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AMERICAN WATER WORKS CO INC

Form 10-Q

August 14, 2002

CONFORMED COPY

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2002

OR

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

For the transition period from to

Commission File Number 1-3437-2

AMERICAN WATER WORKS COMPANY, INC.

(Exact name of registrant as specified in its charter)

Delaware 51-0063696

(State or other jurisdiction of (IRS Employer Identification No.)
incorporation or organization)

1025 Laurel Oak Road, Voorhees, New Jersey 08043

(Address of principal executive offices) (Zip Code)

(856) 346-8200

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since
last report)

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

At August 1, 2002, the number of shares of common stock, \$1.25 par value,
outstanding was 100,061,238 shares.

PART I FINANCIAL INFORMATION

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Item 1. Financial Statements

AMERICAN WATER WORKS COMPANY, INC. AND SUBSIDIARY COMPANIES

Consolidated Statements of Income and Comprehensive Income and of Retained Earnings (Unaudited) (In thousands, except per share amounts)

| | Three Months Ended June 30, | |
|----------------------------------------------------------|--------------------------------|-----------|
| | 2002 | 2001 |
| CONSOLIDATED INCOME AND COMPREHENSIVE INCOME | | |
| Operating revenues | \$424,014 | \$363,878 |
| Operating expenses | | |
| Operation and maintenance | 222,299 | 160,476 |
| Depreciation and amortization | 58,233 | 45,069 |
| General taxes | 35,474 | 32,465 |
| Total operating expenses | 316,006 | 238,010 |
| Operating income | 108,008 | 125,868 |
| Other income (deductions) | | |
| Interest | (57,011) | (48,544) |
| Allowance for other funds used during construction | 1,911 | 1,185 |
| Allowance for borrowed funds used during construction | 1,144 | 1,088 |
| Amortization of debt expense | (718) | (710) |
| Preferred dividends of subsidiaries | (695) | (742) |
| Merger expenses | (786) | - |
| Gain from sale of operating systems | 50,709 | - |
| Gain on sale of other investments | 22,466 | 3,367 |
| Loss on write down of other investments | (10,764) | - |
| Gain on sale of land | 15,851 | - |
| Other, net | 951 | (301) |
| Total other income (deductions) | 23,058 | (44,657) |
| Income before income taxes | 131,066 | 81,211 |
| Provision for income taxes | 64,401 | 31,830 |
| Net income | 66,665 | 49,381 |
| Dividends on preferred stocks | - | 146 |
| Net income to common stock | 66,665 | 49,235 |

Three Months Ended
June 30,
2002 2001

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| | | |
|-----------------------------------------------------------------------|-----------|-----------|
| Other comprehensive income (loss), net of tax | | |
| Unrealized loss on securities | (5,536) | (2,463) |
| Reclassification adjustment for gain (loss) included in net income | 5,837 | (2,052) |
| Foreign currency translation adjustment | 699 | - |
| | ----- | ----- |
| Other comprehensive income (loss), net of tax | 1,000 | (4,515) |
| | ----- | ----- |
| Comprehensive income | \$ 67,665 | \$ 44,720 |
| | ===== | ===== |

| | | |
|--------------------------------------------------|---------|--------|
| Average shares of basic common stock outstanding | 100,034 | 99,256 |
|--------------------------------------------------|---------|--------|

Earnings per average common share outstanding

| | | |
|---------|--------|--------|
| Basic | \$.67 | \$.50 |
| | ===== | ===== |
| Diluted | \$.66 | \$.50 |
| | ===== | ===== |

CONSOLIDATED RETAINED EARNINGS

| | | |
|----------------------------------------------------------------------|-------------|-------------|
| Balance at April 1 | \$1,130,988 | \$1,069,927 |
| Add - net income | 66,665 | 49,381 |
| Gain on treasury stock | - | 406 |
| | ----- | ----- |
| | 1,197,653 | 1,119,714 |
| | ----- | ----- |
| Deduct - dividends paid | | |
| Preferred stock | - | 32 |
| Preference stock | - | 114 |
| Common stock - \$.245 per share in 2002; \$.235 per share in 2001 | 24,508 | 23,297 |
| | ----- | ----- |
| | 24,508 | 23,443 |
| | ----- | ----- |
| Balance at June 30 | \$1,173,145 | \$1,096,271 |
| | ===== | ===== |

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

AMERICAN WATER WORKS COMPANY, INC. AND SUBSIDIARY COMPANIES

Consolidated Statements of Income and Comprehensive Income
and of Retained Earnings (Unaudited)
(In thousands, except per share amounts)

Six Months Ended
June 30,
2002 2001

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| | | |
|-------------------------------------------------------------------|-----------|-----------|
| | ----- | ----- |
| CONSOLIDATED INCOME AND COMPREHENSIVE INCOME | | |
| Operating revenues | \$808,754 | \$680,305 |
| | ----- | ----- |
| Operating expenses | | |
| Operation and maintenance | 431,551 | 311,299 |
| Depreciation and amortization | 113,260 | 89,429 |
| General taxes | 70,232 | 65,776 |
| | ----- | ----- |
| Total operating expenses | 615,043 | 466,504 |
| | ----- | ----- |
| Operating income | 193,711 | 213,801 |
| | ----- | ----- |
| Other income (deductions) | | |
| Interest | (114,423) | (97,141) |
| Allowance for other funds used during construction | 3,531 | 2,266 |
| Allowance for borrowed funds used during construction | 2,170 | 2,067 |
| Amortization of debt expense | (1,391) | (1,388) |
| Preferred dividends of subsidiaries | (1,408) | (1,525) |
| Merger expenses | (1,733) | - |
| Gain from sale of operating systems | 50,709 | - |
| Gain on sale of other investments | 22,466 | 3,367 |
| Loss on write down of other investments | (10,764) | - |
| Gain on sale of land | 15,851 | - |
| Other, net | 17 | (972) |
| | ----- | ----- |
| Total other income (deductions) | (34,975) | (93,326) |
| | ----- | ----- |
| Income before income taxes | 158,736 | 120,475 |
| Provision for income taxes | 76,858 | 47,633 |
| | ----- | ----- |
| Income before cumulative effect of change in accounting principle | 81,878 | 72,842 |
| Cumulative effect of change in accounting principle | 2,679 | - |
| | ----- | ----- |
| Net income | 84,557 | 72,842 |
| Dividends on preferred stocks | 146 | 292 |
| | ----- | ----- |
| Net income to common stock | 84,411 | 72,550 |
| | ----- | ----- |

| | | |
|--------------------------------------------------------------------|------------------|---------|
| | Six Months Ended | |
| | June 30, | |
| | 2002 | 2001 |
| | ----- | ----- |
| Other comprehensive income (loss), net of tax | | |
| Unrealized loss on securities | (8,462) | (4,457) |
| Reclassification adjustment for gain (loss) included in net income | 5,837 | (2,052) |
| Foreign currency translation adjustment | 1,407 | - |
| | ----- | ----- |
| Other comprehensive income (loss), net of tax | (1,218) | (6,509) |

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| | | |
|----------------------------------------------------------------------------|-------------|-------------|
| Comprehensive income | \$ 83,193 | \$ 66,041 |
| Average shares of basic common stock outstanding | 100,031 | 99,066 |
| Earnings per average common share outstanding | | |
| Income before cumulative effect of change in accounting principle | \$.81 | \$.73 |
| Cumulative effect of change in accounting principle | .03 | - |
| Basic | \$.84 | \$.73 |
| Income before cumulative effect of change in accounting principle | \$.81 | \$.73 |
| Cumulative effect of change in accounting principle | .03 | - |
| Diluted | \$.84 | \$.73 |
| CONSOLIDATED RETAINED EARNINGS | | |
| Balance at January 1 | \$1,137,772 | \$1,069,486 |
| Add - net income | 84,557 | 72,842 |
| Preferred stock redemption premium | (25) | - |
| Gain on treasury stock | - | 744 |
| | 1,222,304 | 1,143,072 |
| Deduct - dividends paid | | |
| Preferred stock | 32 | 64 |
| Preference stock | 114 | 228 |
| Common stock - \$.49 per share in 2002; | | |
| \$.47 per share in 2001 | 49,013 | 46,509 |
| | 49,159 | 46,801 |
| Balance at June 30 | \$1,173,145 | \$1,096,271 |
| The accompanying notes are an integral part of these financial statements. | | |

AMERICAN WATER WORKS COMPANY, INC. AND SUBSIDIARY COMPANIES

Consolidated Balance Sheet (Unaudited) (In thousands)

| | June 30, 2002 | December 31, 2001 |
|---------------------------------------|------------------|----------------------|
| ASSETS | | |
| Property, plant and equipment | | |
| Utility plant - at original cost less | | |

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| | | |
|-----------------------------------------------------------|--------------|--------------|
| accumulated depreciation | \$ 6,018,369 | \$ 5,458,909 |
| Utility plant acquisition adjustments, net | 214,568 | 68,916 |
| Non-utility property, net of accumulated depreciation | 98,297 | 94,149 |
| | ----- | ----- |
| Total property, plant and equipment | 6,331,234 | 5,621,974 |
| | ----- | ----- |
| Current assets | | |
| Cash and cash equivalents | 24,479 | 19,691 |
| Customer accounts receivable | 178,567 | 153,142 |
| Allowance for uncollectible accounts | (8,898) | (7,660) |
| Unbilled revenues | 101,380 | 86,065 |
| Miscellaneous receivables | 20,590 | 16,483 |
| Materials and supplies | 33,505 | 32,281 |
| Deferred vacation pay | 13,281 | 11,422 |
| Other | 27,583 | 19,164 |
| | ----- | ----- |
| Total current assets | 390,487 | 330,588 |
| | ----- | ----- |
| Regulatory and other long-term assets | | |
| Regulatory asset - income taxes recoverable through rates | 212,775 | 217,330 |
| Other investments | 23,927 | 39,956 |
| Debt and preferred stock expense | 47,882 | 45,882 |
| Deferred pension expense | 36,472 | 30,712 |
| Deferred postretirement benefit expense | 8,884 | 9,318 |
| Deferred security costs | 16,400 | 7,058 |
| Deferred business services project expenses | 40,742 | 36,311 |
| Deferred insurance expense | 9,335 | 4,998 |
| Deferred tank painting costs | 14,312 | 16,585 |
| Restricted funds | - | 8,570 |
| Goodwill | 219,133 | 136,488 |
| Intangible assets | 81,866 | 23,400 |
| Other | 91,483 | 77,929 |
| | ----- | ----- |
| Total regulatory and other long-term assets | 803,211 | 654,537 |
| | ----- | ----- |
| TOTAL ASSETS | \$ 7,524,932 | \$ 6,607,099 |
| | ===== | ===== |

| | | |
|----------------------------------------------------------------------------|------------------|----------------------|
| | June 30, 2002 | December 31, 2001 |
| | ----- | ----- |
| CAPITALIZATION AND LIABILITIES | | |
| Capitalization | | |
| Common stockholders' equity | \$ 1,792,412 | \$ 1,758,018 |
| Preferred stocks without mandatory redemption requirements | - | 11,673 |
| Preferred stocks of subsidiaries with mandatory redemption requirements | 28,620 | 30,474 |
| Preferred stocks of subsidiaries without mandatory redemption requirements | 6,708 | 7,268 |
| Long-term debt | | |
| American Water Works Company, Inc. | 216,000 | 297,000 |
| Subsidiaries | 3,164,321 | 2,253,019 |

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| | | | |
|--------------------------------------------------|--------------|--------------|-------|
| Total capitalization | 5,208,061 | 4,357,452 | |
| Current liabilities | | | |
| Short-term debt | 290,162 | 414,083 | |
| Current portion of long-term debt | 244,158 | 166,087 | |
| Accounts payable | 61,303 | 67,996 | |
| Taxes accrued, including federal income | 90,065 | 21,756 | |
| Interest accrued | 59,088 | 43,015 | |
| Accrued vacation pay | 13,468 | 11,577 | |
| Other | 110,292 | 100,220 | |
| Total current liabilities | 868,536 | 824,734 | |
| Regulatory and other long-term liabilities | | | |
| Advances for construction | 255,901 | 230,801 | |
| Deferred income taxes | 611,645 | 624,449 | |
| Deferred investment tax credits | 36,311 | 38,633 | |
| Accrued pension expense | 70,872 | 62,355 | |
| Accrued postretirement benefit expense | 13,964 | 13,808 | |
| Accrued insurance expense | 10,907 | | 5,020 |
| Other | 39,572 | 35,987 | |
| Total regulatory and other long-term liabilities | 1,039,172 | 1,011,053 | |
| Contributions in aid of construction | 409,163 | 413,860 | |
| Commitments and contingencies | -- | -- | |
| TOTAL CAPITALIZATION AND LIABILITIES | \$ 7,524,932 | \$ 6,607,099 | |

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

AMERICAN WATER WORKS COMPANY, INC. AND SUBSIDIARY COMPANIES

Consolidated Statement of Cash Flows (Unaudited)
(In thousands)

| | Six Months Ended June 30, | |
|-----------------------------------------------------|------------------------------|-----------|
| | 2002 | 2001 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$ 84,557 | \$ 72,842 |
| Adjustments | | |
| Depreciation and amortization | 113,260 | 89,429 |
| Cumulative effect of change in accounting principle | (2,679) | - |
| Gain from sale of operating systems | (50,709) | - |
| Gain on sale of other investments | (22,466) | (3,367) |
| Loss on write down of other investments | 10,764 | - |
| Gain on sale of land | (15,851) | - |

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| | | |
|---------------------------------------------------------------------|-----------|-----------|
| Provision for deferred income taxes | 11,169 | 6,255 |
| Provision for losses on accounts receivable | 6,231 | 4,555 |
| Allowance for other funds used during construction | (3,531) | (2,266) |
| Employee benefit expenses greater (less) than funding | 1,966 | (280) |
| Employee stock plan expenses | 2,087 | 2,192 |
| Deferred regulatory costs | (15,869) | (22,678) |
| Amortization of deferred charges | 10,405 | 7,344 |
| Other, net | (3,279) | (2,243) |
| Changes in assets and liabilities, net of effects from acquisitions | | |
| Accounts receivable | (26,217) | (12,889) |
| Unbilled revenues | (15,775) | (15,337) |
| Other current assets | (11,416) | (2,935) |
| Accounts payable | (9,609) | (14,712) |
| Taxes accrued, including federal income | 66,544 | 27,433 |
| Interest accrued | 17,607 | (134) |
| Other current liabilities | 10,365 | (8,437) |
| Net cash from operating activities | 157,554 | 124,772 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Construction expenditures | (198,025) | (153,488) |
| Allowance for other funds used during construction | 3,531 | 2,266 |
| Acquisitions | (883,064) | (54,173) |
| Proceeds from the sale of assets | 164,612 | 4,950 |
| Removal costs from property, plant and equipment retirements | (2,414) | (5,090) |
| Restricted funds | 8,570 | (247) |
| Net cash used in investing activities | (906,790) | (205,782) |

Six Months Ended

| | June 30, | |
|--------------------------------------------------------------|-----------|----------|
| | 2002 | 2001 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from long-term debt | 984,365 | 146,765 |
| Proceeds from common stock | 980 | 21,109 |
| Purchase of common stock for treasury | (36) | (386) |
| Net borrowings (repayments) under short-term debt agreements | (116,318) | 6,172 |
| Advances and contributions for construction, net of refunds | 16,147 | 12,936 |
| Debt issuance costs | (6,767) | (1,114) |
| Repayment of long-term debt | (62,445) | (66,530) |
| Redemption of preferred stocks | (12,743) | (1,940) |
| Dividends paid | (49,159) | (46,801) |
| Net cash from financing activities | 754,024 | 70,211 |
| Net increase(decrease) in cash and cash equivalents | 4,788 | (10,799) |
| Cash and cash equivalents at January 1 | 19,691 | 28,571 |

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| | | |
|--------------------------------------|-----------|-----------|
| | ----- | ----- |
| Cash and cash equivalents at June 30 | \$ 24,479 | \$ 17,772 |
| | ===== | ===== |

Common stock placed into treasury in connection with the Employees Stock Ownership Plan, the Savings Plan for Employees, and 2000 Stock Award and Incentive Plan totaled \$983 in 2002 and \$1,774 in 2001.

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

AMERICAN WATER WORKS COMPANY, INC. AND SUBSIDIARY COMPANIES

Information Accompanying Financial Statements (Unaudited)
(In thousands, except share and per share amounts)

| | | |
|------------------------------------------------------------|----------|--------------|
| | June 30, | December 31, |
| | 2002 | 2001 |
| | ----- | ----- |
| Preferred stocks without mandatory redemption requirements | | |
| (All shares redeemed March 1, 2002) | | |
| Cumulative preferred stock - \$25 par value | | |
| Authorized 1,770,000 shares | | |
| 5% series (one-tenth of a vote per share) | | |
| - 101,777 shares outstanding in 2001 | \$ -- | \$ 2,544 |
| Cumulative preference stock - \$25 par value | | |
| Authorized - 750,000 shares | | |
| 5% series (non-voting) - 365,158 shares | | |
| outstanding in 2001 | -- | 9,129 |
| Cumulative preferential stock - \$35 par value | | |
| Authorized - 3,000,000 shares | | |
| (one-tenth of a vote per share)- | | |
| no outstanding shares | -- | -- |
| | ----- | ----- |
| | \$ -- | \$ 11,673 |
| | ===== | ===== |

Common stockholders' equity
Common stock - \$1.25 par value

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| | | |
|-------------------------------------------------|-------------|-------------|
| Authorized - 300,000,000 shares | | |
| Issued - 100,062,186 shares in 2002; | | |
| 100,016,273 shares in 2001 | \$ 125,078 | \$ 125,020 |
| Paid-in capital | 490,131 | 489,868 |
| Retained earnings | 1,173,145 | 1,137,772 |
| Accumulated other comprehensive income | 4,740 | 5,958 |
| Unearned compensation | -- | (539) |
| Treasury stock at cost - 16,111 shares in 2002; | | |
| 1,891 shares in 2001 | (682) | (61) |
| | ----- | ----- |
| | \$1,792,412 | \$1,758,018 |
| | ===== | ===== |

At June 30, 2002, common shares reserved for issuance in connection with the Company's stock plans were 80,865,863 shares for the Stockholder Rights Plan, 1,641,852 shares for the Dividend Reinvestment and Stock Purchase Plan, 565,493 shares for the Employees' Stock Ownership Plan and 532,381 shares for the Savings Plan for Employees. Up to 4,234,367 shares of common stock may be issued under the 2000 Stock Award and Incentive Plan, of which approximately 3,300,000 shares were available to be granted at June 30, 2002.

AMERICAN WATER WORKS COMPANY, INC. AND SUBSIDIARY COMPANIES

Notes to Consolidated Financial Statements (Unaudited)

NOTE 1 -- Financial Statement Presentation

The information presented in this Form 10-Q is unaudited. In the opinion of management the information reported reflects all adjustments which were necessary to a fair statement of the results for the periods reported. Certain reclassifications have been made to conform previously reported data to the current presentation.

NOTE 2 -- Merger Agreement with RWE

On September 16, 2001 the Company entered into a merger agreement with RWE Aktiengesellschaft and Thames Water Aqua Holdings GmbH, which is RWE's holding company for its global water business, to merge with a subsidiary of RWE and become a wholly owned indirect subsidiary of RWE. Under the terms of the merger agreement RWE will purchase all the outstanding shares of American Water Works Company common stock at a price of \$46.00 per share in cash.

RWE is a global multi-utility company that does business through its subsidiaries and affiliates in over 120 countries. Its core businesses are electricity, gas, water, and waste and recycling. Upon completion of the transaction, American Water will be combined with the U.S. operations of Thames Water Plc, RWE's London-based international water services business. American Water will manage the joint operations in North, Central and South America.

The transaction was approved at a special meeting of the stockholders of

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American Water Works Company on January 17, 2002. Before the transaction can be completed, state and federal regulatory approvals are required. As of the end of January 2002, all of the applications for approval were filed where required by state regulatory authorities. The states where applications for approval have been filed are Arizona, California, Hawaii, Illinois, Kentucky, Maryland, New Jersey, New Mexico, New York, Pennsylvania, Tennessee, Virginia and West Virginia. The states of Georgia and Michigan do not regulate the Company's utility operations, and the states of Indiana, Iowa, Missouri, Ohio and Texas have no statutory jurisdiction over the RWE transaction. The Company is still awaiting approval in nine states. Those states are Arizona, California, Illinois, Maryland, New Jersey, New Mexico, New York, Pennsylvania and West Virginia. In Arizona hearings will be conducted in August and a final decision is anticipated during the early part of the fourth quarter of 2002. In California a schedule for processing the request has been issued by the Commission that could result in an Administrative Law Judge (ALJ) assigned to the case issuing a recommended decision no later than December 19, 2002. Once the ALJ's decision is issued there is a 25-day period for comments by the applicants and intervenors before the record is presented to the Commission for decision. In Illinois hearings have been completed and it is anticipated that a final decision will be issued by the end of the year. In Maryland hearing dates have not been established. In New Jersey hearings are scheduled to conclude during August and a final decision is anticipated early in the fourth quarter. In New Mexico the ALJ assigned to the case issued a decision that recommends approval of the acquisition with conditions, and a final decision from the Commission on the Judge's recommendation is anticipated during August. In New York the

labor union representing a portion of the Company's workforce has recommended that the Commission approve the acquisition, with a final decision from the Commission anticipated prior to the end of 2002. In Pennsylvania the ALJ assigned to the case issued a decision that recommends approval of the acquisition with conditions, and a final decision from the Commission on the Judge's recommendation is anticipated during August. In West Virginia an agreement has been reached among the parties that recommends approval of the acquisition and identifies conditions to be included in the order, and a final Commission decision regarding the agreement is anticipated during August. Since approving the transaction in May, the Kentucky Public Service Commission reaffirmed its decision and clarified some of the conditions set forth in its original order. Although the Indiana Public Utility Commission does not have statutory jurisdiction over the transaction, that Commission is conducting a review of the transaction that is anticipated to be concluded during September. The Company made a Hart-Scott-Rodino filing with the Federal Trade Commission in the second quarter of 2002 and the investigation period expired without additional inquiry. The Company continues to believe that the original projection for a closing to occur some time during the first six months of 2003 remains a reasonable expectation.

One condition of the agreement requires the Company to redeem its publicly traded preferred stock prior to closing. That redemption was completed on March 1, 2002.

During the first six months of 2002 the Company recorded a charge of \$1.7 million, reflecting costs incurred in connection with the merger. The merger related costs have been reported on a separate line in the consolidated statement of income and comprehensive income. No tax benefit was recognized for these legal fees because it is not probable that these costs will be deductible for tax purposes.

On November 6, 2001 the Company and its financing subsidiary, American

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Water Capital Corp.(AWCC), executed a Note Purchase Agreement with RWE for \$1.2 billion in senior unsecured notes at an interest rate of 4.92%. The notes were purchased at par by RWE and mature on November 6, 2006.

The Company and its subsidiaries used the proceeds from the sale of the notes to acquire the common stock of Azurix North America Corp. and Azurix Industrials Corp., to fund the acquisition of the water and wastewater assets of Citizens Communications Company and to reduce outstanding short-term debt. Closing occurred in two tranches with one on November 6, 2001 in the amount of \$298.5 million and another on January 14, 2002 in the amount of \$900 million.

On June 12, 2002 the Company and AWCC executed a Note Purchase Agreement with RWE for \$320 million in senior unsecured notes. The agreement calls for up to \$170 million in notes at an interest rate of 5.65% and \$150 million in notes at a floating interest rate based on LIBOR rates plus 20 basis points. Closing occurred on \$40 million of the 5.65% senior notes on June 12, 2002 and the Company expects closing of the remaining \$130 million of 5.65% notes to occur in the fourth quarter of 2002. The 5.65% notes and floating rate notes are due on June 12, 2007 and June 26, 2003, respectively. These notes will be primarily used to repay short-term debt.

NOTE 3 -- Acquisition Of Water And Wastewater Assets Of Citizens Communications Company

On January 15, 2002 the Company and its subsidiaries completed their acquisition of all of the water and wastewater assets of Citizens Communications Company (NYSE:CZN) for \$859 million in cash and \$120 million of assumed liabilities. A \$.8 million increase to the purchase price has been agreed upon after the substantial completion of an audited closing statement of net assets. The acquired operations provide water and wastewater service to almost 300,000 regulated customers in Arizona, California, Illinois, Indiana, Ohio and Pennsylvania. Citizens also had developed a water supply project in Illinois with the possibility of additional wholesale customers along the pipeline.

The Company is completing the determination of the amounts to be assigned to intangible assets and goodwill. At June 30, 2002, \$80.6 million and \$59.6 were recorded as goodwill and intangibles, respectively, in connection with this transaction. A value of \$54.3 million was assigned to intangible assets with an indefinite life, and \$5.3 million of value was assigned to intangible assets with lives from 15 to 21 years.

The purchase price for these assets was consistent with the multiples paid in other similar transactions. Regulatory and strategic considerations contributed to a purchase price that resulted in the recognition of goodwill. The assets reside in progressive regulatory environments where the Company currently operates and broadens the geographic diversity of the Company's total operations. The inclusion of the acquired customers in California and Arizona increases the Company's customers in the Western United States to 10% of its total customer base. With the acquisition, the Company becomes one of the principal water purveyors in the Phoenix area and strengthens its competitive position for the privatization opportunities in this rapidly growing region and the other states included in the acquisition footprint.

The unaudited pro forma results listed below were prepared as if the acquisition occurred on January 1, 2001 and include the historical results of the Company and of the acquired operations. The unaudited pro forma

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information is not necessarily indicative of the results of operations that might have occurred had the acquisition actually taken place on the date indicated, or of future results of operations of the combined entities:

| Three months ended June 30, | 2002 | 2001 | |
|-------------------------------------------------------------------|--------|-----------|-----------|
| Revenues | | \$424,014 | \$394,014 |
| Net income | | 66,672 | 46,450 |
| Earnings per average common share outstanding | | | |
| Basic | | \$.67 | \$.47 |
| Diluted | | \$.66 | \$.47 |
| Six months ended June 30, | 2002 | 2001 | |
| Revenues | | \$813,578 | \$734,200 |
| Income before cumulative effect of change in accounting principle | 80,439 | 65,276 | |
| Net income | | 83,118 | 65,276 |
| Earnings per average common share outstanding | | | |
| Income before cumulative effect of change in accounting principle | \$.80 | \$.66 | |
| Cumulative effect of change in accounting principle | | .03 | - |
| Basic | | .83 | \$.66 |
| Income before cumulative effect of change in accounting principle | \$.80 | \$.66 | |
| Cumulative effect of change in accounting principle | | .03 | - |
| Diluted | | .83 | .66 |

NOTE 4 -- Goodwill and Intangible Assets

Goodwill increased from \$136.5 million at December 31, 2001 to \$219.1 million at June 30, 2002, primarily due to goodwill associated with the Citizens acquisition that was completed on January 15, 2002. At June 30, 2002 \$103.3 million of the Company's goodwill was assigned to the regulated utility services segment and \$115.8 million was assigned to the unregulated services segment.

Intangible assets increased from \$23.4 million at December 31, 2001 to \$81.9 million at June 30, 2002, reflecting \$59.6 million of intangible assets acquired in the Citizens transaction. At June 30, 2002 \$59.5 million of the intangible assets were in the regulated utility services segment and \$22.4 million were in the unregulated services segment. Intangible assets with finite lives at June 30, 2002 consisted of \$5.3 million (\$5.2 million net) in the regulated utility services segment with lives from 15 to 21 years and \$23.4 million (\$22.4 million net) in the unregulated services segment with lives of 11 years.

NOTE 5 -- Other Investments

On April 2, 2002 the Company tendered approximately 2.2 million shares of its 3.5 million shares of ITC Holding Company (ITC) common stock. The Company tendered the shares as part of ITC's program to repurchase its own stock. The Company acquired this stock with the 1999 acquisition of National Enterprises Inc. (NEI) as it was part of NEI's non-water related investments. The sale resulted in proceeds of \$26.2 million, and a \$14 million after-tax gain which was reflected in second quarter 2002 results.

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This cash gain was offset by a \$10.8 million non-cash loss, \$6.7 million after tax, that was also recorded during the second quarter when the Company determined that the value of two other securities acquired as part of the NEI acquisition had become permanently impaired. The Company continues to review all reasonable options regarding the remaining securities that include 1.3 million shares of Deutsche Telekom and 1.3 million shares of ITC acquired as part of the NEI acquisition.

NOTE 6 -- Gain From Sale Of Operating Systems

Kelda Group plc and the Company jointly announced on August 30, 2001 that they had reached an agreement whereby Kelda's Aquarion Company would acquire the Company's New England operations. On April 25, 2002 the Company completed the divestiture and received its initial cash payment of \$120.5 million subject to the terms and conditions of the agreement. An \$18.6 million after-tax gain was reflected in second quarter 2002 results.

The utility operations acquired by Aquarion serve a total of 65,000 customers and had revenues of \$51 million in 2001. A finance subsidiary of the Company, which owns and leases certain assets to its affiliated operating company in Massachusetts, was also acquired by Aquarion as part of the transaction.

NOTE 7 -- Gain On Sale Of Land

Two of the Company's subsidiaries completed separate transactions for the sale of non-essential property that resulted in \$10 million in after-tax net gains during the second quarter of 2002. These sales resulted in proceeds of approximately \$16 million.

NOTE 8 -- Earnings Per Share

The average number of shares used to calculate diluted earnings per share includes 13,520 of potential common shares issuable in connection with the long-term incentive program for the three-month period ended June 30, 2001 and 259,534 and 145,483 potential common shares for employee stock options for the three-month periods ended June 30, 2002 and 2001, respectively.

The average number of shares used to calculate diluted earnings per share includes 8,128 of potential common shares issuable in connection with the long-term incentive program for the six-month period ended June 30, 2001 and 287,490 and 119,110 potential common shares for employee stock options for the six-month periods ended June 30, 2002 and 2001, respectively.

NOTE 9 -- Segment Information

The following table presents information about the Company's reportable segments.

Regulated
Utility
Services

Unregulated
Services

Other
Items

Consolidated

Three months ended June 30, 2002

Revenues from external
customers

\$370,085

\$ 53,929

\$ -

\$ 424,014

Intersegment revenues

-

2,098

(2,098)

-

Net income

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48,530
 1,508
 16,627
 66,665
 Net income excluding unusual
 items

42,859

 (2,676)

 (8,529)

 31,654

Three months ended June 30, 2001

Revenues from external
 customers

\$353,914

\$ 9,964

\$ -

\$ 363,878

Intersegment revenues

-

1,964

(1,964)

Net income

54,965

(624)

(4,960)

49,381

Net income excluding unusual
 items

54,965

(624)

(7,014)

47,327

Six months ended June 30, 2002

Revenues from external
 customers

\$708,446

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\$100,308

\$ -

\$ 808,754

Intersegment revenues

-

3,656

(3,656)

-

Income before cumulative
effect of change in
accounting principle

73,880

(552)

8,550

81,878

Net income

76,559

(552)

8,550

84,557

Net income excluding unusual
items

68,209

(4,736)

(15,659)

47,814

Total assets

7,204,634

330,450

(10,152)

7,524,932

Six months ended June 30, 2001

Revenues from external
customers

\$660,056

\$ 20,249

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-

\$ 680,305

Intersegment revenues

-

3,314

(3,314)

-

Income before cumulative
effect of change in
accounting principle

85,185

(1,365)

(10,978)

72,842

Net income

85,185

(1,365)

(10,978)

72,842

Net income excluding unusual
items

85,185

(1,365)

(13,032)

70,788

Total assets

6,176,579

101,193

11,806

6,289,578

The "other items" include corporate costs of American Water Works Company and intersegment eliminations. Total revenues are from United States of America (U.S.) operations except Unregulated Services Canadian revenues of \$13,983 and \$22,770 for the three and six months ended June 30, 2002, respectively. Total assets are from U.S. operations except Unregulated Services Canadian assets of \$63,603 at June 30, 2002. Unusual items include merger expenses, a gain on the sale of operating systems, gains from the sale of other investments, a loss on the write down of other investments, and gains on the sale of land.

NOTE 10 -- New Accounting Standards

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, "Business Combinations" (SFAS 141) and No. 142, "Goodwill and Other Intangible Assets" (SFAS 142), collectively referred to as the "Standards." SFAS 141 supersedes

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Accounting Principles Board Opinion (APB) No. 16, "Business Combinations." The provisions of SFAS 141 (1) require that the purchase method of accounting be used for all business combinations initiated after June 30, 2001, (2) provided specific criteria for the initial recognition and measurement of intangible assets apart from goodwill, and (3) require that unamortized negative goodwill be written off immediately as an extraordinary gain instead of being deferred and amortized. SFAS 141 also requires that upon adoption of SFAS 142 the Company reclassify the carrying amounts of certain intangible assets into or out of goodwill, based on certain criteria. SFAS 142 supersedes APB 17, "Intangible Assets," and is effective for fiscal years beginning after December 15, 2001. SFAS 142 primarily addresses the accounting for goodwill and intangible assets subsequent to their initial recognition. The provisions of SFAS 142 (1) prohibit the amortization of goodwill and indefinite-lived intangible assets, (2) require that goodwill and indefinite-lived intangible assets be tested annually for impairment (and in interim periods if certain events occur indicating that the carrying value of goodwill and/or indefinite-lived intangible assets may be impaired), (3) require that reporting units be identified for the purpose of assessing potential future impairments of goodwill, and (4) remove the forty-year limitation on the amortization period of intangible assets that have finite lives. The Company adopted the provisions of the Standards on January 1, 2002.

The Standards require the excess of the fair values of acquired net assets over cost recorded in the statement of financial position to be recognized as the effect of a change in accounting principle as of the date SFAS 141 is initially applied in its entirety. In compliance with this transition requirement the Company recognized a \$2.7 million gain on January 1, 2002.

During the second quarter of 2002 the Company completed the process of making the determinations as to what its reporting units are and what amounts of goodwill, intangible assets, other assets and liabilities should be allocated to those reporting units as of January 1, 2002. The reporting units were the 27 separate regulated utility subsidiaries (including the five New England subsidiaries that were sold on April 25, 2002) and unregulated services reporting units at American Water Resources and American Water Services. The Company's carrying value of goodwill at January 1, 2002 was \$139.2 million, of which \$23.4 million is assigned to various regulated subsidiaries and \$115.8 million is assigned to American Water Services. Intangible assets with an assigned value of \$23.4 million were management contracts at American Water Services that have a finite life.

A transitional impairment test for goodwill as of January 1, 2002 was completed by the Company in the second quarter of 2002. Income and market approaches were used for reporting unit valuations. The methodologies used to implement the market approach were the market multiples methodology, which results in an indication of value by comparing the business being valued to guideline publicly traded companies, and the

similar transactions methodology, which develops an indication of value based on prices paid for comparable business. The methodology used to implement the income approach was the capitalized income approach that bases the value of an asset on the future cash flows attributable to that asset. Based on these approaches the Company determined that goodwill is not currently impaired. The Company will perform required annual impairment tests in the fourth quarter after the long-term planning process has been completed.

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The Company is no longer recording \$1.7 million of annual tax deductible amortization relating to the goodwill associated with the 1999 acquisition of its joint venture partner's interest in AmericanAnglian Environmental Technologies. The remainder of the goodwill and intangible assets at January 1, 2002 were not being amortized because they are related to business combinations completed after the July 1, 2001 effective date of SFAS 141 or the goodwill was related to acquisitions that occurred prior to October 31, 1970 that was not being amortized because in the opinion of management there had been no diminution in value. The following table reflects consolidated results adjusted as though the adoption of the Standards occurred as of the beginning of the three and six-month periods ended June 30, 2001:

2002

2001

Three months ended June 30

| |
|--------------------------------|
| Reported net income |
| \$66,665 |
| \$49,381 |
| Add back goodwill amortization |
| - |
| 269 |
| Adjusted net income |
| \$66,665 |
| \$49,650 |

Basic earnings per share:

| |
|-----------------------|
| Reported net income |
| \$.67 |
| \$.50 |
| Goodwill amortization |
| - |
| - |
| Adjusted net income |
| \$.67 |
| \$.50 |

Diluted earnings per share:

| |
|-----------------------|
| Reported net income |
| \$.66 |
| \$.50 |
| Goodwill amortization |
| - |
| - |
| Adjusted net income |
| \$.66 |
| \$.50 |

Six months ended June 30

Reported income before cumulative

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effect of change in
accounting principle

\$81,878

\$72,842

Add back goodwill amortization

-

539

Adjusted income before cumulative
effect of change in accounting
principle

\$81,878

\$73,381

Reported net income

\$84,557

\$72,842

Add back goodwill amortization

-

539

Adjusted net income

\$84,557

\$73,381

Basic earnings per share:

Income before cumulative effect
of change in accounting
principle

\$.81

\$.73

Cumulative effect of change in
accounting principle

.03

-

As reported

.84

.73

Goodwill amortization

-

.01

Adjusted

\$.84

\$.74

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Diluted earnings per share:

| | |
|----------------------------------------------------------------------|--|
| Income before cumulative effect of change in accounting principle | |
| \$.81 | |
| \$.73 | |
| Cumulative effect of change in accounting principle | |
| .03 | |
| - | |
| As reported | |
| .84 | |
| .73 | |
| Goodwill amortization | |
| - | |
| .01 | |
| Adjusted | |
| \$.84 | |
| \$.74 | |

In June of 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations," (SFAS 143) on the accounting for obligations associated with the retirement of long-lived assets. SFAS 143 requires a liability to be recognized in the financial statements for retirement obligations meeting specific criteria. Measurement of the initial obligation is to approximate fair value with an equivalent amount recorded as an increase in the value of the capitalized asset. The asset will be depreciable in accordance with normal depreciation policy and the liability will be increased, with a charge to the income statement, until the obligation is settled. SFAS 143 is effective for fiscal years beginning after June 15, 2002. The Company is currently evaluating the effects that adoption of the provisions of SFAS 143 will have on its results of operations and financial position but does not expect them to be material.

In August of 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," (SFAS 144) that replaces Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." SFAS 144 requires that one accounting model be used for long-lived assets to be disposed of by sale and broadens discontinued operations to include more disposal transactions. Under SFAS 144, operating losses of discontinued operations are recognized in the period in which they occur, instead of accruing future operating losses before they occur. The effects of adoption of the provisions of SFAS 144 by the Company on January 1, 2002 did not have a material effect on its results of operations and financial position.

In April of 2002 the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 145, "Recession of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical

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Corrections (SFAS 145)." SFAS 145 updates, clarifies and simplifies existing accounting pronouncements. The Company does not expect the adoption of the provisions of SFAS 145 to have a material effect on its results of operations and financial position.

In June of 2002 the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 146, "Accounting For Costs Associated with Exit or Disposal Activities," (SFAS 146). SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The principal difference between SFAS 146 and Issue 94-3 relates to its requirements for recognition of a liability for a cost associated with an exit or disposal activity. SFAS 146 requires that a

liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under Issue 94-3, a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. SFAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The Company is currently evaluating the effects that adoption of the provisions of SFAS 146 will have on its results of operations and financial position but does not expect them to be material.

PART I - FINANCIAL INFORMATION

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

The operating results of the Azurix North American Corp. and Azurix Industrials Corp. (Azurix), and the water and wastewater assets of Citizens Communications Company (Citizens) acquisitions have been included in the consolidated statements of income and comprehensive income since the completion of the acquisitions on November 7, 2001 and January 15, 2002, respectively.

Consolidated revenues for the second quarter and first six months of 2002 were higher than for the same periods of 2001 by 17% and 19%, respectively. These increases reflect the additional revenues from the Company's Azurix and Citizens acquisitions, that were partially offset by the sale of the New England subsidiaries on April 25, 2002.

Approximately \$44 million and \$80 million of the overall revenue increase in the second quarter and first six months in 2002 occurred in the unregulated services segment, reflecting the November 2001 acquisition of Azurix. The portion of the Company's overall revenue from its unregulated businesses grew from 3% during the second quarter of 2001 to 13% during the second quarter of 2002.

Regulated business revenues increased by 5% and 7% for the second quarter and first six months of 2002 compared to the same periods in 2001. The primary reason for the increase in revenue generated by the regulated businesses during the second quarter of 2002 was the addition of \$32 million in revenue from the Citizens acquisition. The Citizens acquisition added revenues of \$53 million during the first six months of 2002.

During the first six months of 2002, four utility subsidiaries received rate orders that are expected to provide \$26.3 million in additional

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annual revenues. The largest of these rate increases was a \$24 million annual rate increase authorization in Pennsylvania that became effective in January of 2002. Three of the Company's subsidiaries have rate increase applications on file requesting additional annual revenues of \$19.6 million. The \$12.7 million request by the Company's Indiana subsidiary accounts for the major portion of the pending requests.

The addition of almost 300,000 customers from the Citizens acquisition resulted in increases of 6% and 5% in total water sales in the second quarter and six months over the same periods in 2001. Even though revenues and sales increased between the second quarter and first six months of 2001 and the same periods in 2002, per customer water sales, excluding the Citizens acquisition, were less than prior year amounts. These decreases are mainly a result of weather patterns and the economy.

Mandated restrictions on water use due to drought conditions in New Jersey and Pennsylvania, and unusually high rainfall in the Midwest and Southeast, were the primary causes for water use reductions for residential and small business customers.

In addition, industrial water use continued on a decline that began in late 2001. Industrial sales for the second quarter and first six months were down 8% and 9%, or 900 million gallons and 1.8 billion gallons, compared to the same periods in 2001. Present economic conditions continue to put pressure on these large customers, forcing curtailments or closing of operations.

Operating expenses in the second quarter and the first six months of 2002 were 33% and 32% higher than the same periods in 2001. The inclusion of the operating expenses related to the Azurix and Citizens operations during the second quarter and first six months of 2002 significantly increased total expenses as these acquisitions were not part of the company's consolidated financial information during the same periods last year. Approximately \$60 million of the \$62 million increase in operation and maintenance expenses (O&M) and \$73 million of the \$78 million increase in total operating expenses experienced by the Company during the second quarter of 2002 over the second quarter of 2001 resulted from the addition of expenses from Azurix and Citizens.

Included in these expenses are costs to integrate the businesses, particularly the Azurix operations into existing operations. These costs will continue throughout the year as the Company continues to transition systems and locations.

On a per customer basis, regulated operations experienced a 2% increase in O&M expenses in the second quarter of 2002 compared to the second quarter of 2001, reflecting the beginning of the realization of the synergies with the Citizens acquisition. Per customer O&M expenses for the six months ended June 30, 2002 had increased by 4% over the first six months in 2001. During the remainder of the year the Company anticipates O&M per customer expense savings will continue to materialize as projects to consolidate certain business functions are completed. However, it should be noted that expenses will be negatively impacted by anticipated increases in pension and insurance costs reflecting external market dynamics.

The increases in depreciation expense for the second quarter and first six months were related to the Company's ongoing program of utility plant construction.

Interest expense rose by \$8.5 million in the second quarter and \$17.3 million in the first six months of 2002 compared to the same periods in 2001. This increase is attributable to approximately \$1.2 billion of new

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debt associated with the Azurix and Citizens acquisitions.

Income taxes increased in the second quarter and first six months of 2002 when compared to the second quarter and first six months in 2001 reflecting increased earnings due to the sale of operating systems, investments and land. The Company's effective income tax rate for the six months ended June 30 increased to 48.4% in 2002 from 39.5% in 2001, reflecting the relatively low tax basis in the stock of the New England subsidiaries that was sold in 2002 and \$1.7 million of expenses incurred in 2002 in connection with the pending merger with RWE Aktiengesellschaft for which it is not probable that the Company will receive a tax deduction.

Net income to common stock was \$66.7 million for the second quarter of 2002 compared with \$49.2 million for the same period in 2001. Net income to common stock for the first six months of 2002 was \$84.4 million compared with \$72.6 million for the same period in 2001.

Other comprehensive income, net of tax, was \$1 million in the second quarter of 2002 compared to a \$4.5 million loss in the same period in 2001. Other comprehensive loss, net of tax, was \$1.2 million and \$6.5 million in the first six months of 2002 and 2001, respectively. The Company's other comprehensive income or loss represents the after-tax unrealized gain or loss on passive investments in publicly traded securities and foreign currency translation adjustments.

Comprehensive income increased to \$67.7 million and \$83.2 million in the second quarter and first six months of 2002, respectively, compared to comprehensive income of \$44.7 million and \$66.0 million in the same periods in 2001.

Diluted earnings per share of common stock in the second quarter of 2002 were \$.66 compared to \$.50 in the same period in 2001. These 2002 results include a 19-cent per share positive impact associated with the sale of the Company's New England operations, a 14-cent positive impact from the sale of other investments in ITC Holding Company stock, a seven-cent negative impact from the permanent write-down of other investments that were part of non-water investments included in the Company's 1999 acquisition of National Enterprises Inc. (NEI), a ten-cent positive impact resulting from sales of land and expenses of one-cent per share related to the RWE merger. Diluted earnings per share of common stock in the first six months of 2002 were \$.84 compared to \$.73 in the same period in 2001. These 2002 results include a three-cent per share positive impact of adopting the new financial accounting standards relating to business combinations, a 19-cent per share positive impact associated with the sale of the Company's New England operations, a 14-cent positive impact from the sale of other investments in ITC Holding Company stock, a seven-cent negative impact from the permanent write-down of other investments that were part of non-water investments included in the Company's 1999 acquisition of NEI, a ten-cent positive impact resulting from sales of land and expenses of two-cents per share related to the RWE merger.

Capital Resources and Liquidity

On January 14, 2002 the Company's financing subsidiary, American Water Capital Corp. (AWCC) closed on its second and final issue totaling \$900 million under its November 6, 2001 Note Purchase Agreement with RWE. These 4.92% notes were primarily used to fund the acquisition of the Citizens water and wastewater assets. On June 12, 2002 the Company and AWCC executed another Note Purchase Agreement with RWE for up to \$320 million in senior unsecured notes. The agreement allows AWCC to issue up to \$170 million in notes at an interest of 5.65% and \$150 million in notes

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at a floating interest rate based on LIBOR rates plus 20 basis points. Closing occurred on \$40 million of the 5.65% senior notes on June 12, 2002 and the Company expects closing of the remaining \$130 million of 5.65% notes to occur in the fourth quarter of 2002. The 5.65% notes and floating rate notes are due on June 12, 2007 and June 26, 2003, respectively. These notes will be primarily used to repay short-term debt.

On July 31, 2002 AWCC extended for one year its current 364-day \$500 million revolving credit agreement with a group of eleven domestic and international banks. The revolving credit agreement supports AWCC's commercial paper program.

Two subsidiaries issued \$39.9 million in tax-exempt long-term debt during the first six months of 2002.

In the first six months of 2002, the Company invested \$19.5 million in the common stock of three subsidiaries.

A condition of the merger agreement with RWE required the Company to redeem all of its issued and outstanding shares of 5% Cumulative Preference Stock and 5% Cumulative Preferred Stock prior to closing. That redemption was completed on March 1, 2002. The 365,158 shares of 5% Cumulative Preference Stock were redeemed for \$25.00 per share and the 101,777 shares of 5% Cumulative Preferred Stock were redeemed for \$25.25 per share, in each case without interest.

On April 2, 2002 the Company tendered approximately 2.2 million shares of its 3.5 million shares of ITC Holding Company (ITC) common stock. The Company tendered the shares as part of ITC's program to repurchase its own stock. The Company acquired this stock with the 1999 acquisition of National Enterprises Inc. (NEI) as it was part of NEI's non-water related investments. The sale resulted in proceeds of \$26.2 million, and a \$14 million after-tax gain which was reflected in second quarter 2002 results. This cash gain was offset by a \$10.8 million non-cash loss, \$6.7 million after tax, that was also recorded during the second quarter when the Company determined that the value of two other securities acquired as part of the NEI acquisition had become permanently impaired. The Company continues to review all reasonable options regarding the remaining securities that include 1.3 million shares of Deutsche Telekom and 1.3 million shares of ITC acquired as part of the NEI acquisition.

The value of the Company's pension plan assets decreased to \$339.3 million at June 30, 2002 from \$365.9 million at December 31, 2001, reflecting negative equity returns. Negative investment returns will increase the Company's pension expense and plan contributions in the future.

New Accounting Standards

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, "Business Combinations" (SFAS 141) and No. 142, "Goodwill and Other Intangible Assets" (SFAS 142), collectively referred to as the "Standards." SFAS 141 supersedes Accounting Principles Board Opinion (APB) No. 16, "Business Combinations." The provisions of SFAS 141 (1) require that the purchase method of accounting be used for all business combinations initiated after June 30, 2001, (2) provided specific criteria for the initial recognition and measurement of intangible assets apart from goodwill, and (3) require that unamortized negative goodwill be written off immediately as an extraordinary gain instead of being deferred and amortized. SFAS 141 also requires that upon adoption of SFAS 142 the Company reclassify the carrying amounts of certain intangible assets into or out of goodwill, based on certain criteria. SFAS 142 supersedes APB 17, "Intangible Assets," and is effective for fiscal years beginning after December 15, 2001. SFAS 142 primarily addresses the accounting for goodwill and intangible assets subsequent to their initial recognition. The provisions of SFAS 142 (1) prohibit the amortization of goodwill and indefinite-lived intangible assets, (2) require that goodwill and indefinite-lived intangible assets be tested annually for impairment (and in interim periods if certain events occur indicating that the carrying value of goodwill and/or indefinite-lived intangible assets may be impaired), (3) require that reporting units be identified for the purpose of assessing potential future impairments of goodwill, and (4) remove the forty-year limitation on the amortization period of intangible assets that have finite lives. The Company adopted the provisions of the Standards on January 1, 2002.

The Standards require the excess of the fair values of acquired net assets over cost recorded in the statement of financial position to be recognized as the effect of a change in accounting principle as of the date SFAS 141 is initially applied in its entirety. In compliance with this transition requirement the Company recognized a \$2.7 million gain on January 1, 2002.

During the second quarter of 2002 the Company completed the process of making the determinations as to what its reporting units are and what amounts of goodwill, intangible assets, other assets and liabilities should be allocated to those reporting units as of January 1, 2002. The reporting units were the 27 separate regulated utility subsidiaries (including the five New England subsidiaries that were sold on April 25, 2002) and unregulated services reporting units at American Water Resources and American Water Services. The Company's carrying value of goodwill at January 1, 2002 was \$139.2 million, of which \$23.4 million is assigned to various regulated subsidiaries and \$115.8 million is assigned to American Water Services. Intangible assets with an assigned value of \$23.4 million were management contracts at American Water Services that have a finite life.

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A transitional impairment test for goodwill as of January 1, 2002 was completed by the Company in the second quarter of 2002. Income and market approaches were used for reporting unit valuations. The methodologies used to implement the market approach were the market multiples methodology, which results in an indication of value by comparing the

business being valued to guideline publicly traded companies, and the similar transactions methodology, which develops an indication of value based on prices paid for comparable business. The methodology used to implement the income approach was the capitalized income approach that bases the value of an asset on the future cash flows attributable to that asset. Based on these approaches it was determined that goodwill is not currently impaired. The Company will perform required annual impairment tests in the fourth quarter after the long-term planning process has been completed.

The Company is no longer recording \$1.7 million of annual tax deductible amortization relating to the goodwill associated with the 1999 acquisition of its joint venture partner's interest in AmericanAnglian Environmental Technologies. The remainder of the goodwill and intangible assets at January 1, 2002 were not being amortized because they are related to business combinations completed after the July 1, 2001 effective date of SFAS 141 or the goodwill was related to acquisitions that occurred prior to October 31, 1970 that was not being amortized because in the opinion of management there had been no diminution in value. The following table reflects consolidated results adjusted as though the adoption of the Standards occurred as of the beginning of the three and six-month periods ended June 30, 2001:

2002

2001

Three months ended June 30

| |
|--------------------------------|
| Reported net income |
| \$66,665 |
| \$49,381 |
| Add back goodwill amortization |
| - |
| 269 |
| Adjusted net income |
| \$66,665 |
| \$49,650 |

Basic earnings per share:

| |
|-----------------------|
| Reported net income |
| \$.67 |
| \$.50 |
| Goodwill amortization |
| - |
| - |
| Adjusted net income |
| \$.67 |
| \$.50 |

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Diluted earnings per share:

| | |
|-----------------------|--|
| Reported net income | |
| \$.66 | |
| \$.50 | |
| Goodwill amortization | |
| - | |
| - | |
| Adjusted net income | |
| \$.66 | |
| \$.50 | |

Six months ended June 30

Reported income before cumulative
effect of change in
accounting principle

\$81,878

\$72,842

Add back goodwill amortization

-

539

Adjusted income before cumulative
effect of change in accounting
principle

\$81,878

\$73,381

| | |
|--------------------------------|--|
| Reported net income | |
| \$84,557 | |
| \$72,842 | |
| Add back goodwill amortization | |
| - | |
| 539 | |
| Adjusted net income | |
| \$84,557 | |
| \$73,381 | |

Basic earnings per share:

Income before cumulative effect
of change in accounting
principle

\$.81

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\$.73
 Cumulative effect of change in
 accounting principle

.03

-

As reported

.84

.73

Goodwill amortization

-

.01

Adjusted net income

\$.84

\$.74

Diluted earnings per share:

Income before cumulative effect
 of change in accounting
 principle

\$.81

\$.73

Cumulative effect of change in
 accounting principle

.03

-

As reported

\$.84

\$.73

Goodwill amortization

-

.01

Adjusted

\$.84

\$.74

In June of 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations," (SFAS 143) on the accounting for obligations associated with the retirement of long-lived assets. SFAS 143 requires a liability to be recognized in the financial statements for retirement obligations meeting specific criteria. Measurement of the initial obligation is to approximate fair value with an equivalent amount recorded as an increase in the value of the capitalized asset. The asset will be depreciable in accordance with normal depreciation policy and the liability will be increased, with a charge to the income statement, until

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the obligation is settled. SFAS 143 is effective for fiscal years beginning after June 15, 2002. The Company is currently evaluating the effects that adoption of the provisions of SFAS 143 will have on its results of operations and financial position but does not expect them to be material.

In August of 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," (SFAS 144) that replaces Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." SFAS 144 requires that one accounting model be used for long-lived assets to be disposed of by sale and broadens discontinued operations to include more disposal transactions. Under SFAS 144, operating losses of discontinued operations are recognized in the period in which they occur, instead of accruing future operating losses before they occur. The effects of adoption of the provisions of SFAS 144 by the Company on January 1, 2002 did not have a material effect on its results of operations and financial position.

In April of 2002 the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 145, "Recession of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections (SFAS 145)." SFAS 145 updates, clarifies and simplifies existing accounting pronouncements. The Company does not expect the adoption of the provisions of SFAS 145 to have a material effect on its results of operations and financial position.

In June of 2002 the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 146, "Accounting For Costs Associated with Exit or Disposal Activities," (SFAS 146). SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The principal difference between SFAS 146 and Issue 94-3 relates to its requirements for recognition of a liability for a cost associated with an exit or disposal activity. SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under Issue 94-3, a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. SFAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The Company is currently evaluating the effects that adoption of the provisions of SFAS 146 will have on its results of operations and financial position but does not expect them to be material.

Forward Looking Information

Forward looking statements in this report, including, without limitation, statements relating to the Company's plans, strategies, objectives, expectations, intentions and adequacy of resources, are made pursuant to the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. These forward looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual

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results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward looking statements. These factors include, among others, the following: the success of pending applications for rate increases, inability to obtain, or to meet conditions imposed for, regulatory approval of pending acquisitions, weather conditions that tend to extremes of temperature or duration; availability, terms and development of capital; business abilities and judgment of personnel; changes in, or the failure to comply with governmental regulations, particularly those affecting the environment and water quality; competition; success of operating initiatives, advertising and promotional efforts; existence of adverse publicity or litigation; changes in business strategy or plans; quality of management; general economic and business conditions; and other factors described in filings of the Company with the SEC. The Company undertakes no obligation to publicly update or revise any forward looking statement, whether as a result of new information, future events or otherwise.

PART I - FINANCIAL INFORMATION

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no significant changes in the Company's exposure to market risks described in the Company's Annual Report on Form 10-K for the Year Ended December 31, 2001.

PART II - OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders

- (a) The Company held its annual meeting of shareholders on May 2, 2002.
- (b) Class I Directors (with a term expiring in 2005) were elected by a vote of:

| | For --- | Withheld ----- |
|-----------------------|------------|-------------------|
| J. James Barr | 90,256,263 | 562,361 |
| Elizabeth H. Gemmill | 90,259,959 | 558,665 |
| Nancy Ware Wainwright | 90,229,487 | 589,137 |
| Paul W. Ware | 90,244,309 | 574,315 |
| William S. White | 90,338,173 | 538,316 |

The appointment of PricewaterhouseCoopers LLP as the Company's independent accountants for the year ending December 31, 2002 was approved by a vote of 89,055,798 for the appointment and 1,503,888 against, with 258,938

abstentions.

PART II - OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

A. Exhibits

| Exhibit Number | Description |
|----------------|-------------|
|----------------|-------------|

10 Material Contracts

(a) Note Purchase Agreement dated June 12, 2002 between American Water Capital Corp. and RWE Aktiengesellschaft for up to \$320 Million Senior Unsecured Notes and related Note and Registration Rights Agreement.

99 Additional Exhibits

Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code)

B. Reports on Form 8-K

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A current report on Form 8-K was filed on May 9, 2002 by the Company regarding an employee communication relating to its proposed merger with and into a subsidiary of RWE/AG.

A current report on Form 8-K was filed on June 20, 2002 by the Company regarding an employee communication relating to its proposed merger with and into a subsidiary of RWE/AG.

SIGNATURES

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

AMERICAN WATER WORKS COMPANY, INC.
(Registrant)

Date August 14, 2002

\s\ Ellen C. Wolf

Vice President and Chief Financial Officer
(Authorized Officer)

Date August 14, 2002

\s\ Robert D. Sievers

Comptroller
(Chief Accounting Officer)

