

ARTESIAN RESOURCES CORP

Form 10-Q

August 09, 2012

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012

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 000-18516

ARTESIAN RESOURCES CORPORATION

-----  
(Exact name of registrant as specified in its charter)

Delaware

51-0002090

-----  
(State or other jurisdiction of incorporation or  
organization)

-----  
(I.R.S. Employer Identification Number)

664 Churchmans Road, Newark, Delaware 19702

-----  
Address of principal executive offices

(302) 453 – 6900

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Registrant's telephone number, including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

☒ Yes

☐ No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

☒Yes      ☐No

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

Large Accelerated Filer	Accelerated Filer	Non-Accelerated Filer	Smaller Reporting Company
<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

☐Yes      ☒No

As of August 6, 2012, 7,780,430 shares of Class A Non-Voting Common Stock and 881,452 shares of Class B Common Stock were outstanding.

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TABLE OF CONTENTS

ARTESIAN RESOURCES CORPORATION  
FORM 10-Q

Part I - Financial Information:

Item 1 - Financial Statements

Condensed Consolidated Balance Sheets as of June 30, 2012 and December 31, 2011 (unaudited)

Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2012 and 2011 (unaudited)

Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2012 and 2011 (unaudited)

Notes to the Condensed Consolidated Financial Statements

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

Item 3 - Quantitative and Qualitative Disclosures about Market Risk

Item 4 - Controls and Procedures

Part II - Other Information:

Item 1 - Legal Proceedings

Item 1A - Risk Factors

Item 4 Mine Safety Disclosures

Item 6 - Exhibits

Signatures

Table of Contents

## PART I – FINANCIAL INFORMATION

## ITEM 1 – FINANCIAL STATEMENTS

ARTESIAN RESOURCES CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETSUnaudited  
(In thousands)

	June 30, 2012	December 31, 2011
<b>ASSETS</b>		
Utility plant, at original cost less accumulated depreciation	\$359,055	\$353,397
Current assets		
Cash and cash equivalents	391	311
Accounts receivable (less allowance for doubtful accounts 2012 - \$217; 2011-\$216)	4,692	4,997
Unbilled operating revenues	2,868	3,636
Materials and supplies	1,431	1,483
Prepaid property taxes	2	1,293
Prepaid expenses and other	1,550	1,530
Total current assets	10,934	13,250
Other assets		
Non-utility property (less accumulated depreciation 2012-\$477; 2011-\$417)	4,160	4,214
Other deferred assets	5,301	5,142
Total other assets	9,461	9,356
Regulatory assets, net	2,602	2,734
	\$382,052	\$378,737
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Stockholders' equity		
Common stock	\$8,660	\$8,611
Preferred stock	---	---
Additional paid-in capital	87,152	86,311
Retained earnings	19,955	18,075
Total stockholders' equity	115,767	112,997
Long-term debt, net of current portion	106,043	106,539
	221,810	219,536
Current liabilities		
Lines of credit	8,754	11,740
Overdraft payable	1,334	365
Current portion of long-term debt	1,726	1,718
Accounts payable	2,945	2,784
Accrued expenses	2,476	2,253
Deferred income taxes	370	772
Accrued interest	1,266	1,223
Customer deposits	955	942
Other	3,200	2,863
Total current liabilities	23,026	24,660
Commitments and contingencies	---	---
Deferred credits and other liabilities		

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Net advances for construction	13,913	14,405
Postretirement benefit obligation	455	455
Deferred investment tax credits	632	643
Utility plant retirement cost obligation	1,148	---
Deferred income taxes	43,786	41,732
Total deferred credits and other liabilities	59,934	57,235
Net contributions in aid of construction	77,282	77,306
	\$382,052	\$378,737

See notes to the condensed consolidated financial statements.

Table of Contents

ARTESIAN RESOURCES CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

Unaudited

(In thousands, except per share amounts)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Operating revenues				
Water sales	\$16,201	\$14,683	\$31,244	\$27,598
Other utility operating revenue	711	711	1,447	1,458
Non-utility operating revenue	1,000	1,116	1,919	2,211
	17,912	16,510	34,610	31,267
Operating expenses				
Utility operating expenses	8,308	8,136	16,237	16,214
Non-utility operating expenses	550	775	1,048	1,715
Depreciation and amortization	1,964	1,823	3,924	3,633
State and federal income taxes	1,839	1,260	3,530	1,954
Property and other taxes	957	928	1,990	1,944
	13,618	12,922	26,729	25,460
Operating income	4,294	3,588	7,881	5,807
Other income, net				
Allowance for funds used during construction (AFUDC)	85	38	119	73
Miscellaneous	131	(25 )	784	572
Income before interest charges	4,510	3,601	8,784	6,452
Interest charges	1,762	1,848	3,534	3,690
Net income applicable to common stock	\$2,748	\$1,753	\$5,250	\$2,762
Income per common share:				
Basic	\$0.32	\$0.23	\$0.61	\$0.36
Diluted	\$0.32	\$0.23	\$0.61	\$0.36
Weighted average common shares outstanding:				
Basic	8,651	7,672	8,638	7,662
Diluted	8,686	7,714	8,674	7,706
Cash dividends per share of common stock	\$0.1978	\$0.1902	\$0.3908	\$0.3794

See notes to the condensed consolidated financial statements.



Table of Contents

ARTESIAN RESOURCES CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited  
(In thousands)

For the Six Months  
Ended June 30,  
2012                  2011

**CASH FLOWS FROM OPERATING ACTIVITIES**

Net income	\$5,250	\$2,762
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,924	3,633
Deferred income taxes, net	1,641	1,233
Stock compensation	58	62
AFUDC, equity portion	(76 )	(45 )
Changes in assets and liabilities:		
Accounts receivable, net of allowance for doubtful accounts	305	685
Unbilled operating revenues	768	(760 )
Materials and supplies	52	(114 )
Prepaid property taxes	1,291	1,257
Prepaid expenses and other	(20 )	1,635
Other deferred assets	(246 )	(239 )
Regulatory assets	132	(35 )
Accounts payable	161	(765 )
Accrued expenses	223	721
Accrued interest	43	26
Customer deposits and other, net	350	491
Postretirement benefit obligation	---	(107 )
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>13,856</b>	<b>10,440</b>

**CASH FLOWS USED IN INVESTING ACTIVITIES**

Capital expenditures (net of AFUDC, equity portion)	(9,962 )	(6,588 )
Proceeds from sale of assets	14	30
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(9,948 )</b>	<b>(6,558 )</b>

**CASH FLOWS FROM FINANCING ACTIVITIES**

Net repayments under lines of credit agreements	(2,986 )	(3,439 )
Increase (decrease) in overdraft payable	969	(315 )
Net advances and contributions in aid of construction	1,167	447
Change in deferred debt issuance costs	48	58
Net proceeds from issuance of common stock	832	638
Equity issuance costs	---	(135 )
Dividends paid	(3,370 )	(2,903 )
Issuance of long-term debt	---	2,837
Principal repayments of long-term debt	(488 )	(1,061 )
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(3,828 )</b>	<b>(3,873 )</b>

**NET INCREASE IN CASH AND CASH EQUIVALENTS**

80                  9



CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	311	179
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$391	\$188
Supplemental Disclosures of Cash Flow Information:		
Utility plant received as construction advances and contributions	\$395	\$382
Interest paid	\$3,491	\$3,664
Income taxes paid	\$335	\$---

See notes to the condensed consolidated financial statements.

Table of Contents

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – GENERAL

Artesian Resources Corporation, or Artesian Resources, includes income from the earnings of our eight wholly owned subsidiaries and the income derived from our Service Line Protection Plans described below. The terms “we”, “our”, “Artesian” and the “Company” as used herein refer to Artesian Resources and its subsidiaries.

DELAWARE REGULATED SUBSIDIARIES

Artesian Water Company Inc., or Artesian Water, our principal subsidiary, is the oldest and largest public water utility in the State of Delaware and has been providing water service within the state since 1905. Artesian Water distributes and sells water to residential, commercial, industrial, governmental, municipal and utility customers throughout the State of Delaware. In addition, Artesian Water provides services to other water utilities, including operations and billing functions, and also has contract operation agreements with private and municipal water providers. We also provide water for public and private fire protection to customers in our service territories.

Artesian Wastewater Management, Inc., or Artesian Wastewater, is a regulated entity that owns wastewater collection and treatment infrastructure and provides wastewater services to customers in Delaware as a regulated public wastewater service company. As of June 30, 2012, Artesian Wastewater owned and operated four wastewater treatment facilities, which are capable of treating approximately 730,000 gallons per day and can be expanded to treat approximately 1.6 million gallons per day, or mgd. As contemplated in our original service agreement, ownership of one of our wastewater treatment facilities located in Sussex County and operated by Artesian Wastewater was transferred to Sussex County. The transfer was scheduled to occur once Sussex County had sewer service available to service the area. The utility plant of \$2.2 million related to this wastewater treatment facility was originally received as a contribution in aid of construction and subsequently removed from contributions in aid of construction following the transfer.

MARYLAND REGULATED SUBSIDIARIES

Artesian Water Maryland, Inc., or Artesian Water Maryland, began operations in August 2007. Artesian Water Maryland distributes and sells water to residential, commercial, industrial and municipal customers in Cecil County, Maryland.

On December 21, 2011, Artesian Water Maryland completed its purchase from Cecil County of all of Cecil County’s right, title and interest in and to the Meadowview, Pine Hills, Harbourview and Route 7 water facilities and the associated parcels of real property, easement rights and water transmission and distribution systems pursuant to an Asset Purchase Agreement, dated October 7, 2008, as amended, (the “Asset Purchase Agreement”). The total price for the purchased assets was \$2.2 million, which, pursuant to the Asset Purchase Agreement, was equal to the net asset value of the purchased assets at closing. Artesian Water Maryland paid the full purchase price and assumed certain liabilities at closing. As previously disclosed, on August 31, 2011, the Maryland Public Service Commission, or MDPSC, issued an order granting Artesian Water Maryland authority to exercise the franchise area served by the water facilities acquired under the Asset Purchase Agreement. The water systems serve approximately 1,500 customers.

Artesian Wastewater Maryland, Inc., or Artesian Wastewater Maryland, is a regulated wastewater entity in the State of Maryland and was incorporated on June 3, 2008 specifically for the purpose of executing two purchase agreements, or

the Asset Purchase Agreements, relating to the Meadowview Wastewater Facility, Highlands Wastewater Facility, Cherry Hill Wastewater Facility and the Harbourview Wastewater Facility, and related real property, easement rights and wastewater collection systems with respect to each facility or the wastewater facilities.

On September 27, 2011, Artesian Resources, Artesian Wastewater Maryland and Cecil County mutually agreed to enter into a Termination of Asset Purchase Agreements, Franchise and Parent Guaranty, or the Termination Agreement, to terminate the Asset Purchase Agreements relating to the wastewater facilities. Certain ancillary agreements, including a wastewater franchise agreement between Artesian Wastewater Maryland and Cecil County, and a parent guaranty between Artesian Resources and Cecil County, were also terminated by the Termination Agreement. Termination of the wastewater franchise agreement was approved by the MDPSC on April 18, 2012.

In May 2012, Artesian Water Maryland entered into an Asset Transfer Agreement with CECO Utilities, Inc., or CECO. Upon closing, which is expected to occur by year-end, CECO will transfer its water utility assets, which includes water mains, a treatment facility and an elevated water storage tank, to Artesian Water Maryland. The CECO water system currently serves approximately 200 customers. At closing, the CECO system will be connected to Artesian Water Maryland's Meadowview water system.

Table of Contents

PENNSYLVANIA REGULATED SUBSIDIARY

Artesian Water Pennsylvania, Inc., or Artesian Water Pennsylvania, began operations upon receiving recognition as a regulated public water utility by the Pennsylvania Public Utility Commission, or PAPUC, in 2002. It provides water service to a residential community in Chester County. Artesian Water Pennsylvania filed an application with the PAPUC to increase our service area in Pennsylvania, which was approved and a related order was entered on February 4, 2005. This application involved specific developments, in which we expect modest future growth.

OTHER SUBSIDIARIES

Our three other subsidiaries, none of which are regulated, are Artesian Utility Development, Inc., or Artesian Utility, Artesian Development Corporation, or Artesian Development, and Artesian Consulting Engineers, Inc., or Artesian Consulting Engineers.

Artesian Utility was formed in 1996. It designs and builds water and wastewater infrastructure and provides contract water and wastewater services on the Delmarva Peninsula. Artesian Utility also evaluates land parcels, provides recommendations to developers on the size of water or wastewater facilities and the type of technology that should be used for treatment at such facilities, and operates water and wastewater facilities in Delaware and Maryland for municipal and governmental organizations. Artesian Utility also has contracts with developers for design and construction of wastewater facilities within the Delmarva Peninsula, using a number of different technologies for treatment of wastewater at each facility. In addition, as further discussed below, effective April 2012, Artesian Utility operates the Water Service Line Protection Plan, or WSLP Plan, and the Sewer Service Line Protection Plan, or SSLP Plan.

We currently operate wastewater treatment facilities for the town of Middletown, in southern New Castle County, or Middletown, under a 20-year contract that expires on February 1, 2021. The facilities include two wastewater treatment stations with capacities of up to approximately 2.5 mgd and 250,000 gallons per day, respectively.

One of the wastewater treatment facilities in Middletown now provides reclaimed wastewater for use in spray irrigation on public and agricultural lands in the area. Our relationship with the Town of Middletown has given us the opportunity to create the Artesian Water Resource Management Partnership, or AWRMP, to encourage and support the use of reclaimed water for agricultural irrigation and other needs. Using reclaimed water to irrigate farm fields can save the Delmarva region millions of gallons of groundwater each day. The AWRMP's first project in Middletown will save up to three million gallons of water per day during the peak growing season. Through the AWRMP initiative, Artesian will provide planning, engineering and technical expertise and help bring together the various state, local and private partners needed for water recycling project approvals.

Artesian Utility currently operates the WSLP Plan and the SSLP Plan, effective April 2012. The WSLP Plan was initiated in March 2005. The WSLP Plan covers all parts, material and labor required to repair or replace participating customers' leaking water service lines up to an annual limit. The WSLP Plan was expanded in the second quarter of 2008 to include maintenance or repair to customers' sewer lines. The SSLP Plan covers all parts, material and labor required to repair or replace participating customers' leaking or clogged sewer lines up to an annual limit. Also, in the second quarter of 2010, the WSLP Plan and SSLP Plan were extended to include non-utility customers of Artesian Resources. As of June 30, 2012, approximately 17,300, or 25.0%, of our eligible water customers had signed up for the WSLP Plan, approximately 10,000, or 14.5%, of our eligible customers had signed up for the SSLP Plan and approximately 900 non-customer participants have signed up for either the WSLP Plan or SSLP Plan.

Artesian Development is a real estate holding company that owns properties, including land zoned for office buildings, a water treatment plant and wastewater facility, as well as property for current operations, including an office facility in Sussex County, Delaware. The facility consists of approximately 10,000 square feet of office space along with nearly 10,000 square feet of warehouse space. This facility allows all of our Sussex County, Delaware operations to be housed in one central location.

Artesian Consulting Engineers acquired all the assets of Meridian Architects and Engineers in June 2008. As a result of the decline in new housing and development due to the economic downturn, the need for development and architectural services has remained depressed. Therefore, in April 2011, management decided to reduce staffing levels and reorganize the business. Artesian Consulting Engineers no longer provides development and architectural services to outside third parties. Artesian Consulting Engineers will continue to work with existing clients on projects already in progress for engineering services until those projects are complete. Artesian will continue to provide design and engineering contract services through our Artesian Utility subsidiary.

Table of Contents

## NOTE 2 – BASIS OF PRESENTATION

## Basis of Presentation

The unaudited condensed consolidated financial statements are presented in accordance with the requirements of Form 10-Q and consequently do not include all the disclosures required in the financial statements included in the Company's annual report on Form 10-K. Accordingly, these financial statements and related notes should be read in conjunction with the financial statements and related notes in the Company's annual report on Form 10-K for fiscal year 2011 as filed with the Securities and Exchange Commission on March 15, 2012.

The condensed consolidated financial statements include the accounts of Artesian Resources Corporation and its wholly-owned subsidiaries, including its principal operating company, Artesian Water. In the opinion of the Company, the accompanying unaudited condensed consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the Company's balance sheet position as of June 30, 2012, the results of operations for the three and six month periods ended June 30, 2012 and 2011 and cash flows for the six month periods ended June 30, 2012 and 2011.

The results of operations for the interim period presented are not necessarily indicative of the results for the full year or for future periods.

## Reclassification

Certain accounts in the prior year financial statements have been reclassified for comparative purposes to conform with the presentation in the current year financial statements. These reclassifications had no effect on net income or stockholders' equity.

## NOTE 3 – STOCK COMPENSATION PLANS

On May 25, 2005, the Company's stockholders approved a new Equity Compensation Plan, which authorizes up to 500,000 shares of Class A Non-Voting Common Stock, or Class A Stock, for issuance, referred to as the 2005 Equity Compensation Plan, or the Plan. Since May 25, 2005, no additional grants have been made under the Company's other stock-based compensation plans that were previously available. The Company accounts for stock options issued after January 1, 2006 under FASB Accounting Standards Codification, or ASC Topic, 718. For the three and six months ended June 30, 2012, compensation expense of approximately \$29,000 and \$58,000 was recorded for stock options granted in May 2012 and May 2011. Approximately \$31,000 and \$62,000 in compensation expense was recorded during the three and six months ended June 30, 2011 for stock options issued in May 2011 and May 2010. Costs were determined based on the fair value at the grant dates and those costs are being charged to income over the service period associated with the grants.

The fair value of each option grant is estimated using the Black-Scholes-Merton option pricing model with the following weighted-average assumptions used for grants issued in 2012 and 2011. All options were granted at market value with a 10-year option term with a vesting period of one year from the date of grant.

	2012		2011	
Expected Dividend Yield	4.18	%	3.99	%
Expected Stock Price Volatility	25.13	%	24.97	%
Weighted Average Risk-Free Interest Rate	1.87	%	3.12	%
Weighted Average Expected Life of Options (in years)	9.47		8.36	

The expected dividend yield was based on a 12-month rolling average of the Company's dividend yield. The expected volatility is the standard deviation of the change in the natural logarithm of the stock price (expressed as an annual rate) for the expected term shown above. The expected term was based on historic exercise patterns for similar grants. The risk-free interest rate is the 10-year Treasury Constant Maturity rate as of the date of the grants.

Table of Contents

The following summary reflects changes in the shares of Class A Stock underlying options:

	Option Shares	Weighted Average Exercise Price	Weighted Average Remaining Life (Yrs.)	Aggregate Intrinsic Value (in thousands)
Plan options				
Outstanding at January 1, 2012	450,000	\$ 17.61		
Granted	33,750	19.01		
Exercised	(27,000 )	13.01		
Expired	---			
Outstanding at June 30, 2012	456,750	\$ 17.98	4.67	\$ 1,625
Options exercisable at June 30, 2012	423,000	\$ 17.90	4.26	\$ 1,540

The total intrinsic value of options exercised during the six months ended June 30, 2012 was approximately \$166,400.

The following summary reflects changes in the non-vested shares of Class A Stock underlying options:

	Option Shares	Weighted Average Grant – Date Fair Value Per Option
Non-vested Shares		
Non-vested at January 1, 2012	33,750	\$3.50
Granted	33,750	2.92
Vested	33,750	3.50
Canceled	---	---
Non-vested at June 30, 2012	33,750	\$2.92

As of June 30, 2012, there was \$84,000 of total unrecognized expense related to non-vested option shares granted under the Plan. The cost will be recognized over the remaining 0.86 year vesting period of the unvested options.

## NOTE 4 - REGULATORY ASSETS

FASB ASC Topic 980 stipulates generally accepted accounting principles for companies whose rates are established or subject to approvals by a third-party regulatory agency. Certain expenses are recoverable through rates charged to our customers, without a return on investment, and are deferred and amortized during future periods using various methods as permitted by the Delaware Public Service Commission, or DEPSC, the MDPSC and the PAPUC. Depreciation and salary study expenses are amortized on a straight-line basis over a period of five years and two years for all other expenses related to Delaware rate proceedings and applications to increase rates. Other expenses related to Maryland rate proceedings and applications to increase rates are amortized on a straight line basis over a period of five years or until the next rate increase application. The postretirement benefit obligation is the recognition of an offsetting regulatory asset as it relates to the accrual of the expected cost of providing postretirement health care and life insurance benefits to retired employees when they render the services necessary to earn the benefits. The deferred income taxes will be amortized over future years as the tax effects of temporary differences



that previously flowed through to our customers are reversed. Goodwill was recognized as a result of the acquisition of Mountain Hill in August 2008 and is currently being amortized on a straight-line basis over a period of fifty years. Deferred acquisition and franchise costs are the result of due diligence costs related to the December 2011 purchase of water assets in Cecil County, Maryland and the November 2010 purchase of the Port Deposit, Maryland water assets. Amortization of these deferred acquisition costs began once the acquired assets were placed into service. The amortization of the Port Deposit acquisition began in November 2010 and the amortization of the Cecil County acquisition began in December 2011. These acquisition costs will be amortized over a period of twenty years, while the franchise costs will be amortized over a period of eighty years.

Table of Contents

Regulatory assets, net of amortization, comprise:

	Unaudited (in thousands)	
	June 30, 2012	December 31, 2011
Postretirement benefit obligation	\$567	\$567
Deferred income taxes	499	506
Goodwill	344	348
Deferred acquisition and franchise costs	810	816
Expense of rate and regulatory proceedings	382	497
	\$2,602	\$2,734

Artesian Water contributed \$58,000 to its postretirement benefit plan in the first six months of 2012. These contributions consist of insurance premium payments for medical, dental and life insurance benefits made on behalf of the Company's eligible retired employees.

## NOTE 5 - NET INCOME PER COMMON SHARE AND EQUITY PER COMMON SHARE

Basic net income per share is based on the weighted average number of common shares outstanding. Diluted net income per share is based on the weighted average number of common shares outstanding and the potentially dilutive effect of employee stock options. The following table summarizes the shares used in computing basic and diluted net income per share:

	For the Three Months Ended June 30, 2012      2011 (in thousands)		For the Six Months Ended June 30, 2012      2011 (in thousands)	
Weighted average common shares outstanding during the period for Basic computation	8,651	7,672	8,638	7,662
Dilutive effect of employee stock options	35	42	36	44
Weighted average common shares outstanding during the period for Diluted computation	8,686	7,714	8,674	7,706

For the three and six months ended June 30, 2012, employee stock options to purchase 200,250 and 234,000 shares of common stock were excluded from the calculations of diluted net income per share, respectively, as the calculated proceeds from the options' exercise were greater than the average market price of the Company's common stock during this period.

The Company has 15,000,000 authorized shares of Class A Stock and 1,040,000 authorized shares of Class B Stock. As of June 30, 2012, 7,778,057 shares of Class A Stock and 881,452 shares of Class B Stock were issued and outstanding. As of June 30, 2011, 6,793,856 shares of Class A Stock and 881,452 shares of Class B Stock were issued and outstanding. The par value for both classes is \$1.00 per share. For the three months ended June 30, 2012 and June 30, 2011, the Company issued 17,814 and 10,045 shares of Class A Stock, respectively. For the six months ended June 30, 2012 and June 30, 2011, the Company issued 48,551 and 38,202 share of Class A Stock.

Equity per common share was \$13.40 and \$13.91 at June 30, 2012 and December 31, 2011, respectively. These amounts were computed by dividing common stockholders' equity by the number of weighted average shares of

common stock outstanding on June 30, 2012 and December 31, 2011, respectively.

#### NOTE 6 - REGULATORY PROCEEDINGS

Our water and wastewater utilities generate operating revenue from customers based on rates that are established by state Public Service Commissions through a rate setting process that may include public hearings, evidentiary hearings and the submission of evidence and testimony in support of the requested level of rates by the Company.

We are subject to regulation by the following state regulatory commissions: The DEPSC regulates both Artesian Water and Artesian Wastewater. Artesian Water Maryland and Artesian Wastewater Maryland are subject to the regulatory jurisdiction of the MDPSC, and Artesian Water Pennsylvania is subject to the regulatory jurisdiction of the PAPUC.

## Table of Contents

### Rate Proceedings

Our regulated utilities periodically seek rate increases to cover the cost of increased operating expenses, increased financing expenses due to additional investments in utility plant and other costs of doing business. In Delaware, utilities are permitted by law to place rates into effect, under bond, on a temporary basis pending completion of a rate increase proceeding. The first temporary increase may be up to the lesser of \$2.5 million on an annual basis or 15% of gross water sales. Should the rate case not be completed within seven months, by law, the utility may put the entire requested rate relief, up to 15% of gross water sales, in effect under bond until a final resolution is ordered and placed into effect. If any such rates are found to be in excess of rates the DEPSC finds to be appropriate, the utility must refund the portion found to be in excess to customers with interest. The timing of our rate increase requests are therefore dependent upon the estimated cost of the administrative process in relation to the investments and expenses that we hope to recover through the rate increase. We can provide no assurances that rate increase requests will be approved by applicable regulatory agencies and, if approved, we cannot guarantee that these rate increases will be granted in a timely or sufficient manner to cover the investments and expenses for which we initially sought the rate increase.

Artesian Water, the DEPSC, and the Division of the Public Advocate entered into an agreement to settle Artesian Water's April 2011 application for an increase in rates. PSC Order No. 8097, issued on January 31, 2012, approved the settlement agreement, authorizing a permanent rate increase in revenue of approximately 11.13%, or \$6.25 million on an annualized basis. Since the permanent rate increase did not exceed amounts already collected under previously approved temporary increases in rates, Artesian Water was not required to refund any amounts to its customers. The approved permanent rate increase became effective January 1, 2012. The settlement also authorized a return on equity of 10%. Additionally, effective January 1, 2012, the settlement agreement permitted a tariff change that includes the use of a seasonal connection charge as well as a new approach for presenting the cost of retired property and ratemaking treatment for salvage costs to be recovered in rates. Previously, when depreciable units of utility plant were retired, the cost of retired property, together with any cost associated with retirement less any salvage value or proceeds received, was charged to accumulated depreciation. Under the settlement agreement, effective January 1, 2012, any cost associated with retirement less any salvage value or proceeds received is charged to a regulated retirement liability. This new approach resulted in an approximately \$1.2 million reclassification of accumulated depreciation of utility plant to deferred credits and other liabilities on our Condensed Consolidated Balance Sheet as of June 30, 2012. The settlement also authorized Artesian Water to change from quarterly to monthly billing, which was implemented in April 2012.

### Service Territory Expansion Proceedings

On September 27, 2011, Artesian Wastewater Maryland and Cecil County mutually agreed to terminate two Asset Purchase Agreements and a wastewater franchise agreement with respect to certain wastewater facilities in Cecil County. Termination of the wastewater franchise agreement was approved by the MDPSC on April 18, 2012. On December 21, 2011, Artesian Water Maryland completed its purchase of water assets from Cecil County and began serving the franchise area granted to the Company by Cecil County and expanded water service to approximately 1,500 customers. See Note 1 – General – Maryland Regulated Subsidiaries for further discussion.

### Other Proceedings

Delaware law permits water utilities to put into effect, on a semi-annual basis, increases related to specific types of distribution system improvements through a Distribution System Improvement Charge, or DSIC. This charge may be implemented by water utilities between general rate increase applications that normally recognize changes in a water utility's overall financial position. The DSIC approval process is less costly when compared to the approval process for general rate increase requests. The DSIC rate applied between base rate filings is capped at 7.5% of the amount

billed to customers under otherwise applicable rates and charges, and the DSIC rate increase applied cannot exceed 5% within any 12-month period. In 2011, the DEPSC approved a 1.47% DSIC rate that was effective January 1, 2011. For the six months ended June 30, 2011, we earned approximately \$347,000 in DSIC revenue. We did not have any DSIC rates in effect during the six months ended June 30, 2012. In May 2012, Artesian Water filed an application with the DEPSC for approval to collect a 0.14% increase in the DSIC rate to be effective July 1, 2012. This increase is based on approximately \$486,000 in eligible plant improvements since the last rate increase. On June 19, 2012, the DEPSC approved the DSIC effective July 1, 2012, subject to audit at a later date.

#### NOTE 7 – INCOME TAXES

Under FASB ASC Topic 740, an uncertain tax position represents our expected treatment of a tax position taken, or planned to be taken in the future, that has not been reflected in measuring income tax expense for financial reporting purposes. As a result of our review of our tax positions, we determined that we had no material uncertain tax positions. The Company would recognize, if applicable, interest accrued and penalties related to unrecognized tax benefits in interest expense and in accordance with the regulations of the jurisdictions involved. There were no such interest and penalty charges for the six months ended June 30, 2012 or June 30, 2011. The Company remains subject to examination by state authorities for tax years 2008 through 2011 and by federal authorities for the tax years 2009 through 2011.

Table of Contents

NOTE 8 – FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value.

Current Assets and Liabilities

For those current assets and liabilities that are considered financial instruments, the carrying amounts approximate fair value because of the short maturity of those instruments.

Long-term Financial Liabilities

The fair value of Artesian Resources' long-term debt as of June 30, 2012 and December 31, 2011, determined by discounting their future cash flows using current market interest rates on similar instruments with comparable maturities as guided under FASB ASC 825 are shown below:

In thousands

	June 30, 2012	December 31, 2011
Carrying amount	\$107,769	\$108,257
Estimated fair value	130,057	127,912

The fair value of Advances for Construction cannot be reasonably estimated due to the inability to accurately estimate the timing and amounts of future refunds expected to be paid over the life of the contracts. Refund payments are based on the water sales to new customers in the particular development constructed. The fair value of Advances for Construction would be less than the carrying amount because these financial instruments are non-interest bearing.

NOTE 9 - IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS

For the six months ended June 30, 2012, there have been no significant accounting pronouncements or changes in accounting pronouncements that have become effective that materially impact or are expected to materially impact the Company.

Table of Contents

ITEM 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS FOR THE PERIOD ENDED JUNE 30, 2012

OVERVIEW

Our profitability is primarily attributable to the sale of water by Artesian Water. Gross water sales in Artesian Water comprise 88.0% of total operating revenues. Our profitability is also attributed to the various contract operations, water and sewer Service Line Protection Plans and other services we provide. Water sales are subject to seasonal fluctuations, particularly during summer when water demand may vary with rainfall and temperature. In the event temperatures during the typically warmer months are cooler than expected, or rainfall is greater than expected, the demand for water may decrease and our revenues may be adversely affected. We believe the effects of weather are short term and do not materially affect the execution of our strategic initiatives. Our contract operations and other services provide a revenue stream that is not affected by changes in weather patterns.

While water sales revenues are our primary source of revenues, we continue to seek growth opportunities to provide wastewater service in Delaware and the surrounding areas. We also continue to explore and develop relationships with developers and municipalities in order to increase revenues from contract water and wastewater operations, wastewater management services, design, construction and engineering services. We plan to continue developing and expanding our contract operations and other services in a manner that complements our growth in water service to new customers. Our anticipated growth in these areas is subject to changes in residential and commercial construction, which may be affected by interest rates, inflation and general housing and economic market conditions. We anticipate continued growth in our non-regulated division due to our water and sewer Service Line Protection Plans.

Water Division

Artesian Water, Artesian Water Maryland and Artesian Water Pennsylvania provide water service to residential, commercial, industrial, governmental, municipal and utility customers. Increases in the number of customers served contributed to increases in our operating revenue. The Town of Middletown, which is one of our municipal customers and is located in southern New Castle County, Delaware, has nearly doubled in population since 2001, and population growth in this area is expected to continue for some time as a result of ongoing and future residential construction. As population growth continues in Middletown and other areas in Delaware, we believe that the demand for water will increase, thereby contributing to an increase in our operating revenues. As of June 30, 2012, we had approximately 78,700 metered water customers in Delaware, an increase of approximately 400 compared to June 30, 2011. The number of metered water customers in Maryland increased by approximately 1,500 compared to 2011 following the purchase of the Cecil County assets and the number of metered water customers in Pennsylvania remained consistent with 2011.

Wastewater Division

Artesian Wastewater owns wastewater infrastructure and began providing wastewater services in Delaware in July 2005. Artesian Wastewater Maryland was incorporated on June 3, 2008 to provide regulated wastewater services in Maryland. Our wastewater customers are billed a flat monthly fee, which contributes to providing a revenue stream unaffected by weather.

On September 27, 2011, Artesian Resources, Artesian Wastewater Maryland and Cecil County mutually agreed to enter into a Termination of Asset Purchase Agreements, Franchise and Parent Guaranty, or the Termination Agreement, to terminate two purchase agreements, or the Asset Purchase Agreements, relating to the Meadowview Wastewater Facility, Highlands Wastewater Facility, Cherry Hill Wastewater Facility and the Harbourview Wastewater Facility, and related real property, easement rights and wastewater collection systems with respect to each facility or the wastewater facilities. Certain ancillary agreements, including a wastewater franchise agreement between Artesian Wastewater Maryland and Cecil County, and a parent guaranty between Artesian Resources and Cecil County, were also terminated by the Termination Agreement. Termination of the wastewater franchise agreement was approved by the MDPSC on April 18, 2012.



## Table of Contents

### Non-Regulated Division

Artesian Utility provides contract water and wastewater operation services to private, municipal and governmental institutions. Artesian Utility currently operates wastewater treatment facilities for the town of Middletown, in southern New Castle County, or Middletown, under a 20-year contract that expires on February 1, 2021. The facilities include two wastewater treatment stations with capacities of up to approximately 2.5 mgd and 250,000 gallons per day, respectively. We also operate a wastewater disposal facility in Middletown in order to support the 2.5 mgd wastewater facility.

One of the wastewater treatment facilities in Middletown now provides reclaimed wastewater for use in spray irrigation on public and agricultural lands in the area. Our relationship with the Town of Middletown has given us the opportunity to create the Artesian Water Resource Management Partnership, or AWRMP, to encourage and support the use of reclaimed water for agricultural irrigation and other needs. Using reclaimed water to irrigate farm fields can save the Delmarva region millions of gallons of groundwater each day. The AWRMP's first project in Middletown will save up to three million gallons of water per day during the peak growing season. Through the AWRMP initiative, Artesian will provide planning, engineering and technical expertise and help bring together the various state, local and private partners needed for water recycling project approvals.

Artesian Utility currently operates the WSLP Plan and the SSLP Plan, effective April 2012. Artesian Resources initiated the WSLP Plan in March 2005. The WSLP Plan covers all parts, material and labor required to repair or replace participating customers' leaking water service lines up to an annual limit. The WSLP Plan was expanded in the second quarter of 2008 to include maintenance or repair to customers' sewer lines. The SSLP Plan covers all parts, material and labor required to repair or replace participating customers' leaking or clogged sewer lines up to an annual limit. Also, in the second quarter of 2010, the WSLP Plan and SSLP Plan were extended to include non-customers of Artesian Resources. As of June 30, 2012, approximately 17,300, or 25.0%, of our eligible water customers had signed up for the WSLP Plan, approximately 10,000, or 14.5%, of our eligible customers had signed up for the SSLP Plan and approximately 900 non-customer participants have signed up for either the WSLP Plan or SSLP Plan.

Artesian Development is a real estate holding company that owns properties, including land zoned for office buildings, a water treatment plant and wastewater facility, as well as property for current operations, including an office facility in Sussex County, Delaware. The facility consists of approximately 10,000 square feet of office space along with nearly 10,000 square feet of warehouse space. This facility allows all of our Sussex County, Delaware operations to be housed in one central location.

Artesian Consulting Engineers acquired all the assets of Meridian Architects and Engineers in June 2008. As a result of the decline in new housing and development due to the economic downturn, the need for development and architectural services has remained depressed. Therefore, in April 2011, we decided to reduce staffing levels and reorganize the business. Artesian Consulting Engineers no longer provides development and architectural services to outside third parties. Artesian Consulting Engineers will continue to work with existing clients on projects already in progress for engineering services until those projects are complete. We will continue to provide design and engineering contract services through our Artesian Utility subsidiary.

### Strategic Direction

Our strategy is to significantly increase customer growth, revenues, earnings and dividends by expanding our water, wastewater and Service Line Protection Plan services across the Delmarva Peninsula. We remain focused on providing superior service to our customers and continuously seeking ways to improve our efficiency and performance. By providing water and wastewater services, we believe we are positioned as the primary resource for

developers and communities throughout the Delmarva Peninsula seeking to fill both needs simultaneously. We have a proven ability to acquire and integrate high growth, reputable entities, through which we have captured additional service territories that will serve as a base for future revenue. With respect to recent acquisitions, we have successfully integrated their operations, infrastructure, technology and employees. We believe this experience presents a strong platform for further expansion and that our success to date also produces positive relationships and credibility with regulators, municipalities, developers and customers in both existing and prospective service areas.

In our regulated water division, our strategy is to focus on a wide spectrum of activities, which include identifying new and dependable sources of supply, developing the wells, treatment plants and delivery systems to supply water to customers and educating customers on the wise use of water. Our strategy includes focused efforts to expand in new regions added to our Delaware service territory over the last 10 years. In addition, we believe growth will occur in the Maryland counties on the Delmarva Peninsula. We plan to expand our regulated water service area in the Cecil County designated growth corridor and to expand our business through the design, construction, operation, management and acquisition of additional water systems. The expansion of our exclusive franchise areas elsewhere in Maryland and the award of additional contracts will similarly enhance our operations within the state.

## Table of Contents

We believe that Delaware's generally lower cost of living in the region, availability of development sites in relatively close proximity to the Atlantic Ocean in Sussex County, and attractive financing rates for construction and mortgages have resulted, and will continue to result, in increases to our customer base. Delaware's lower property and income tax rate make it an attractive region for new home development and retirement communities. Substantial portions of Delaware are currently not served by a public water system, which could also assist in an increase to our customer base as systems are added.

In our regulated wastewater division, we foresee significant growth opportunities and will continue to seek strategic partnerships and relationships with developers and municipalities to complement existing agreements for the provision of wastewater service on the Delmarva Peninsula. Artesian Wastewater completed an agreement with Georgetown, Delaware in July 2008 to provide wastewater treatment and disposal services for Georgetown's growth and annexation areas. Artesian Wastewater will provide up to 1 mgd of wastewater capacity for the town. The preliminary engineering and design work was completed on a regional wastewater treatment and disposal facility located in the northern Sussex County area that has the potential to treat up to approximately 8 mgd. This facility is strategically situated on 75 acres to provide service to the growing population in the Georgetown, Ellendale and Milton areas, as well as to neighboring municipal systems. This facility was granted conditional use approval by Sussex County Council to serve the Elizabethtown subdivision of approximately 4,000 homes and 439,000 square feet of proposed commercial space, as well as seven additional projects comprising approximately 3,000 residential units. The facility will also be capable of offering wastewater services to local municipalities. Artesian Wastewater will manage the design and construction of the facility and, once constructed, the operation of the facility.

The general need for increased capital investment in our water and wastewater systems is due to a combination of population growth, more protective water quality standards and aging infrastructure. Our capital investment plan for the next five years includes projects for water treatment plant improvements and additions in both Delaware and Maryland and wastewater treatment plant improvements and additions in Delaware. Capital improvements are planned and budgeted to meet anticipated changes in regulations and needs for increased capacity related to projected growth. The Delaware Public Service Commission and Maryland Public Service Commission have generally recognized the operating and capital costs associated with these improvements in setting water and wastewater rates for current customers and capacity charges for new customers.

In our non-regulated division, we are actively pursuing opportunities to expand our contract operations. Through Artesian Utility, we will seek to expand our contract design and construction services of water and wastewater facilities for developers, municipalities and other utilities. Artesian Development owns two nine-acre parcels of land, located in Sussex County, Delaware, which will allow for construction of a water treatment facility and wastewater treatment facility. Artesian Consulting Engineers no longer provides development and architectural services to outside third parties. Artesian Consulting Engineers will continue to work with existing clients on projects already in progress for engineering services until those projects are complete. Artesian will continue to provide design and engineering contract services through our Artesian Utility subsidiary.

## Regulatory Matters and Inflation

Our water and wastewater utility operations are subject to regulation by their respective state regulatory commissions, which have broad administrative power and authority to regulate rates charged for service, determine franchise areas and conditions of service, approve acquisitions, authorize the issuance of securities and oversee other matters. The profitability of our utility operations is influenced, to a great extent, by the timeliness and adequacy of rate allowances we are granted by the respective regulatory commissions or authorities in the states in which we operate.

Artesian Water, the DEPSC, and the Division of the Public Advocate entered into an agreement to settle Artesian Water's April 2011 application for an increase in rates. PSC Order No. 8097, issued on January 31, 2012, approved

the settlement agreement, authorizing a permanent rate increase in revenue of approximately 11.13%, or \$6.25 million on an annualized basis. Since the permanent rate increase did not exceed amounts already collected under previously approved temporary increases in rates, Artesian Water was not required to refund any amounts to its customers. The approved permanent rate increase was effective as of January 1, 2012. The settlement also authorized a return on equity of 10%. Additionally, effective January 1, 2012, the settlement agreement permitted a tariff change that includes the use of a seasonal connection charge as well as a new approach for presenting the cost of retired property and ratemaking treatment for salvage costs to be recovered in rates. Previously, when depreciable units of utility plant were retired, the cost of retired property, together with any cost associated with retirement less any salvage value or proceeds received, was charged to accumulated depreciation. Under the settlement agreement, effective January 1, 2012, any cost associated with retirement less any salvage value or proceeds received is charged to a regulated retirement liability. This new approach resulted in an approximately \$1.2 million reclassification of accumulated depreciation of utility plant to deferred credits and other liabilities on our Condensed Consolidated Balance Sheet as of June 30, 2012. The settlement also authorized Artesian Water to change from quarterly to monthly billing, which was implemented in April 2012.

We are affected by inflation, most notably by the continually increasing costs required to maintain, improve and expand our service capability. The cumulative effect of inflation results in significantly higher facility costs compared to investments made 20 to 40 years ago, which must be recovered from future cash flows.

Table of Contents

Results of Operations – Analysis of the Three Months Ended June 30, 2012 Compared to the Three Months Ended June 30, 2011

Operating Revenues

Revenues totaled \$17.9 million for the three months ended June 30, 2012, \$1.4 million, or 8.5%, above revenues for the three months ended June 30, 2011 of \$16.5 million. Water sales revenues increased \$1.5 million, or 10.3%, for the three months ended June 30, 2012 over the corresponding period in 2011. Water sales revenue increased primarily due to an 11.13% permanent increase in rates effective January 1, 2012. The permanent rate increase equals the combined temporary rate increases that were placed into effect on June 10, 2011 and November 11, 2011 of 4.45% and 6.68%, respectively. In addition, water sales revenue increased due to the addition of customers and increased water consumption in Cecil County, Maryland. We realized 90.4% of our total operating revenue for the three months ended June 30, 2012 from the sale of water as compared to 88.9% for the three months ended June 30, 2011.

Non-utility operating revenue decreased \$0.1 million for the three months ended June 30, 2012, or 10.4%, from \$1.1 million in 2011 to \$1.0 million for the same period in 2012. This decrease is primarily due to an approximately \$0.2 million decrease in Artesian Utility revenue, related to a decrease in design and permitting services performed and a decrease in contract services performed for municipalities in Maryland following the purchase of the Cecil County water assets. The decrease in non-utility operating revenue is partially offset by an approximately \$0.1 million increase in water and wastewater Service Line Protection Plan, or SLP Plans, revenue. The SLP Plans provide coverage for all material and labor required to repair or replace participants' leaking water service or clogged sewer lines up to an annual limit.

Operating Expenses

Operating expenses, excluding depreciation and income taxes, decreased 0.2% for the three months ended June 30, 2012, compared to the same period in 2011. The components of the change in operating expenses include an increase in utility operating expenses of \$0.2 million and a decrease in non-utility operating expenses of \$0.2 million.

The increase in utility operating expenses of \$0.2 million, or 2.1%, for the three months ended June 30, 2012 over the same period in 2011, is primarily due to an increase in payroll and benefit expenses and repair and maintenance expenses, partially offset by a decrease in administration expenses and electric purchased power expenses.

Payroll and benefit expenses increased approximately \$0.2 million, or 4.9%, primarily due to an increase in medical benefit premiums and an increase in wages effective October 2011.

Repair and maintenance expenses increased approximately \$0.2 million, or 32.0%, primarily due to increased water treatment equipment maintenance costs and increased software support fees.

Administration expenses decreased \$0.2 million, or 13.2%, primarily due to reduced legal costs associated with the litigation against Chester Water Authority.

Electric purchased power expenses decreased \$0.1 million, or 15.7%, primarily due to the signing of a two-year supply contract at a fixed price. The contract was renewed at a lower fixed price which continues to mitigate future significant increases in electric purchased power expenses. Our most recent supply contract was effective May 2011.

Non-utility expenses decreased approximately \$0.2 million, or 29.0%, primarily the result of decreased project activity in Artesian Utility as compared to the same period in 2011.



## Table of Contents

The ratio of operating expense, excluding depreciation and income taxes, to total revenue was 54.8% for the three months ended June 30, 2012, compared to 59.6% for the three months ended June 30, 2011.

Depreciation and amortization expense increased \$141,000, or 7.7%, primarily due to continued investment in utility plant in service providing supply, treatment, storage and distribution of water.

Federal and state income tax expense increased \$579,000 primarily due to higher taxable income for the three months ended June 30, 2012, compared to the three months ended June 30, 2011.

### Other Income (Expense), Net

Miscellaneous income increased approximately \$156,000 primarily due to an approximately \$168,000 refund of assessment payments previously paid to the Delaware Public Service Commission, or DEPSC. Each year public utility companies, like Artesian Water, are required to fund the DEPSC's operations by paying an assessment based on their estimated annual gross revenues. After periodic review by the DEPSC, excess funds above those necessary to operate the DEPSC are refunded to the respective public utility company. The amount refunded to Artesian in 2012 reflects an assessment that covers a 4 year period from 2007 to 2010. The DEPSC is currently analyzing the funding from 2011 forward. Refunds from the DEPSC related to excess fund payments are not typical and we can make no assurances that refunds for excess payments will be issued in the future.

### Interest Charges

Interest charges decreased \$86,000, or 4.7%, primarily due to a decrease in short-term debt outstanding. We used the proceeds from our July 2011 and August 2011 offering of common stock to repay short-term borrowings.

### Net Income

Our net income applicable to common stock increased \$1.0 million for the three months ended June 30, 2012, compared to the same period a year ago. This increase in net income was primarily due to higher operating income margins in our water utility business, primarily the result of increased water sales revenue.

## Results of Operations – Analysis of the Six Months Ended June 30, 2012 Compared to the Six Months Ended June 30, 2011

### Operating Revenues

Revenues totaled \$34.6 million for the six months ended June 30, 2012, \$3.3 million, or 10.7%, above revenues for the six months ended June 30, 2011 of \$31.3 million. Water sales revenues increased \$3.6 million, or 13.2%, for the six months ended June 30, 2012 over the corresponding period in 2011. Water sales revenue increased primarily due to an 11.13% permanent increase in rates effective January 1, 2012. The permanent rate increase equals the combined temporary rate increases that were placed into effect on June 10, 2011 and November 11, 2011 of 4.45% and 6.68%, respectively. In addition, water sales revenue increased due to the addition of customers and increased water consumption in Cecil County, Maryland. We realized 90.3% of our total operating revenue for the six months ended June 30, 2012 from the sale of water as compared to 88.3% for the six months ended June 30, 2011.

Non-utility operating revenue decreased \$0.3 million for the six months ended June 30, 2012, or 13.2%, from \$2.2 million in 2011 to \$1.9 million for the same period in 2012. This decrease is primarily due to an approximately \$0.4 million decrease in Artesian Utility revenue, related to a decrease in design and permitting services performed and a decrease in contract services performed for municipalities in Maryland following the purchase of the Cecil County

water assets. In addition, consulting revenue earned by Artesian Consulting Engineers decreased approximately \$0.1 million due to the reduction and reorganization of the business. The decrease in non-utility operating revenue is partially offset by an approximately \$0.2 million increase in water and wastewater Service Line Protection Plan, or SLP Plans, revenue. The SLP Plans provide coverage for all material and labor required to repair or replace participants' leaking water service or clogged sewer lines up to an annual limit.



## Table of Contents

### Operating Expenses

Operating expenses, excluding depreciation and income taxes, decreased \$0.6 million, or 3.0%, to \$19.3 million for the six months ended June 30, 2012, compared to \$19.9 million for the same period in 2011. The components of the change in operating expenses include a decrease in non-utility operating expenses of \$0.7 million, offset by a slight increase in utility operating expenses.

Non-utility expenses decreased approximately \$0.7 million, or 38.9%, primarily the result of decreased project activity in Artesian Utility as compared to the same period in 2011. The decrease in non-utility expenses is also due to a decrease in legal costs of approximately \$0.2 million related to the federal grand jury subpoena associated with an investigation that was previously conducted by the United States Attorney's Office in the Eastern District of Pennsylvania and the Environmental Protection Agency.

The increase in utility operating expenses of 0.1% for the six months ended June 30, 2012 over the same period in 2011 is primarily due to an increase in payroll and benefit expenses and repair and maintenance expenses, partially offset by a decrease in administration expenses and electric purchased power expenses.

Payroll and benefit expenses increased approximately \$0.2 million, or 2.5%, primarily due to an increase in medical benefit premiums and an increase in wages effective October 2011.

Repair and maintenance expenses increased approximately \$0.2 million, or 15.8%, primarily due to increased water treatment equipment maintenance costs and increased software support fees.

Administration expenses decreased \$0.2 million, or 7.1%, primarily due to reduced legal costs associated with the litigation against Chester Water Authority.

Electric purchased power expenses decreased \$0.2 million, or 18.9%, primarily due to the signing of a two-year supply contract at a fixed price. The contract was renewed at a lower fixed price which continues to mitigate future significant increases in electric purchased power expenses. Our most recent supply contract was effective May 2011.

The ratio of operating expense, excluding depreciation and income taxes, to total revenue was 55.7% for the six months ended June 30, 2012, compared to 63.6% for the six months ended June 30, 2011.

Depreciation and amortization expense increased \$0.3 million, or 8.0%, primarily due to continued investment in utility plant in service providing supply, treatment, storage and distribution of water.

Federal and state income tax expense increased \$1.6 million primarily due to higher taxable income for the six months ended June 30, 2012, compared to the six months ended June 30, 2011.

### Other Income (Expense), Net

Miscellaneous income increased approximately \$212,000 primarily due to an approximately \$168,000 refund of assessment payments previously paid to the Delaware Public Service Commission, or DEPSC. Each year public utility companies, like Artesian Water, are required to fund the DEPSC's operations by paying an assessment based on their estimated annual gross revenues. After periodic review by the DEPSC, excess funds above those necessary to operate the DEPSC are refunded to the respective public utility company. The amount refunded to Artesian in 2012 reflects an assessment that covers a 4 year period from 2007 to 2010. The DEPSC is currently analyzing the funding from 2011 forward. Refunds from the DEPSC related to excess fund payments are not typical and we can make no assurances that refunds for excess payments will be issued in the future.

### Interest Charges

Interest charges decreased \$156,000, or 4.2%, primarily due to a decrease in short-term debt outstanding. We used the proceeds from our July 2011 and August 2011 offering of common stock to repay short-term borrowings.

### Net Income

Our net income applicable to common stock increased \$2.5 million for the six months ended June 30, 2012, compared to the same period a year ago. This increase in net income was due to higher operating income margins in our water utility business, primarily the result of increased water sales revenue. This increase is also due to the decrease in non-utility expenses, the decrease in interest charges and the increase in miscellaneous income.

## Table of Contents

### LIQUIDITY AND CAPITAL RESOURCES

#### Overview

Our primary sources of liquidity for the six months ended June 30, 2012 were \$13.9 million provided by cash flow from operating activities, \$1.2 million in net contributions and advances from developers and \$0.8 million in net proceeds from the issuance of common stock. Cash flow from operating activities is primarily provided by our utility operations, and is impacted by the timeliness and adequacy of rate increases and changes in water consumption as a result of year-to-year variations in weather conditions, particularly during the summer. A significant part of our ability to maintain and meet our financial objectives is to ensure that our investments in utility plant and equipment are recovered in the rates charged to customers. As such, from time to time, we file rate increase requests to recover increases in operating expenses and investments in utility plant and equipment.

#### Investment in Plant and Systems

The primary focus of Artesian Water's investment was to continue to provide high quality reliable service to our growing service territory. We invested \$10.0 million in capital expenditures during the first six months of 2012 compared to \$6.6 million invested during the same period in 2011. During the first six months of 2012, we invested \$4.1 million to enhance or improve existing treatment facilities and for the rehabilitation of pumping equipment to better serve our customers. We invested \$0.8 million to upgrade and automate our meter reading equipment. We invested approximately \$2.1 million for our rehabilitation program for transmission and distribution facilities by replacing aging or deteriorating mains and for new transmission and distribution facilities. We invested approximately \$0.5 million in mandatory utility plant expenditures due to governmental highway projects which require the relocation of water service mains in addition to facility improvements and upgrades. Developers financed \$0.8 million for the installation of water mains and hydrants for the first six months of 2012 compared to \$0.6 million for the first six months of 2011. We also invested \$0.8 million for equipment purchases, computer hardware and software upgrades and furniture and equipment related to renovations made to our main office building located in New Castle County. An additional \$0.8 million was invested in wastewater projects in Delaware.

#### Lines of Credit

At June 30, 2012, Artesian Resources had a \$40 million line of credit with Citizens Bank, or Citizens, which is available to all subsidiaries of Artesian Resources. As of June 30, 2012, there was \$31.2 million of available funds under this line of credit. The interest rate for borrowings under this line is the London Interbank Offered Rate, or LIBOR, plus 1.00%. This is a demand line of credit and therefore the financial institution may demand payment for any outstanding amounts at any time. The term of this line of credit expires on the earlier of May 30, 2013 or any date on which Citizens demands payment. In 2011, the Company completed the sale of 888,290 shares of its Class A Non-Voting Common Stock and used the net proceeds of approximately \$15.6 million (after deducting underwriting discounts and commissions and offering expenses) to fund a paid-in capital contribution in the same amount to Artesian Water. Artesian Water used the paid-in capital contribution to repay short-term borrowings (including borrowings incurred under our line of credit with Citizens that is available to all of our subsidiaries).

At June 30, 2012, Artesian Water had a \$20 million line of credit with CoBank, ACB, or CoBank, that allows for the financing of operations for Artesian Water, with up to \$10 million of this line available for the operations of Artesian Water Maryland. As of June 30, 2012, there were no borrowings under this line of credit. The interest rate for borrowings under this line is LIBOR plus 1.50%. The term of this line of credit expires on January 16, 2013.

#### Line of Credit Commitments

#### Commitment Due by Period

In thousands	Less than 1 Year	1-3 Years	4-5 Years	Over 5 Years
Lines of Credit	\$8,754	\$-----	\$-----	\$-----

Table of Contents

## Long-Term Debt

On August 1, 2008, Artesian Water Maryland executed a promissory note in the amount of approximately \$2.3 million to Sunrise Holdings, L.P., or Sunrise, in connection with the Mountain Hill acquisition, that bears interest at a variable interest rate of LIBOR plus 1.50%. The note is payable in four equal annual installments, commencing on the first anniversary of the closing date. Three annual installment payments were made in the amount of \$0.6 million each. The remaining principal balance due on this note, as of June 30, 2012, is \$0.6 million. The note is secured by a first lien security interest in all of Mountain Hill's assets in favor of Sunrise and is guaranteed by Artesian Resources.

Artesian Water's trust indentures, which set certain criteria for the issuance of new long-term debt, limit long-term debt, including the short-term portion thereof, to 66 % of total capitalization. Our debt to total capitalization, including the short-term portion thereof, was 48.2% at June 30, 2012. In addition, our revolving line of credit with CoBank contains customary affirmative and negative covenants that are binding on us (which are in some cases subject to certain exceptions), including, but not limited to, restrictions on our ability to make certain loans and investments, guaranty certain obligations, enter into, or undertake, certain mergers, consolidations or acquisitions, transfer certain assets, change our business or incur additional indebtedness. In addition, this line of credit requires us to abide by certain financial covenants and ratios. As of June 30, 2012, we were in compliance with these covenants.

We expect to fund our activities for the next 12 months using our available cash balances and bank credit lines, plus projected cash generated from operations.

## Contractual Obligations

In thousands	Payments Due by Period				Total
	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years	
First Mortgage Bonds (Principal and Interest)	\$7,037	\$13,929	\$13,776	\$147,721	\$182,463
State revolving fund loans (Principal and Interest)	832	1,719	1,719	7,270	11,540
Note Payable (Principal and Interest)	590	---	---	---	590
Operating leases	68	101	107	1,740	2,016
Unconditional purchase obligations	3,780	7,561	7,571	17,038	35,950
Tank painting contractual obligation	339	156	---	---	495
Total contractual cash obligations	\$12,646	\$23,466	\$23,173	\$173,769	\$233,054

Long-term debt obligations reflect the maturities of certain series of our first mortgage bonds, which we intend to refinance when due. The state revolving fund loan obligation has an amortizing mortgage payment payable over a 20-year period, and will be refinanced as future securities are issued. Both the long-term debt and the state revolving fund loan have certain financial covenant provisions, the violation of which could result in default and require the obligation to be immediately repaid, including all interest. We have not experienced conditions that would result in our default under these agreements, and we do not anticipate any such occurrence. Payments for unconditional purchase obligations reflect minimum water purchase obligations based on rates that are subject to change under our interconnection agreement with the Chester Water Authority.

## Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, including any arrangements with any structured finance, special purpose or variable interest entities.

## Critical Accounting Assumptions, Estimates and Policies; Recent Accounting Standards

This discussion and analysis of our financial condition and results of operations is based on the accounting policies used and disclosed in our 2011 consolidated financial statements and accompanying notes that were prepared in accordance with accounting principles generally accepted in the United States of America and included as part of our annual report on Form 10-K for the year ended December 31, 2011. The preparation of those financial statements required management to make assumptions and estimates that affected the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements as well as the reported amounts of revenues and expenses during the reporting periods. Actual amounts or results could differ from those based on such assumptions and estimates.

Our critical accounting policies are described in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our annual report on Form 10-K for the year ended December 31, 2011. There have been no changes in our critical accounting policies. Our significant accounting policies are described in our notes to the 2011 consolidated financial statements included in our annual report on Form 10-K for the year ended December 31, 2011.

## Table of Contents

Information concerning our implementation and the impact of recent accounting standards issued by the Financial Accounting Standards Board is included in the notes to our 2011 consolidated financial statements included in our annual report on Form 10-K for the year ended December 31, 2011 and also in the notes to our consolidated financial statements contained in this quarterly report on Form 10-Q. We did not adopt any accounting policy in the first six months of 2012 that had a material impact on our financial condition, liquidity or results of operations.

## CAUTION REGARDING FORWARD-LOOKING STATEMENTS

Statements in this Quarterly Report on Form 10-Q which express our “belief,” “anticipation” or “expectation,” as well as other statements which are not historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act, Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act and the Private Securities Litigation Reform Act of 1995. Statements regarding our goals, priorities, growth and expansion plans and expectation for our water and wastewater subsidiaries and non-regulated subsidiaries, customer base growth opportunities in Delaware and Cecil County, Maryland, our belief regarding our capacity to provide water services for the foreseeable future to our customers, our belief relating to our compliance and the cost to achieve compliance with relevant governmental regulations, our expectation of the timing of decisions by regulatory authorities, the impact of weather on our operations and the execution of our strategic initiatives, our expectation of the timing for construction on new projects, our belief regarding our reliance on outside engineering firms, our expectation relating to the adoption of recent accounting pronouncements, contract operations opportunities, legal proceedings, our properties, deferred tax assets, adequacy of our available sources of financing, the expected recovery of expenses related to our long-term debt, our expectation to be in compliance with financial covenants in our debt instruments, our ability to refinance our debt as it comes due, the timing and terms of renewals of our lines of credit, plans to increase our wastewater treatment operations, engineering services and other revenue streams less affected by weather, expected future contributions to our postretirement benefit plan, the reclassification on our balance sheet regarding our utility plant, anticipated growth in our non-regulated division, the impact of recent acquisitions on our ability to expand and foster relationships, anticipated investments in certain of our facilities and systems, the positioning of our Company resulting from our simultaneous provision of water and wastewater services and the sources of funding for such investments, sufficiency of internally generated funds and credit facilities to provide working capital and our liquidity needs are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and involve risks and uncertainties that could cause actual results to differ materially from those projected. Words such as “expects”, “anticipates”, “intends”, “plans”, “believes”, “seeks”, “estimates”, “projects”, “forecasts”, “may”, “should”, “wa” words and similar expressions are intended to identify such forward-looking statements. Certain factors as discussed under Item 1A -Risk Factors, in the Company’s annual report on Form 10-K, such as changes in weather, changes in our contractual obligations, changes in government policies, the timing and results of our rate requests, changes in economic and market conditions generally, and other matters could cause results to differ materially from those in the forward-looking statements. While the Company may elect to update forward-looking statements, we specifically disclaim any obligation to do so and you should not rely on any forward-looking statement as representation of the Company’s views as of any date subsequent to the date of the filing of this Quarterly Report on Form 10-Q.

## ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is subject to the risk of fluctuating interest rates in the normal course of business. Our policy is to manage interest rates through the use of fixed rate long-term debt and, to a lesser extent, short-term debt. The Company's exposure to interest rate risk related to existing fixed rate, long-term debt is due to the term of the majority of our First Mortgage Bonds, which have final maturity dates ranging from 2018 to 2043, which exposes the Company to interest rate risk as interest rates may drop below the existing fixed rate of the long-term debt prior to such debt’s maturity. In addition, the Company has interest rate exposure on \$60 million of variable rate lines of credit

with two banks, under which the interim bank loans payable at June 30, 2012 were approximately \$8.8 million. An increase in interest rates will result in an increase in the cost of borrowing on this variable rate line. We are also exposed to market risk associated with changes in commodity prices. Our risks associated with price increases in chemicals, electricity and other commodities are mitigated by our ability to recover our costs through rate increases to our customers. We have also sought to mitigate future significant electric price increases by signing a two year supply contract, at a fixed price.



Table of Contents

ITEM 4 – CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report were designed to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is (1) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (2) accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. In addition, the Chief Executive Officer and the Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report were effective to achieve the foregoing objectives. A control system cannot provide absolute assurance, however, that the objectives of the control system are met and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

(b) Change in Internal Control over Financial Reporting

No change in our internal control over financial reporting occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1 – LEGAL PROCEEDINGS

As previously disclosed, on December 22, 2010, Artesian Water filed a complaint in the United States District Court for the Eastern District of Pennsylvania against Chester Water Authority claiming breach of contract, unjust enrichment and requesting declaratory judgment in relation to an agreement by Chester Water to supply bulk water supplies to Artesian Water. On February 11, 2011, Artesian Water received an answer and counterclaim from Chester Water Authority denying Artesian Water's claims and allegations, asserting a counterclaim for breach of contract and seeking monetary damages, related costs and attorneys' fees. Although Artesian Water intends to pursue its claims and defense in the action vigorously, there can be no assurances that it will prevail on any of the claims in the action, or, if it does prevail on one or more claims, of the amount or nature of recovery that may be awarded.

Periodically, we are involved in other proceedings or litigation arising in the ordinary course of business. We do not believe that the ultimate resolution of these matters will materially affect our business, financial position or results of operations. However, we cannot assure that we will prevail in any litigation and, regardless of the outcome, may incur significant litigation expense and may have significant diversion of management attention.

ITEM 1A – RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2011, which could materially affect our business, financial condition or future results. There have been no material changes to the risk factors described in such Annual Report on Form 10-K.

#### ITEM 4 – MINE SAFETY DISCLOSURES

The information concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 104 of Regulation S-K (17 CFR 229.104) is not applicable to our Company.

Table of Contents

ITEM 6 - EXHIBITS

Exhibit No. Description

- 31.1    Certification of Chief Executive Officer of the Registrant required by Rule 13a – 14 (a) under the Securities Exchange Act of 1934, as amended.\*
- 31.2    Certification of Chief Financial Officer of the Registrant required by Rule 13a – 14 (a) under the Securities Exchange Act of 1934, as amended.\*
- 32      Certification of Chief Executive Officer and Chief Financial Officer required by Rule 13a-14(b) under the Securities Exchange Act of 1934, as amended and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. Section 1350).\*
- 101      The following financial statements from Artesian Resources Corporation's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2012 formatted in eXtensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Balance Sheets; (ii) the Condensed Consolidated Statements of Operations; (iii) the Condensed Consolidated Statements of Cash Flows; and (iv) the Notes to the Condensed Consolidated Financial Statements.

\* Filed herewith

Table of Contents

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.

ARTESIAN RESOURCES CORPORATION

Date: August 9, 2012 By: /s/ DIAN C. TAYLOR  
Dian C. Taylor (Principal Executive Officer)

Date: August 9, 2012 By: /s/ DAVID B. SPACHT  
David B. Spacht (Principal Financial and Accounting  
Officer)

Table of Contents

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Table of Contents