger of Thames US Holdings into American Water with American Water being the surviving entity.
- The Refinancing, comprising:
  - the non-cash equity contribution to the Company by RWE of $100.0 million of debt of our subsidiaries held by RWE on March 29, 2007 and the $550.0 million cash equity contribution to the Company by RWE on March 29, 2007, which was used to pay down $232.5 million of short-term debt and the remainder was used for general working capital purposes;
  - the $1,750.0 million issuance of RWE redemption notes on September 20, 2007, which was used to fund the early redemption of $1,750.0 million of preferred stock held by RWE;
  - the issuance of $1,500.0 million aggregate principal amount of new senior notes, less issuance costs of $11.7 million on October 22, 2007, which resulted in the repayment of $1,286.0 million aggregate principal amount of RWE redemption notes and $206.0 million of RWE notes;
  - the $8.6 million gain (after tax gains of $5.2 million, net of $3.4 million of tax) on the early repayment of RWE notes;
  - the issuance of $415.0 million of commercial paper to fund the partial repayment of $464.0 million of RWE redemption notes with the balance of $49.0 million of the RWE redemption notes repaid with excess cash; and
  - the cash equity contribution to the Company by RWE of $266.0 million on December 21, 2007, which was used to pay down commercial paper.
- The 160,000-for-1 split of common stock effected on November 7, 2007.
- The initial public offering of our common stock in April 2008, pursuant to which RWE sold approximately 63.2 million shares of our common stock. Of the approximately 63.2 million shares sold, approximately 5.2 million were sold pursuant to the partial exercise of the underwriters over-allotment option on May 27, 2008.

The Equity Contribution, comprising the cash equity contribution of $245.0 million from RWE to us on May 13, 2008.

The issuance and sale by us of $75.0 million aggregate principal amount of existing senior monthly notes on November 26, 2008 with gross proceeds of $75.0 million, net of $3.0 million of issuance costs, to fund the repayment of $72.0 million of short-term debt.

The issuance and sale by us of $75.0 million aggregate principal amount of notes through this offering with gross proceeds of $75.0 million, net of an estimated $2.9 million of issuance costs, to fund the repayment of $72.1 million of short-term debt.

The unaudited pro forma condensed consolidated statement of operations adjustments and financial information do not include the $150.0 million equity contribution from RWE on September 27, 2007.

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Assumptions underlying the pro forma adjustments are described in the accompanying notes, which should be read in conjunction with these unaudited pro forma condensed consolidated financial statements.

The unaudited pro forma adjustments and financial information:

- are based upon available information and certain assumptions that we believe are reasonable under the circumstances;
- are presented for informational purposes only;
- do not purport to represent what our results of operations or financial condition would have been had the Transactions actually occurred on the dates indicated; and
- do not purport to project our results of operations or financial condition for any future period or as of any future date.

The unaudited pro forma condensed consolidated financial statements should be read in conjunction with the information contained in Use of Proceeds, Capitalization, Selected Historical Consolidated Financial Data, Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes thereto appearing elsewhere in this prospectus. All pro forma adjustments and their underlying assumptions are described more fully in the notes to our unaudited pro forma condensed consolidated financial statements.

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**American Water Works Company, Inc. and Subsidiary Companies**

**Unaudited Pro Forma Condensed Consolidated Statement of Operations**

For the Year Ended December 31, 2007

| | Historical | Pro Forma Adjustments | Pro Forma |
|---|---|---|---|
| | (in thousands, except per share data) | | |
| Operating revenues | $ 2,214,215 | $ | $ 2,214,215 |
| Operating expenses | | | |
| Operation and maintenance | 1,246,479 | 2,441(A) | 1,248,920 |
| Depreciation and amortization | 267,335 | | 267,335 |
| General taxes | 183,253 | | 183,253 |
| Loss (gain) on sale of assets | (7,326) | | (7,326) |
| Impairment charges | 509,345 | | 509,345 |
| Total operating expenses, net | 2,199,086 | 2,441 | 2,201,527 |
| Operating income (loss) | 15,129 | (2,441) | 12,688 |
| Other income (deductions) | | | |
| Interest | (283,165) | 4,532(B) | (274,995) |
| | | 4,116(C) | |
| | | (478)(D) | |
| Amortization of debt expense | (4,867) | (741)(B) | (5,608) |
| Other, net | 17,384 | | 17,384 |
| Total other income (deductions) | (270,648) | 7,429 | (263,219) |
| Income (loss) from continuing operations before income taxes | (255,519) | 4,988 | (250,531) |
| Provision for income taxes | 86,756 | 1,973(E) | 88,729 |
| Income (loss) from continuing operations | $ (342,275) | $ 3,015 | $ (339,260) |
| Unaudited pro forma earnings per share: | | | |
| Basic | $ (2.14) | | $ (2.12) |
| Diluted | $ (2.14) | | $ (2.12) |
| Weighted average shares used in calculating earnings per share: | | | |
| Basic | 160,000 | | 160,000 |
| Diluted | 160,000(F) | | 160,000 |

See accompanying notes to the Unaudited Pro Forma Condensed Consolidated Financial Statements.

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**American Water Works Company, Inc. and Subsidiary Companies**

**Unaudited Pro Forma Condensed Consolidated Statement of Operations**

For the Nine Months Ended September 30, 2008

| | Historical | Pro Forma Adjustments | Pro Forma |
|---|---|---|---|
| | (in thousands, except per share data) | | |
| Operating revenues | $ 1,768,377 | $ | $ 1,768,377 |
| Operating expenses | | | |
| Operation and maintenance | 984,063 | (1,565)(A) | 982,498 |
| Depreciation and amortization | 199,599 | | 199,599 |
| General taxes | 151,074 | | 151,074 |
| Loss (gain) on sale of assets | (413) | | (413) |
| Impairment charges | 750,000 | | 750,000 |
| Total operating expenses, net | 2,084,323 | (1,565) | 2,082,758 |
| Operating income (loss) | (315,946) | 1,565 | (314,381) |
| Other income (deductions) | | | |
| Interest | (212,718) | (6,700)(B) | (219,418) |
| Amortization of debt expense | (4,360) | (148)(B) | (4,508) |
| Other, net | 17,808 | | 17,808 |
| Total other income (deductions) | (199,270) | (6,848) | (206,118) |
| Income (loss) from continuing operations before income taxes | (515,216) | (5,283) | (520,499) |
| Provision for income taxes | 83,612 | (2,090)(E) | 81,522 |
| Income (loss) from continuing operations | $ (598,828) | $ (3,193) | $ (602,021) |
| Unaudited pro forma earnings per share: | | | |
| Basic | $ (3.74) | | $ (3.76) |
| Diluted | $ (3.74) | | $ (3.76) |
| Weighted average shares used in calculating earnings per share: | | | |
| Basic | 159,960 | | 159,960 |
| Diluted | 159,960(F) | | 159,960 |

See accompanying notes to the Unaudited Pro Forma Condensed Consolidated Financial Statements.

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**American Water Works Company, Inc. and Subsidiary Companies**

**Unaudited Pro Forma Condensed Consolidated Balance Sheet**

As of September 30, 2008

| | Historical | Pro Forma Adjustments | Pro Forma |
|---|---|---|---|
| | (in thousands, except per share data) | | |
| ASSETS | | | |
| Property, plant and equipment | | | |
| Utility plant at original cost, net of accumulated depreciation | $ 9,742,671 | $ | $ 9,742,671 |
| Nonutility property, net of accumulated depreciation | 128,920 | | 128,920 |
| Total property, plant and equipment | 9,871,591 | | 9,871,591 |
| Current assets | | | |
| Cash and cash equivalents | 6,689 | | 6,689 |
| Other current assets | 490,535 | | 490,535 |
| Total current assets | 497,224 | | 497,224 |
| Regulatory and other long-term assets | | | |
| Goodwill | 1,704,310 | | 1,704,310 |
| Other regulatory and other long-term assets | 707,607 | 5,901(G) | 713,508 |
| Total regulatory and other long-term assets | 2,411,917 | 5,901 | 2,417,818 |
| TOTAL ASSETS | $ 12,780,732 | $ 5,901 | $ 12,786,633 |
| CAPITALIZATION & LIABILITIES | | | |
| Capitalization | | | |
| Common stockholders equity | $ 4,162,357 | $ | $ 4,162,357 |
| Preferred stock without mandatory redemption requirements | 4,557 | | 4,557 |
| Long-term debt | | | |
| Long-term debt | 4,669,502 | 150,000(B) | 4,819,502 |
| Redeemable preferred stock at redemption value | 24,217 | | 24,217 |
| Total capitalization | 8,860,633 | 150,000 | 9,010,633 |
| Current liabilities | | | |
| Short-term debt and current portion of long-term debt | 423,021 | (144,099)(B) | 278,922 |
| Other current liabilities | 514,469 | | 514,469 |
| Total current liabilities | 937,490 | (144,099) | 793,391 |
| Total regulatory and other long-term liabilities | 2,104,311 | | 2,104,311 |
| Contributions in aid of construction | 878,298 | | 878,298 |
| TOTAL CAPITALIZATION AND LIABILITIES | $ 12,780,732 | $ 5,901 | $ 12,786,633 |

See accompanying notes to the Unaudited Pro Forma Condensed Consolidated Financial Statements.

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**American Water Works Company, Inc. and Subsidiary Companies**

**Notes to the Unaudited Pro Forma Condensed Consolidated Financial Statements**

Explanatory Note: On September 28, 2007, Thames US Holdings was merged with and into American Water, with American Water as the surviving entity. American Water was an indirect wholly-owned subsidiary of RWE until its initial public offering in April 2008. The historical consolidated financial statements of American Water represent the consolidated results of the Company, formerly issued under the name Thames Water Aqua US Holdings, Inc. and Subsidiary Companies.

(A) Reflects the granting of 2,077,814 unvested stock options, 269,254 restricted stock units and 89,921 restricted stock awards to our employees in connection with the initial public offering. The awards were issued under the American Water 2007 Omnibus Equity Compensation Plan and were recorded as equity awards. The restricted stock units and stock options vest over the 3-year periods commencing January 1, 2007 and 2008 and approximately 566,562 unvested stock options and 71,852 restricted stock units are expected to vest over the three-year periods based on our assessment of the probability of achieving performance conditions. The 89,921 restricted stock awards vested over a three-month period which commenced with the pricing of our initial public offering.

(B) The sources and uses of funds in connection with the Transactions and the related impact on interest expense related to the Transactions are summarized below, which are defined and further discussed elsewhere in this prospectus.

| | Principal | Rate | Interest Expense 12 Months | Interest Expense 9 Months(2) (in thousands) | Debt Expense Amortization 12 Months | Debt Expense Amortization 9 Months(2) |
|---|---|---|---|---|---|---|
| SOURCES: | | | | | | |
| RWE redemption notes(1) | $ 1,750,000 | 5.72% | $ 88,022 | $ | $ | $ |
| New senior notes(1) | 1,500,000 | 6.34% | 77,140 | | | |
| Commercial paper(1) | 415,000 | 5.31% | 22,036 | | | |
| RWE cash equity contribution(1) | 266,000 | | | | | |
| RWE cash equity contribution(3) | 245,000 | | | | | |
| Excess cash(1) | 49,026 | | | | | |
| Existing senior monthly notes(1) | 75,000 | 10% | 7,500 | 5,625 | | |
| Notes offered hereby(4) | 75,000 | 8.25% | 6,188 | 4,641 | | |
| Total sources | $ 4,375,026 | | $ 200,886 | $ 10,266 | $ | |
| USES: | | | | | | |
| Redeemable preferred stock(1) | $ 1,750,000 | | $ (74,569) | $ | $ | $ |
| RWE redemption notes(1) | 1,750,000 | | (100,100) | | | |
| RWE notes(1) | 202,370 | | (9,100) | | | |
| Commercial paper(1) | 266,000 | | (13,738) | | | |
| Short-term debt(4)(1) | 144,099 | | (7,911) | (3,566) | | |
| Financing costs | 17,557 | | | | 741 | 148 |
| Working capital(3) | 245,000 | | | | | |
| Total used | $ 4,375,026 | | $ (205,418) | $ (3,566) | $ 741 | $ 148 |
| Net increase (decrease) | | | $ (4,532) | $ 6,700 | $ 741 | $ 148 |

(1)

The issuance of $1,750.0 million of RWE redemption notes on September 20, 2007 was used to fund the early redemption of $1,750.0 million of preferred stock held by RWE. The RWE redemption notes were repaid early with $1,286.0 million of the proceeds of the new senior notes, $415.0 million of commercial paper and $49.0 million of excess cash. $202.4 million of the proceeds of the new senior notes were used to

fund the repayment of $206.0 million (including after tax gains of $2.2 million, net of $1.4 million of tax) of RWE notes. The cash equity contribution to the Company by RWE of $266.0 million on December 21, 2007 was used to pay down commercial paper. The issuance of $75.0 million of existing senior monthly notes was used to repay short-term debt.

(2) No interest and amortization expense adjustment is required for transactions that occurred prior to January 1, 2008 as the impact of the transaction is already reflected in the unaudited historical consolidated statement of operations of American Water for the nine months ended September 30, 2008.

(3) The $245.0 million Equity Contribution by RWE to the Company on May 13, 2008 was used to fund working capital.

(4) The issuance and sale of 8.25% notes due 2038 through this offering with gross proceeds of $75.0 million, net of an estimated $2.9 million of issuance costs to fund the repayment of $72.1 million of short-term debt.

(C) Reflects the non-cash equity contribution to the Company by RWE of $100.0 million of debt of our subsidiaries held by RWE and the $550.0 million of cash equity contribution to the Company by RWE on March 29, 2007. The cash was used to pay down $232.5 million of short-term debt with the remainder used for general working capital purposes.

The resulting reduction in interest expense is computed as follows:

| | RWE Notes | Commercial Paper | Total |
|---|---|---|---|
| Principal redemption | $ 100,000 | $ 232,500 | $ 332,500 |
| Calculated effective rate | 4.00% | 5.44% | |
| Reduction in interest expense for the year ended December 31, 2007 | $ 989 | $ 3,127(1) | $ 4,116 |

(1) Reflects actual interest accrued from January 1, 2007 to March 27, 2007.

(D) Reflects the amortization of the $8.6 million gain on the early extinguishment of RWE notes, which was recorded as a long-term regulatory liability, over the lives of the debt tranches that were repaid.

(E) Represents the reduction in income tax expense resulting from the Transactions at the estimated blended tax rate of 39.6%.

(F) The weighted average number of shares of common stock used to compute pro forma diluted earnings per share is based on the number of shares of our common stock plus the potential dilution that could occur if options and restricted stock units granted under the American Water 2007 Omnibus Equity Compensation Plan were exercised or converted into common stock. There are no dilutive incremental shares of common stock included in the calculation of pro forma diluted earnings per share, as the potentially dilutive instruments would be antidilutive.

(G) Estimated issuance costs of $5.9 million associated with the notes and the existing senior monthly notes have been reflected as other assets and will be amortized over the term of the notes and the existing senior monthly notes.

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**SELECTED HISTORICAL CONSOLIDATED FINANCIAL DATA**

The following table presents our selected historical consolidated financial data at the dates and for the periods indicated. The statement of operations data for the years ended December 31, 2005, 2006 and 2007 and the balance sheet data as of December 31, 2006 and 2007 have been derived from our audited consolidated financial statements included elsewhere in this prospectus. The historical financial data as of December 31, 2005 have been derived from our audited consolidated financial statements not included in this prospectus. The statement of operations for the years ended December 31, 2003 and 2004, and the financial data as of December 31, 2003 and 2004 have been derived from our historical financial statements, in each case, which are not included in this prospectus. The statement of operations data for the nine months ended September 30, 2007 and 2008 and the balance sheet dated as of September 30, 2008 have been derived from our unaudited historical consolidated financial statements and the notes to those statements included elsewhere in this prospectus, which have been prepared on a basis consistent with our annual consolidated financial statements. In the opinion of management, such unaudited financial data reflects all adjustments, consisting only of normal and recurring adjustments, necessary for fair presentation of the results for those periods. The results of operations for the nine months ended September 30, 2008 are not necessarily indicative of the results to be expected for the full year or any future period.

Our historical consolidated financial data are not necessarily indicative of our future performance or what our financial position and results of operations would have been if we had operated as a separate, stand-alone entity during the periods shown. This financial data should be read in conjunction with, and is qualified in its entirety by reference to, the information in the sections of this prospectus entitled Summary Historical Consolidated and Unaudited Pro Forma Financial Data, Use of Proceeds, Capitalization, Unaudited Pro Forma Condensed Consolidated Financial Information, Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the notes thereto included elsewhere in this prospectus.

| | For the Years Ended December 31, | | | | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|---|---|---|
| | 2003 (unaudited) | 2004 | 2005 | 2006 | 2007 | 2007 (unaudited) | 2008 (unaudited) |
| | (in thousands, except per share data) | | | | | | |
| **Statement of operations data(1):** | | | | | | | |
| Operating revenues | $ 1,890,291 | $ 2,017,871 | $ 2,136,746 | $ 2,093,067 | $ 2,214,215 | $ 1,660,394 | $ 1,768,377 |
| Operating expenses | | | | | | | |
| Operation and maintenance | 1,089,071 | 1,121,970 | 1,201,566 | 1,174,544 | 1,246,479 | 910,304 | 984,063 |
| Depreciation and amortization | 210,588 | 225,260 | 261,364 | 259,181 | 267,335 | 202,463 | 199,599 |
| General taxes | 164,677 | 170,165 | 183,324 | 185,065 | 183,253 | 140,910 | 151,074 |
| Loss (gain) on sale of assets(2) | (16,771) | (8,611) | (6,517) | 79 | (7,326) | (6,821) | (413) |
| Impairment charges | 3,555 | 78,688 | 385,434 | 221,685 | 509,345 | 243,345 | 750,000 |
| Total operating expenses, net | 1,451,120 | 1,587,472 | 2,025,171 | 1,840,554 | 2,199,086 | 1,490,201 | 2,084,323 |
| Operating income (loss) | 439,171 | 430,399 | 111,575 | 252,513 | 15,129 | 170,193 | (315,946) |
| Other income (deductions) | | | | | | | |
| Interest | (280,501) | (315,944) | (345,257) | (365,970) | (283,165) | (211,709) | (212,718) |
| Amortization of debt expense | (3,872) | (3,377) | (4,367) | (5,062) | (4,867) | (3,624) | (4,360) |
| Other, net(3) | (52,387) | 14,350 | 13,898 | 9,581 | 17,384 | 11,532 | 17,808 |
| Total other income (deductions) | (336,760) | (304,971) | (335,726) | (361,451) | (270,648) | (203,801) | (199,270) |
| Income (loss) from continuing operations before income taxes | 102,411 | 125,428 | (224,151) | (108,938) | (255,519) | (33,608) | (515,216) |
| Provision for income taxes | 60,271 | 66,328 | 50,979 | 46,912 | 86,756 | 74,095 | 83,612 |
| Income (loss) from continuing operations | $ 42,140 | $ 59,100 | $ (275,130) | $ (155,850) | $ (342,275) | $ (107,703) | $ (598,828) |
| Income (loss) from continuing operations per basic common share(4) | $ 0.26 | $ 0.37 | $ (1.72) | $ (0.97) | $ (2.14) | $ (0.67) | $ (3.74) |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Income (loss) from continuing operations per diluted common share(4) | $ 0.26 | $ 0.37 | $ (1.72) | $ (0.97) | $ (2.14) | $ (0.67) | $ (3.74) |
| Basic weighted average common shares(4) | 160,000 | 160,000 | 160,000 | 160,000 | 160,000 | 160,000 | 159,960 |
| Diluted weighted average common shares(4) | 160,000 | 160,000 | 160,000 | 160,000 | 160,000 | 160,000 | 159,960 |

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| | For the Years Ended December 31, | | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2007 (unaudited) | 2008 (unaudited) |
| | | | (in thousands) | | |
| **Other data:** | | | | | |
| Cash flows provided by (used in): | | | | | |
| Operating activities | $ 525,435 | $ 323,748 | $ 473,712 | $ 329,913 | $ 392,913 |
| Investing activities | (530,165) | (691,438) | (746,578) | (482,950) | (723,574) |
| Financing activities | (9,049) | 332,367 | 256,593 | 274,542 | 323,869 |
| Construction expenditures | (558,446) | (688,843) | (758,569) | (507,237) | (714,559) |

| | As of December 31, | | | | | As of September 30, |
|---|---|---|---|---|---|---|
| | 2003 (unaudited) | 2004 | 2005 | 2006 | 2007 | 2008 (unaudited) |
| | | | (in thousands) | | | |
| **Balance sheet data:** | | | | | | |
| Cash and cash equivalents | $ 71,097 | $ 78,856 | $ 65,077 | $ 29,754 | $ 13,481 | $ 6,689 |
| Utility plant and property, net of depreciation | 7,377,195 | 7,754,434 | 8,101,769 | 8,605,341 | 9,199,909 | 9,742,671 |
| Total assets | 12,629,354 | 12,728,410 | 12,542,029 | 12,783,059 | 12,934,072 | 12,780,732 |
| Other short-term and long-term debt | 5,063,344 | 5,101,891 | 5,030,078 | 4,103,532 | 4,991,806 | 5,092,523 |
| Redeemable preferred stock | 1,787,777 | 1,775,224 | 1,774,691 | 1,774,475 | 24,296 | 24,217 |
| Total debt | 6,851,121 | 6,877,115 | 6,804,769 | 5,878,007 | 5,016,102 | 5,116,740 |
| Common stockholders equity | 3,198,144 | 3,129,555 | 2,804,716 | 3,817,397 | 4,542,046 | 4,162,357 |
| Preferred stock without mandatory redemption requirements | 5,687 | 4,651 | 4,571 | 4,568 | 4,568 | 4,557 |

(1) On September 28, 2007, Thames US Holdings was merged with and into American Water, with American Water as the surviving entity. American Water was an indirect wholly-owned subsidiary of RWE until its initial public offering in April 2008. The historical consolidated financial statements of American Water represent the consolidated results of the Company, formerly issued under the name Thames Water Aqua US Holdings, Inc. and Subsidiary Companies.

(2) Represents primarily losses (gains) on sales of publicly traded securities and dispositions of assets not needed in utility operations.

(3) Includes allowance for other funds used during construction, allowance for borrowed funds used during construction and preferred dividends of subsidiaries.

(4) The number of shares used to compute income (loss) from continuing operations per basic common share and income (loss) from continuing operations per diluted common share for the fiscal years ended December 31, 2005, 2006 and 2007 and for the nine months ended September 30, 2007 is 160.0 million after giving effect to the 160,000-for-1 stock split on November 7, 2007. For the nine months ended September 30, 2008, the number of shares used to compute loss from continuing operations per basic common share and loss from continuing operations per diluted common share is 160.0 million. For the nine months ended September 30, 2008 there are no dilutive incremental common shares included in diluted earnings per share as all potentially dilutive instruments would be antidilutive.

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**MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL**

**CONDITION AND RESULTS OF OPERATIONS**

*The following discussion and analysis of our financial condition and results of operations covers periods prior to the consummation of our initial public offering and related transactions. Accordingly, the discussion and analysis of historical periods before our initial public offering and related transactions do not reflect the significant impact that these transactions have had or will have on us. You should read the following discussion together with the financial statements and the notes thereto included elsewhere in this prospectus. This discussion contains forward-looking statements that are based on management s current expectations, estimates and projections about our business and operations. The cautionary statements made in this prospectus should be read as applying to all related forward-looking statements whenever they appear in this prospectus. Our actual results may differ materially from those currently anticipated and expressed in such forward-looking statements as a result of a number of factors, including those we discuss under Risk Factors and elsewhere in this prospectus. You should read Risk Factors and Forward-Looking Statements. Certain 2007, 2006 and 2005 amounts have been reclassified within operations and maintenance expense to conform to the 2008 presentation.*

**Overview**

Founded in 1886, American Water is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our approximately 7,000 employees provide approximately 15 million people with drinking water, wastewater and other water-related services in 32 states and Ontario, Canada. In 2007, we generated $2,214.2 million in total operating revenue, representing approximately four times the operating revenue of the next largest investor-owned company in the United States water and wastewater business, and $15.1 million in operating income, which includes $509.3 million of impairment charges relating to continuing operations, and a net loss of $342.8 million. For the nine months ended September 30, 2008, we generated $1,768.4 million in total operating revenue, $315.9 million in operating loss, which includes $750.0 million of impairment charges, and a net loss of $598.8 million.

Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers. Our Regulated Businesses that provide these services are generally subject to economic regulation by state PUCs in the states in which they operate. The federal government and the states also regulate environmental, health and safety and water quality matters. Our Regulated Businesses currently provide services in 20 states and in 2007 served approximately 3.3 million customers, or connections to our water and wastewater networks. We report the results of this business in our Regulated Businesses segment. For the year ended December 31, 2007 and for the nine months ended September 30, 2008, our Regulated Businesses generated $1,987.6 million and $1,579.2 million, respectively, in operating revenue, prior to inter-segment eliminations, representing 89.8% and 89.3%, respectively, of our consolidated operating revenue.

We also provide services that are not subject to economic regulation by state PUCs. Our Non-Regulated Businesses include our:

- Contract Operations Group, which enters into public/private partnerships, including O&M and DBO contracts for the provision of services to water and wastewater facilities for municipalities, the United States military and other customers;
- Applied Water Management Group, which works with customers to design, build and operate small water and wastewater treatment plants; and
- Homeowner Services Group, which provides services to domestic homeowners to protect against the cost of repairing broken or leaking pipes inside and outside their homes.

We report the results of this business in our Non-Regulated Businesses segment. For the year ended December 31, 2007 and for the nine months ended September 30, 2008, our Non-Regulated Businesses generated $242.7 million and $202.1 million, respectively, in operating revenue, prior to inter-segment eliminations.

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*History*

Prior to being acquired by RWE in 2003, we were the largest publicly traded water utility company in the United States. In 2003, we were acquired by RWE and became a private company. Prior to the Merger, Thames US Holdings, formerly an indirect wholly-owned subsidiary of RWE, was the holding company for us and our regulated and unregulated subsidiaries throughout the United States and Ontario, Canada.

Our consolidated statements of operations for the years ended December 31, 2005 and 2006 reflect expense allocations for some central corporate functions historically provided to us by Thames Water Plc, a former subsidiary of RWE, which we refer to as Thames Water, including information systems, human resources, accounting and treasury activities and legal services. These allocations reflect expenses specifically identifiable as relating to our business as well as our share of expenses allocated to us based on capital employed, capital expenditures, headcount, revenues, production volumes, fixed costs, environmental accruals or other methods management considers to be reasonable. During our transition to a separate, stand-alone company, we have developed or obtained additional in-house capabilities related to these functions, and therefore there were no such expense allocations in 2007 from RWE or its affiliates. We and RWE consider these allocations to be a reasonable reflection of our utilization of the services provided by Thames Water. However, our expenses as a separate, stand-alone company may be higher or lower than the amounts reflected in our consolidated statements of operations.

The RWE acquisition resulted in certain changes in our business. For example, our operations and management were managed through Thames Water. Also, we agreed not to file rate cases with some state PUCs for specified periods of time as a condition of the acquisition. As of December 31, 2007, all rate stay-out provisions associated with the RWE acquisition had expired.

As a result of significantly increased costs, our inability to file rate cases and impairment charges, we recorded net losses in the amount of $325.0 million, $162.2 million and $342.8 million for the years ended December 31, 2005, 2006, and 2007, respectively.

In 2005, RWE decided to divest American Water. In March 2006, RWE decided to divest American Water through the sale of shares in one or more public offerings. In order to become a public company once again, we have had to incur substantial initial costs, including costs associated with ensuring adequate internal control over financial reporting in order to achieve compliance with the Sarbanes-Oxley Act. These substantial initial costs will not be recovered in rates charged to our customers. See Our Internal Control and Remediation Initiatives.

We performed valuations of our long-lived assets, investments and goodwill, as of December 31, 2005, 2006 and 2007. As a result of the valuation analyses, we recorded pre-tax charges of $420.4 million and $227.8 million, including impairment charges from discontinued operations, for the years ended December 31, 2005 and 2006, respectively. During the third quarter of 2007, as a result of our debt being placed on review for a possible downgrade and the anticipated sale of a portion of the Company in the initial public offering, an interim impairment test was performed, and a pre-tax impairment charge to goodwill of $243.3 million was recorded in the third quarter of 2007. We completed our annual impairment test for 2007 and recorded an additional pre-tax goodwill impairment charge to the Regulated Businesses reporting unit in the amount of $266.0 million during the fourth quarter of 2007. We determined that an impairment to goodwill had occurred based upon new information regarding our market value. We incorporated this indicated market value into our valuation methodology and, based on those results, an additional pre-tax impairment to our carrying value was recorded. As a result of these impairments, net income was reduced by $388.6 million, $223.6 million and $501.5 million in 2005, 2006 and 2007, respectively.

In our initial public offering, RWE Aqua Holdings GmbH, the selling stockholder, sold approximately 63.2 million shares of the Company s common stock. The Company did not receive any proceeds from the sale of the shares. RWE currently owns approximately 60% of the Company s shares of common stock.

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As of March 31, 2008, in light of the initial public offering price and trading levels in our common stock subsequent to the date of the initial public offering, the Company performed an interim impairment test and, on May 9, 2008, management concluded that the carrying value of the Company s goodwill was impaired. The Company believed that the initial public offering price was indicative of the value of the Company at March 31, 2008, and accordingly, based on those factors recorded an impairment charge to the goodwill of its Regulated reporting unit in the amount of $750.0 million as of March 31, 2008. The impairment charge was primarily attributed to the market price of the Company s common stock (both the initial public offering price and the price during subsequent trading) being less than the estimate of the initial public offering price used during the 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company s debt (due to increased market interest rates). As a result of the impairment charge, RWE Aqua Holdings GmbH (a wholly-owned subsidiary of RWE) transferred $245.0 million to the Company on May 13, 2008. This cash was used to reduce short-term debt. RWE is not obligated to make any additional capital contributions.

The Company has completed its November 30, 2008 annual impairment review and does not believe that the Company s goodwill balance was impaired. Annual impairment reviews are performed at November 30 of each year. The Company may be required to recognize an impairment of goodwill in the future (including as of December 31, 2008) due to market conditions or other factors related to the Company s performance. These market events could include a decline over a period of time of the Company s stock price, a decline over a period of time in valuation multiples of comparable water utilities, the lack of an increase in the Company s market price consistent with its peer companies, or decreases in control premiums and the overhang effect. A decline in the forecasted results in our business plan, such as changes in rate case results or capital investment budgets or changes in our interest rates, could also result in an impairment charge. Recognition of impairments of a significant portion of goodwill would negatively affect the Company s reported results of operations and total capitalization, the effect of which could be material and could make it more difficult to secure financing on attractive terms, maintain compliance with debt covenants and meet expectations of our regulators.

*Our Internal Control and Remediation Initiatives*

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. However, from 2003 to April 28, 2008, we were an indirect wholly-owned subsidiary of RWE and, as a privately owned company, were not required to maintain a system of effective internal control consistent with those reported upon by management in compliance with the requirements of the SEC and the Sarbanes-Oxley Act, nor to prepare our own consolidated financial statements. As a public reporting company, we are required, among other things, to maintain a system of effective internal control over financial reporting suitable to prepare our publicly reported financial statements in a timely and accurate manner, and also to evaluate and report on such system of internal control. In particular, we are required to certify our compliance with Section 404 of the Sarbanes-Oxley Act for the year ended December 31, 2009, which will require us to perform system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting.

In connection with the preparation of our consolidated financial statements as of December 31, 2006, we and our independent registered public accountants identified the following material weaknesses in our internal control over financial reporting:

- Inadequate internal staffing and skills;
- Inadequate controls over financial reporting processes;
- Inadequate controls over month-end closing processes, including account reconciliations;
- Inadequate controls over maintenance of contracts and agreements;

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- Inadequate controls over segregation of duties and restriction of access to key accounting applications; and
- Inadequate controls over tax accounting and accruals.

Since joining the Company in 2006, Donald L. Correll, our Chief Executive Officer, and Ellen C. Wolf, our Chief Financial Officer, have assigned a high priority to the evaluation and remediation of our internal controls, and have taken numerous steps to remediate these material weaknesses and to evaluate and strengthen our other internal controls over financial reporting. Some of the actions taken include:

- Increasing our internal financial staff numbers and skill levels, and using external resources to supplement our internal staff when necessary;
- Implementing detailed processes and procedures related to our period-end financial closing processes, key accounting applications and our financial reporting processes;
- Implementing or enhancing systems used in the financial reporting processes and month-end close processes;
- Conducting extensive training on existing and newly developed processes and procedures as well as explaining to employees Sarbanes-Oxley Act requirements and the value of internal controls;
- Enhancing our internal audit staff;
- Hiring a director of internal control and a director of taxes during 2007;
- Implementing a tracking mechanism and new policy and procedure for approval of all contracts and agreements; and
- Retaining a nationally recognized accounting and auditing firm to assist management in developing policies and procedures surrounding internal controls over financial reporting, to evaluate and test these internal controls and to assist in the remediation of internal control deficiencies.

With respect to the material weaknesses described above, we have formulated remediation plans, which we believe address the areas of material weakness, and tested the effectiveness of controls designed to address certain material weaknesses. Based on these actions and the length of time we believe that certain controls have been operating effectively, as of September 30, 2008, we no longer consider the following control deficiencies to be material weaknesses:

- Inadequate internal staffing and skills; and
- Inadequate controls over month-end closing processes, including account reconciliations.

While we believe that remediation procedures related to the identified material weaknesses are substantially complete, our testing procedures have not yet been fully completed. Therefore, we can make no assurances as to the success of our remediation efforts.

As of September 30, 2008, the Company had incurred $57.8 million to remediate these material weaknesses and to document and test key financial reporting controls. During the fourth quarter of 2008, we completed our remediation procedures related to the identified material

weaknesses, spending an additional estimated $0.4 million. At this time, the Company cannot indicate with certainty that all deficiencies, including material weaknesses, have been remediated or what additional costs may need to be incurred. The Company needs to complete the testing of the effectiveness of controls prior to concluding that all controls are effective. As a condition to state PUC approval of the RWE Divestiture, we agreed that costs incurred in connection with our initial internal control and remediation initiatives would not be recoverable in rates charged to our customers.

Elements of our remediation activities can only be accomplished over time, and our initiatives provide no assurances that they will result in an effective internal control environment. Our board of directors, in coordination with our audit committee, will continually assess the progress and sufficiency of these initiatives and make adjustments, as necessary.

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The Company believes the additional control procedures as designed, when implemented, will fully remediate the material weaknesses described above.

**Factors Affecting Our Results of Operations**

As the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served, our financial condition and results of operations are influenced by a variety of industry-wide factors, including the following:

- economic utility regulation;
- the need for infrastructure investment;
- compliance with environmental, health and safety standards;
- production costs;
- customer growth;
- an overall trend of declining water usage per customer; and
- weather and seasonality.

Since our acquisition by RWE in 2003, our results of operations have also been significantly influenced by goodwill impairments.

Factors that may affect the results of operations of our Regulated Businesses operating performance are mitigated by state PUCs granting us appropriate rate relief that is designed to allow us to recover prudently incurred expenses and to earn an appropriate rate of return on our investment.

*Economic Utility Regulation*

Our subsidiaries in the states in which we operate our Regulated Businesses are generally subject to extensive economic regulation by their respective state PUCs. Although specific authority might differ from state to state, in most states, these state PUCs must approve rates, accounting treatments, long-term financing programs, significant capital expenditures and plant additions, transactions between the regulated subsidiary and affiliated entities, reorganizations and mergers and acquisitions, in many instances prior to their completion. Regulatory policies not only vary from state to state, they may change over time. These policies will affect the timing as well as the extent of recovery of expenses and the realized return on invested capital.

Our operating revenue is typically determined by reference to the volume of water supplied to a customer multiplied by a price-per-gallon set by a tariff approved by the relevant state PUC. The process to obtain approval for a change in rates, or rate case, involves filing a petition with the state PUC on a periodic basis as determined by our capital expenditures needs and our operating costs. Rate cases and other rate-related proceedings can take several months to a year or more to complete. Therefore, there is frequently a delay, or regulatory lag, between the time one of our regulated subsidiaries makes a capital investment or incurs an operating expense increase and when those costs are reflected in rates. The management team at each of our regulated subsidiaries works to minimize regulatory lag.

Our results of operations are significantly affected by rates authorized by the state PUCs in the states in which we operate, and we are subject to risks and uncertainties associated with rate stay-outs and delayed or inadequate rate recovery. In addition to general rate case filings, we generate revenues through other cost recovery procedures. For example, some states in which we operate allow utility subsidiaries to recover system

infrastructure replacement costs without the necessity of filing a full rate proceeding. Since infrastructure replacement is a significant element of capital expenditures made by our subsidiaries, such programs can reduce regulatory lag.

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Currently, Pennsylvania, Illinois, Missouri, Indiana, New York, California and Ohio have allowed the use of these infrastructure surcharges. These surcharges adjust periodically based on qualified capital expenditures being completed or anticipated in a future period. These surcharges are typically reset to zero when new base rates are effective and incorporate the costs of these infrastructure expenditures. As of January 15, 2009, we have been granted an additional $18.0 million in revenues, assuming constant sales volumes, from such surcharges in several of our states. Furthermore, we were granted a $0.6 million increase for an arsenic surcharge in our Arizona subsidiary, allowing recovery for costs associated with the construction and operation of arsenic treatment facilities.

Also, some of the states in which we operate permit pass-through provisions that allow for an increase in certain operating costs, such as purchased power and property taxes, to be passed on to and recovered from the customers outside of a general rate proceeding.

Some states have permitted use of some form of forecast or forward-looking test year instead of historical data to set rates. Examples of these states include Hawaii, Illinois, Kentucky, Ohio, Pennsylvania, New York, Tennessee and California. In addition, a number of states in which we operate have allowed the utility to update historical data for some changes that occur for some limited period of time subsequent to the historical test year. This allows the utility to take account of some more current costs or capital investments in the rate-setting process. Examples of these states include New Mexico, Texas, Missouri, Iowa, Virginia, Maryland, West Virginia, New Jersey and Arizona.

Another regulatory mechanism to address issues of regulatory lag includes the ability, in some circumstances, to recover in rates a return on utility plant before it is actually in service, instead of capitalizing an allowance for funds used during construction. Examples of states that have allowed such recovery include Texas, Pennsylvania, Ohio, Kentucky, Virginia and California.

The infrastructure surcharge, pass-through provisions, the forward-looking test year and the allowance of a return on utility plant before it is actually in service are examples of mechanisms that present an opportunity to limit the risks associated with regulatory lag. We employ each of these mechanisms as part of our rate case management program to ensure efficient recovery of our costs and investment and to ensure positive short-term liquidity and long-term profitability.

In addition, some states have permitted us to seek pre-approval of certain capital projects and associated costs. In this pre-approval process, the PUCs assess the prudency of such projects.

As a condition to our acquisition by RWE in 2003, we agreed not to file rate cases in some of the states where our Regulated Businesses operate. All rate stay-out provisions associated with the RWE acquisition have expired. In 2008 we received authorizations for additional annualized revenues from general rate cases of $187.7 million. We are awaiting the final order for Hawaii s general rate case that was filed in 2007, requesting $1.3 million in total additional annual revenues. In October 2008, The Hawaii Public Utility Commission approved on an interim basis an increase in additional annualized revenues of $0.7 million. The interim rates were effective for the fourth quarter of 2008. Also, at this time, we are awaiting final orders in six states, for general rate cases filed in 2008, requesting additional annualized revenues of $102.7 million. There is no assurance that the filed amount, or any portion thereof, of any requested increases will be granted.

*Infrastructure Investment*

The water and wastewater utility industry is highly capital intensive. In 2007, we invested $758.6 million in net Company-funded capital improvements, and we invested approximately $1.0 billion in net capital improvements in 2008. From 2009 to 2013, we estimate that Company-funded capital investment will total between $4.0 and $4.5 billion. We anticipate spending between $790 million and $1.0 billion yearly on Company-funded capital investment for the foreseeable future, depending upon the timing of major capital projects. Our capital investment includes both infrastructure renewal programs, where we replace existing infrastructure, as needed, and construction of facilities to meet new customer growth. From 2009 to 2013, we

estimate we will invest approximately $1.5 billion to replace aging infrastructure including mains, meters, and supply and treatment facilities. We estimate that we will invest approximately $1.4 billion in facilities to serve new customer growth over this same period. In addition, we estimate that complying with water quality standards and other regulatory requirements will require approximately $400 million of investment. Projects to enhance system reliability, quality of service and risk reduction are estimated to require an investment of approximately $900 million while efficiency related projects are estimated to require an investment of approximately $300 million over this same period.

These capital investments are needed on an ongoing basis to comply with existing and new regulations, renew aging treatment and network assets, provide capacity for new growth and enhance system reliability, security and quality of service. The need for continuous investment presents a challenge due to the potential for regulatory lag, or the delay in recovering our operating expenses and earning an appropriate rate of return on our invested capital and a return of our invested capital. Because the decisions of state PUCs and the timing of those decisions can have a significant impact on the operations and earnings of our Regulated Businesses, we maintain a rate case management program guided by the goals of obtaining efficient recovery of costs of capital and utility operation and maintenance costs, including costs incurred for compliance with environmental, health and safety and water quality regulation. As discussed above under Economic Utility Regulation, we pursue methods to minimize the adverse impact of regulatory lag and have worked with state PUCs and legislatures to implement a number of approaches to achieve this result, including promoting the implementation of forms of forward-looking test years and infrastructure surcharges.

*Compliance with Environmental, Health and Safety Standards*

Our water and wastewater operations are subject to extensive United States federal, state and local and, in the case of our Canadian operations, Canadian laws and regulations, governing the protection of the environment, health and safety, the quality of the water we deliver to our customers, water allocation rights, and the manner in which we collect, treat, discharge and dispose of wastewater. These requirements include the Safe Drinking Water Act, the Clean Water Act and similar state and Canadian laws and regulations. We are also required to obtain various environmental permits from regulatory agencies for our operations. State PUCs also set conditions and standards for the water and wastewater services we deliver. We incur substantial costs associated with compliance with environmental, health and safety and water quality regulation to which our Regulated Businesses are subject.

Environmental, health and safety and water quality regulations are complex and change frequently, and the overall trend has been that they have become more stringent over time. We face the risk that as newer or stricter standards are introduced, they could increase our operating expenses. In the past, we have generally been able to recover expenses associated with compliance for environmental, health and safety standards, but this recovery is affected by regulatory lag and the corresponding uncertainties surrounding rate recovery.

*Production Costs*

Our water and wastewater services require significant production inputs and result in significant production costs. These costs include fuel and power, which is used to operate pumps and other equipment, purchased water and chemicals used to treat water and wastewater. We also incur production costs for waste disposal. For 2007, production costs accounted for approximately 12.6% of our total operating costs. Price increases associated with these inputs impact our results of operations until rate relief is granted.

*Customer Growth*

Customer growth in our Regulated Businesses is driven by (i) organic population growth within our authorized service areas and (ii) by adding new customers to our regulated customer base by acquiring water and wastewater utility systems through acquisitions. Generally, we add customers through tuck-ins of small water and/or

wastewater systems, typically serving fewer than 10,000 customers, in close geographic proximity to where we currently operate our Regulated Businesses. We also seek large acquisitions that allow us to acquire multiple water and wastewater utility systems in our existing markets and markets where we currently do not operate our Regulated Businesses. During 2005, 2006 and 2007, we had cash outflows of $5.0 million, $12.5 million and $15.9 million, respectively, for acquisitions of water and wastewater systems which allowed us to expand our regulated customer base. Our most recent significant acquisition was the 2002 purchase of the water and wastewater assets of Citizens Communications Company, adding approximately 300,000 customers in six states in which we had existing operations. We intend to continue to expand our regulated footprint geographically by acquiring water and wastewater systems in our existing markets and some markets in the United States where we do not currently operate our Regulated Businesses. Our experienced development team evaluates potential acquisition targets across the country, particularly in higher-growth areas. Before entering new markets, we will evaluate the regulatory environment to ensure that we will have the opportunity to achieve an appropriate return on our investment while maintaining our high standards for quality, reliability and compliance with environmental, health and safety and water quality standards. These acquisitions may include large acquisitions of companies that have operations in multiple markets. For further information, see Business Acquisitions.

*Declining Water Usage Per Customer*

Increased water conservation, including through the use of more efficient household fixtures and appliances among residential consumers, combined with declining household sizes in the United States, has contributed to a trend of declining water usage per residential customer.

The average annual change in residential water usage per customer from January 1998 through December 2007 (as a percentage of January 1998 usage) in the larger states served by our Regulated Businesses ranged from 0.66% per year in New Jersey at the low end to as high as 1.63% per year in West Virginia.

Because the characteristics of residential water use are driven by many factors, including socio-economic and other demographic characteristics of our service areas, climate, seasonal weather patterns and water rates, these declining trends vary by state and service area and change over time. The trend of declining residential water usage per customer is higher in the predominantly rural states served by our Regulated Businesses. We do not believe that the trend in any particular state or region will have a disproportionate impact on our results of operations.

Our Regulated Businesses are heavily dependent upon operating revenue generated from rates we charge to our residential customers for the volume of water they use. Declining usage will have a negative impact on our long-term operating revenues if we are unable to secure rate increases or to grow our residential customer base to the extent necessary to offset the residential usage decline.

*Water Supply*

Our ability to meet the existing and future water demands of our customers depends on an adequate supply of water. Drought, governmental restrictions, overuse of sources of water, the protection of threatened species or habitats or other factors may limit the availability of ground and surface water. Also, customer usage of water is affected by weather conditions, in particular during the summer. Our water systems experience higher demand in the summer due to the warmer temperatures and increased usage by customers for lawn irrigation and other outdoor uses. Summer weather that is cooler and wetter than average generally serves to suppress customer water demand, and can have a downward effect on our operating revenue and operating income. Conversely, when weather conditions are extremely dry and even if our water supplies are sufficient to serve our customers, our systems may be affected by drought-related warnings and/or water usage restrictions imposed by governmental agencies, purchase supply allocation and mandatory conservation measures. All of the above conditions serve to reduce customer demand and operating revenues. These restrictions may be imposed at a regional or state level and may affect our service areas regardless of our readiness to meet unrestricted customer demands. We employ

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a variety of measures to ensure that we have adequate sources of water supply, both in the short-term and over the long-term. For additional detail concerning these measures, see Business Our Regulated Businesses Overview of Networks, Facilities and Water Supply.

The geographic diversity of our service areas tends to mitigate some of the effect of weather extremes. In any given summer, some areas are likely to experience drier than average weather while other areas will experience wetter than average weather.

*Goodwill Impairment*

The Company s annual impairment reviews are performed as of November 30 of each year, in conjunction with the timing of the completion of the Company s annual strategic business plan. At November 30, 2008, the Company s goodwill was $1,704.3 million. The Company also undertakes interim reviews 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 uses a two-step impairment test to identify potential goodwill impairment and measure the amount of a goodwill impairment loss to be recognized (if any) in accordance with SFAS No. 142. The step 1 calculation used to identify potential impairment compares the calculated fair value for each of the Company s reporting units to their respective net carrying values (book values), including goodwill, on the measurement date. If the fair value of any reporting unit is less than such reporting unit s carrying value, then step 2 is performed to measure the amount of the impairment loss (if any) for such reporting unit.

The step 2 calculation of the impairment test compares, by reporting unit, the implied fair value of the goodwill to the carrying value of goodwill. The implied fair value of goodwill is equal to the excess of the fair value of each reporting unit above the fair value of such reporting unit s identified assets and liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill for any reporting unit, an impairment loss is recognized in an amount equal to the excess (not to exceed the carrying value of goodwill) for that reporting unit.

The determination of the fair value of each reporting unit and the fair value of each reporting unit s assets and liabilities is performed as of the measurement date using observable market data before and after the measurement date (if that subsequent information is relevant to the fair value on the measurement date).

For the November 30, 2008 impairment test, the estimated fair value of the regulated reporting unit for step 1 was based on a combination of the following valuation techniques:

- observable trading prices of comparable equity securities of publicly-traded water utilities considered by us to be the Company s peers; and

- discounted cash flow models developed from the Company s internal forecasts.

The estimated fair values of the non-regulated reporting units were determined entirely on the basis of discounted cash flow models.

The first valuation technique applies average peer multiples to the Regulated reporting unit s historic and forecasted cash flows. The peer multiples are calculated using the average trading prices of comparable equity securities of publicly-traded water utilities, their published cash flows and forecasts of market price and cash flows for those peers.

The second valuation technique forecasts each reporting unit s five-year cash flows using an estimated long-term growth rate and discounts those cash flows at their respective estimated weighted average cost of capital.

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If step 2 of the impairment test is required, the Company determines the fair value of the applicable reporting unit s assets and liabilities. The fair values for the majority of such assets and liabilities are equal to their carrying values; however, the fair values of the applicable debt are highly dependent upon market conditions surrounding the measurement date. For the step 2 calculations of the fair value of debt, the Company uses observable prices of instruments and indices that have risks similar to those instruments being valued, adjusted to compensate for differences in credit profile, collateral, tax treatment and call features, to calculate the fair value of each reporting unit s debt.

The Company has completed its November 30, 2008 annual impairment review and does not believe that the Company s goodwill balance was impaired. However, there can be no assurances that the Company will not be required to recognize an impairment of goodwill in the future (including as of December 31, 2008) due to market conditions or other factors related to the Company s performance. These market events could include a decline over a period of time of the Company s stock price, a decline over a period of time in valuation multiples of comparable water utilities, the lack of an increase in the Company s market price consistent with its peer companies, or decreases in control premiums and the overhang effect. A decline in the forecasted results in our business plan, such as changes in rate case results or capital investment budgets or changes in our interest rates, could also result in an impairment charge. Recognition of impairments of a significant portion of goodwill would negatively affect the Company s reported results of operations and total capitalization, the effect of which could be material and could make it more difficult to secure financing on attractive terms, maintain compliance with debt covenants and meet expectations of our regulators.

In making the determination, we considered both qualitative and quantitative factors, including the effect of the recent volatility in the equity and debt markets on the Company s market capitalization.

In reaching our conclusion, we also made certain assumptions, which we believe to be appropriate, that support the fair value of our reporting units. We considered, in addition to the listed trading price of the Company s shares, the effect on that price due to RWE s majority ownership, the effect of RWE s expected disposition of its owned Company shares on the market for those shares, the applicability of a control premium to our shares and certain other factors we deemed appropriate. As a result, we concluded that the Company s fair value exceeds what we might otherwise have concluded had we relied on market price alone.

In addition, given recent market conditions, management determined that it was appropriate for the Company to consider the average of the Company s closing market price over a thirty day period rather than using a particular date to calculate its market capitalization. The Company s calculated market capitalization within its 2008 impairment test period was approximately $940.0 million below the aggregate carrying value of its reporting units.

The difference between our calculated market capitalization and the aggregate fair value of our reporting units (which approximates book value) resulted from the estimated control premium and the estimated impact to the Company s market capitalization from the overhang created by RWE s announced plans to divest a substantial portion of its ownership through further public offerings of stock.

The estimated control premium represents the incremental premium a buyer is willing to pay to acquire a controlling, majority interest in the Company. In estimating the control premium, management principally considered the current market conditions and historical premiums paid in utility acquisitions observed in the marketplace.

The estimated stock overhang represents the impact on the Company s share price that we believe results from investor concerns over market price dilution due to the anticipated increase in the number of the Company s publicly traded shares caused by the anticipated RWE sale of the Company s stock. As a condition of certain state regulator approvals for RWE s sale of the Company, RWE had agreed to sell 100% of its holdings of Company stock by April 2010 and previously announced its intentions to reduce its interest to below 50% prior to the end of 2008. Management estimated the impact of this overhang condition using reports from multiple analysts covering the Company s stock and other available market information.

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The determination of our estimated fair value required the exercise of judgment and is highly sensitive to our assumptions. Our estimated fair values approximate the carrying value of reporting units leaving little estimated value in excess of the required threshold of the step 1 test. Had the fair value been less than the carrying value of the reporting units, differences between the carrying value and fair value of our long-term debt (which is not taken into account in step 1 but is required in step 2) would have increased any impairment charge indicated by step 1 by an estimated $300 million, due to accounting guidance that must be followed to measure the implied fair value of goodwill.

For the years ended December 31, 2008, 2007 and 2006, the Company recorded impairment charges for goodwill, including discontinued operations, in the amount of $750.0 million, $509.3 million and $227.8 million, respectively.

As of March 31, 2008, in light of the initial public offering price and trading levels in our common stock subsequent to the date of the initial public offering, the Company performed an interim impairment test and, on May 9, 2008, management concluded that the carrying value of the Company s goodwill was impaired. The Company believed that the initial public offering price was indicative of the value of the Company at March 31, 2008, and accordingly, based on those factors recorded an impairment charge to the goodwill of its Regulated reporting unit in the amount of $750.0 million as of March 31, 2008. The impairment charge was primarily attributed to the market price of the Company s common stock (both the initial public offering price and the price during subsequent trading) being less than the estimate of the initial public offering price used during the 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company s debt (due to increased market interest rates). As a result of the impairment charge, RWE Aqua Holdings GmbH (a wholly-owned subsidiary of RWE) transferred $245.0 million to the Company on May 13, 2008. This cash was used to reduce short-term debt. RWE is not obligated to make any additional capital contributions.

During the third quarter of 2007, as a result of the Company s debt being placed on review for a possible downgrade and the proposed sale of a portion of the Company in the initial public offering, management determined at that time it was appropriate to update its valuation analysis before the next scheduled annual test. Based on this assessment, the Company performed an interim impairment test and recorded an impairment charge to goodwill related to its Regulated reporting unit in the amount of $243.3 million as of September 30, 2007. The decline was primarily due to a slightly lower long-term earnings forecast caused by updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery.

The Company completed its scheduled annual impairment test in the fourth quarter of 2007 and determined that an impairment had occurred based upon information regarding the Company s market value in connection with the initial public offering. Management determined that the indicative fair value of the Company based on estimates of the initial public offering price range was the best evidence of the Company s market value and incorporated this indicated market value into the Company s valuation methodology, which also considered other items, such as peer multiples, discounted cash flows and a control premium. Based on the results of the impairment test, an impairment of $266.0 million to the Company s carrying value was recognized as of December 31, 2007.

The 2006 impairment charge was attributable to higher interest rates in the Regulated reporting unit and a change in the potential net realizable value of a non-regulated reporting unit.

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**Results of Operations**

The following table sets forth our consolidated statement of operations data for the years ended December 31, 2005, 2006 and 2007 and for the nine months ended September 30, 2007 and 2008:

| | For the Years Ended December 31, | | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2007 | 2008 |
| | (in thousands, except per share data) | | | | |
| Operating revenues | $ 2,136,746 | $ 2,093,067 | $ 2,214,215 | $ 1,660,394 | $ 1,768,377 |
| Operating expenses: | | | | | |
| Operation and maintenance | 1,201,566 | 1,174,544 | 1,246,479 | 910,304 | 984,063 |
| Depreciation and amortization | 261,364 | 259,181 | 267,335 | 202,463 | 199,599 |
| General taxes | 183,324 | 185,065 | 183,253 | 140,910 | 151,074 |
| Loss (gain) on sale of assets | (6,517) | 79 | (7,326) | (6,821) | (413) |
| Impairment charges | 385,434 | 221,685 | 509,345 | 243,345 | 750,000 |
| Total operating expenses, net | 2,025,171 | 1,840,554 | 2,199,086 | 1,490,201 | 2,084,323 |
| Operating income (loss) | 111,575 | 252,513 | 15,129 | 170,193 | (315,946) |
| Other income (deductions): | | | | | |
| Interest | (345,257) | (365,970) | (283,165) | (211,709) | (212,718) |
| Allowance for other funds used during construction | 5,810 | 5,980 | 7,759 | 5,197 | 10,370 |
| Allowance for borrowed funds used during construction | 2,420 | 2,652 | 3,449 | 2,358 | 6,063 |
| Amortization of debt expense | (4,367) | (5,062) | (4,867) | (3,624) | (4,360) |
| Preferred dividends of subsidiaries | (227) | (215) | (225) | (169) | (169) |
| Other, net | 5,895 | 1,164 | 6,401 | 4,146 | 1,544 |
| Total other income (deductions) | (335,726) | (361,451) | (270,648) | (203,801) | (199,270) |
| Income (loss) from continuing operations before income taxes | (224,151) | (108,938) | (255,519) | (33,608) | (515,216) |
| Provision for income taxes | 50,979 | 46,912 | 86,756 | 74,095 | 83,612 |
| Income (loss) from continuing operations | (275,130) | (155,850) | (342,275) | (107,703) | (598,828) |
| Income (loss) from discontinued operations, net of tax | (49,910) | (6,393) | (551) | (551) | |
| Net income (loss) | $ (325,040) | $ (162,243) | $ (342,826) | $ (108,254) | $ (598,828) |
| Net income (loss) per common share: | | | | | |
| Basic | | | | | |
| Income (loss) from continuing operations | $ (1.72) | $ (0.97) | $ (2.14) | $ (0.67) | $ (3.74) |
| Income (loss) from discontinued operations, net of tax | $ (0.31) | $ (0.04) | $ (0.00) | $ (0.00) | $ |
| Net income (loss) | $ (2.03) | $ (1.01) | $ (2.14) | $ (0.68) | $ (3.74) |
| Diluted | | | | | |
| Income (loss) from continuing operations | $ (1.72) | $ (0.97) | $ (2.14) | $ (0.67) | $ (3.74) |
| Income (loss) discontinued operations, net of tax | $ (0.31) | $ (0.04) | $ (0.00) | $ (0.00) | $ |
| Net income (loss) | $ (2.03) | $ (1.01) | $ (2.14) | $ (0.68) | $ (3.74) |
| Average common shares outstanding during the period: | | | | | |
| Basic | 160,000 | 160,000 | 160,000 | 160,000 | 159,960 |
| Diluted | 160,000 | 160,000 | 160,000 | 160,000 | 159,960 |

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The following table summarizes certain financial information for our Regulated and Non-Regulated Businesses for the periods indicated (without giving effect to inter-segment eliminations):

| | For the Years Ended December 31, | | | | | | For the Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2005 | | 2006 | | 2007 | | 2007 | | 2008 | |
| | Regulated Businesses | Non-Regulated Businesses | Regulated Businesses | Non-Regulated Businesses | Regulated Businesses | Non-Regulated Businesses | Regulated Businesses | Non-Regulated Businesses | Regulated Businesses | Non-Regulated Businesses |
| | | | (in thousands) | | | | (unaudited) | (unaudited) | (unaudited) | (unaudited) |
| Operating revenues | $ 1,836,061 | $ 310,771 | $ 1,854,618 | $ 248,451 | $ 1,987,565 | $ 242,678 | $ 1,499,763 | $ 175,172 | $ 1,579,214 | $ 202,080 |
| Adjusted EBIT(1) | $ 469,921 | $ (106) | $ 468,701 | $ (4,725) | $ 500,088 | $ 23,579 | $ 394,601 | $ 17,606 | $ 411,076 | $ 16,358 |

(1) Adjusted EBIT is defined as earnings before interest and income taxes from continuing operations. Management evaluates the performance of its segments and allocates resources based on several factors, of which the primary measure is Adjusted EBIT. Adjusted EBIT does not represent cash flows for periods presented and should not be considered as an alternative to cash flows as a source of liquidity. Adjusted EBIT as defined by the Company may not be comparable with Adjusted EBIT as defined by other companies.

Our primary business involves the ownership of water and wastewater utilities that provide services to residential, commercial and industrial customers. As such, our results of operations are significantly impacted by rates authorized by the state regulatory commissions in the states in which we operate. The table below details the annualized revenues, including step increases resulting from rate authorizations and infrastructure charges, which were granted in 2005, 2006 and 2007 and the nine months ended September 30, 2008.

| | Annualized Rate Increases Granted During the | | | |
|---|---|---|---|---|
| | Years Ended December 31, | | | Nine Months Ended September 30, |
| | 2005 | 2006 | 2007 | 2008 |
| **State** | | | | |
| New Jersey | $ | $ | $ 56.2 | $ |
| Pennsylvania | 5.8 | 8.0 | 40.6 | 4.6 |
| Missouri | | 6.8 | 24.0 | 2.7 |
| Illinois | | 0.9 | 1.7 | 22.7 |
| Indiana | 0.9 | 1.8 | 14.0 | 3.9 |
| California | 8.4 | 15.1 | 0.5 | 13.0 |
| West Virginia | 10.0 | | | 14.5 |
| New York | 7.8 | | | 6.6 |
| Arizona | | 7.9 | 3.7 | 8.6 |
| Other | 2.1 | 0.8 | 18.2 | 9.6 |
| Total | $ 35.0 | $ 41.3 | $ 158.9 | $ 86.2 |

The change in annualized rate increases granted between 2006 and 2007 can be attributed to the removal of the stay-out provisions and increased investment in our regulated infrastructure programs.

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***Comparison of Results of Operations for the Nine Months Ended September 30, 2008 and 2007***

***Operating revenues.*** Our operating revenues increased by $108.0 million, or 6.5%, for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. Regulated Businesses revenues increased by $79.5 million, or 5.3%, for the nine months ended September 30, 2008 compared to the same period in the prior year. The Non-Regulated Businesses revenues for the nine months ended September 30, 2008 increased by $26.9 million, or 15.4%, compared to the nine months ended September 30, 2007.

The increase in the Regulated Businesses revenues for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 was primarily due to rate increases obtained through general rate cases in New Jersey, Pennsylvania, Missouri and Indiana (which were granted and became effective in 2007) as well as other states totaling approximately $95.1 million and a $1.4 million retroactive rate adjustment in California made in June 2008. This increase was offset by a $25.0 million decrease in revenues related to lower customer consumption, mainly in our states in the Midwestern region of the United States, for the nine months ended September 30, 2008 compared to the same period in the prior year.

Non-Regulated Businesses operating revenues increased by $26.9 million, or 15.4%, for the nine months ended September 30, 2008 compared to the same period in 2007. The net increase was primarily attributable to higher revenues of $28.6 million in our Contract Operations Group and $5.6 million in our Homeowner Services Group, partially offset by decreased revenues of $6.8 million and $0.7 million in our Applied Water Management Group and Canadian Fixed Residuals, respectively. The increase in Contract Operations Group revenues was primarily attributable to incremental revenues associated with design and build contracts, as well as increased military construction and O&M project revenues. The increase from our Homeowner Service Group represented increased product penetration within its existing customer base. Applied Water Management Group revenues were lower due to the decline in design and build activity resulting from the downturn in new home construction.

The following table sets forth the percentage of Regulated Businesses revenues and water sales volume by customer class:

| | For the Nine Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2007 | 2008 | 2007 | 2008 |
| | Operating Revenues | | Water Sales Volume | |
| **Customer Class** | | | | |
| Water service: | | | | |
| Residential | 57.9% | 57.9% | 53.0% | 53.0% |
| Commercial | 19.4% | 19.3% | 21.9% | 22.1% |
| Industrial | 4.8% | 5.0% | 10.5% | 10.5% |
| Public and other | 12.3% | 12.1% | 14.6% | 14.4% |
| Other water revenues | 1.8% | 2.0% | | |
| Total water revenues | 96.2% | 96.3% | 100.0% | 100.0% |
| Wastewater service | 3.8% | 3.7% | | |
| | 100.0% | 100.0% | | |

*Water Services* Water service operating revenues from residential customers for the nine months ended September 30, 2008 totaled $913.1 million, a $44.3 million increase, or 5.1%, over the same period of 2007, mainly due to rate increases offset by a decrease in sales volume. The volume of water sold to residential customers decreased by 3.5% for the nine months ended September 30, 2008 to 162.3 billion gallons, from 168.2 billion gallons for the same period in 2007, largely as a result of wetter weather conditions in California and the Midwestern region in the United States.

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Water service operating revenues from commercial water customers for the nine months ended September 30, 2008 increased by $14.3 million, or 4.