

UTILITIES, INC.

ORIGINAL

2355 Sanders Road
Northbrook, Illinois 60062-6196
Telephone 847 498-6440
Facsimile 847 498-2066

September 29, 1998

Ms. Blanco S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

RE: **Docket No. 980957-WS**
Application for Transfer of Majority Organizational Control
Sanlando Utilities Corporation

Dear Ms. Bayo:

Below are responses to the questions put forth in a letter from Mr. John Williams dated August 26, 1998.

- 1. **As required by Rule 25-30.037(3)(f), Florida Administrative Code (F.A.C.) the utility must include a summary of the buyer's financial ability to provide service. The statement, "The Buyer's financial ability to provide service is well known to the Commission" is inadequate. Please, provide more information of financial ability.**

Enclosed herewith are the 1997 audited financial statements of Utilities, Inc. and Subsidiaries. These financial statements should show that the Buyer has the financial ability to provide service.

- 2. **As required by Rule 25-30.037(3)(k), Florida Administrative Code (F.A.C.) provide the current certificates, so they can be updated with the final order.**

Enclosed are the original certificates.

- 3. **As required by Rule 25-30.037(3)(e), Florida Administrative Code (F.A.C.) provide a statement describing the financing of the purchase. The utility statement that the purchase of stock of Lake Holding, Inc. is a cash transaction financed by a loan from First Union is not sufficient. Please provide the amount financed and the terms of the loan.**

Utilities, Inc. financed the purchase of the common stock of Sanlando Utilities Corporation with a two year loan from First Union Bank. The two year note can be renegotiated/renewed at the end of the two year term. The note carries a variable interest rate at 125 basis points over LIBOR (the former owners carried this type of debt at 230 basis points over LIBOR). The current interest rate is 6.94%. The amount financed was \$9,956,668.

ACK _____
 AFA _____
 APC _____
 CAP _____
 CI _____
 CT _____
 EAL _____
 LEG 1
 LIN _____
 OPC _____
 RCH _____
 SEC 1
 WAS 1
 OTH _____

John Williams

DOCUMENT NUMBER-DATE

10776 SEP 30 8

FPSC-RECORDS/REPORTING

Bayo
September 29, 1998
page 2

4. **Based on your response in the application to item number 10, is it correct that all regulatory assessment fees for 1998 will be paid by Utilities, Inc. or will the fees be prorated between the buyer and seller? Please clarify.**

Utilities, Inc. assumed responsibility for the 1998 Regulatory Assessment Fees. There was no proration at closing.

5. **Based on your response in the application to item number 10, is it correct that you will satisfy all refund obligations from the over collection of CIAC gross-up in the pending docket 981070-WS or will the original owners remain responsible?**

Utilities, Inc. assumed responsibility for any potential refund obligation of CIAC gross-up refunds.

Please feel free to contact me with any additional questions.

Respectfully submitted,



Carl J. Wenz
Vice President, Regulatory Matters

ARTHUR ANDERSEN LLP

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders and
Board of Directors of Utilities, Inc.:

We have audited the accompanying balance sheets and statements of capitalization of UTILITIES, INC. (an Illinois corporation) AND SUBSIDIARY COMPANIES as of December 31, 1997 and 1996, and the related consolidated statements of income, common shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Utilities, Inc. and Subsidiary Companies as of December 31, 1997 and 1996, and the results of their operations and their cash flows for the years then ended, in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

Chicago, Illinois,
February 19, 1998

UNITED STATES AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEETS - DECEMBER 31

ASSETS	1997	1996	CAPITALIZATION AND LIABILITIES	1997	1996
LAND AND EQUIPMENT, at cost:					
Land	\$ 134,280,383	\$ 125,128,641	CAPITALIZATION (see statements):		
Buildings and equipment	157,261,867	148,128,003	Common shareholders' equity	\$ 41,381,612	\$ 43,329,406
Leasehold improvements	6,430,873	6,702,865	Long-term debt, exclusive of current maturities	43,337,574	44,414,964
	<u>\$ 297,973,123</u>	<u>\$ 280,017,509</u>		<u>\$ 84,719,186</u>	<u>\$ 87,744,370</u>
Accumulated depreciation	34,725,105	30,587,207	BOOK VALUE OF OPERATING COMPANIES IN EXCESS OF INVESTMENT, being amortized	\$ 7,338,349	\$ 7,296,352
Provision adjustment, being	<u>20,085,528</u>	<u>17,429,506</u>	CONTRIBUTIONS IN AID OF CONSTRUCTION	\$ 138,241,815	\$ 131,808,798
Construction	\$ 243,162,490	\$ 232,000,796	ADVANCES IN AID OF CONSTRUCTION	309,540	293,010
	<u>3,498,743</u>	<u>1,830,258</u>	TOTAL CONTRIBUTIONS AND ADVANCES	<u>\$ 138,551,355</u>	<u>\$ 132,101,808</u>
CASH, NET	<u>\$ 246,661,233</u>	<u>\$ 233,831,054</u>	CURRENT LIABILITIES:		
Accounts payable (including accrued revenue)- less allowance for uncollectible \$306,708 and \$334,501	\$ 1,162,855	\$ 940,667	Notes payable to banks	\$ 7,231,000	\$ -
Accounts receivable	7,946,700	7,770,172	Accounts payable	6,243,360	5,837,697
Inventory	1,253,749	1,310,627	Current maturities of long-term debt	3,402,390	1,902,260
	<u>898,630</u>	<u>840,886</u>	Customer deposits	1,269,923	1,245,507
PREPARED ASSETS	<u>\$ 11,261,934</u>	<u>\$ 10,862,352</u>	Payable to developers	1,212,602	1,578,188
PROPERTY AND OTHER ASSETS:			Accrued interest	907,984	913,359
Intangible assets, being amortized	\$ 1,218,974	\$ 1,057,350	Accrued taxes	188,762	216,576
Goodwill	2,886,215	2,530,633	Deferred revenue	112,569	76,343
Lease and other assets	<u>3,535,195</u>	<u>3,818,961</u>	TOTAL CURRENT LIABILITIES	<u>\$ 20,568,590</u>	<u>\$ 11,769,930</u>
DEFERRED CHARGES AND OTHER ASSETS	<u>\$ 7,640,384</u>	<u>\$ 7,406,944</u>	DEFERRED CREDITS AND OTHER:		
OTHER ASSETS	<u>\$ 265,563,551</u>	<u>\$ 252,100,350</u>	Deferred income taxes	\$ 11,878,715	\$ 10,868,703
			Deferred investment tax credits	1,439,434	1,474,963
			Other	<u>1,067,922</u>	<u>844,224</u>
			TOTAL DEFERRED CREDITS AND OTHER	<u>\$ 14,386,071</u>	<u>\$ 13,187,890</u>
			TOTAL CAPITALIZATION AND LIABILITIES	<u>\$ 265,563,551</u>	<u>\$ 252,100,350</u>

Refer to consolidated financial statements
for a full description of these statements.

UTILITIES, INC. AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF CAPITALIZATION - DECEMBER 31

	<u>1997</u>	<u>1996</u>
COMMON SHAREHOLDERS' EQUITY:		
Common shares, \$.10 par value; authorized 10,000,000 shares; issued and outstanding 3,123,618 and 3,417,497 shares respectively; 264,000 and 178,300 shares reserved for stock options, respectively	\$ 312,362	\$ 341,750
Treasury shares and other (59,364 treasury shares in 1997 and 10,000 treasury shares in 1996)	(1,717,912)	(142,500)
Paid-in capital	14,394,377	15,593,762
Retained earnings (\$18,567,812 restricted at December 31, 1997)	<u>28,392,785</u>	<u>27,536,394</u>
TOTAL COMMON SHAREHOLDERS' EQUITY	<u>\$ 41,381,612</u>	<u>\$ 43,329,406</u>
LONG-TERM DEBT:		
Collateral trust notes-		
7.87%, due June 1, 2005	\$ 15,000,000	\$ 15,000,000
9.01%, \$1,500,000 due in annual installments beginning November 30, 1998 through 2007	15,000,000	15,000,000
9.16%, \$1,000,000 due in annual installments through 2006	9,000,000	10,000,000
10.39%, \$900,000 due in annual installments through 2003	5,400,000	6,300,000
Mortgage notes-		
5.6%, due in monthly installments of \$264 including interest, through June, 2003	14,964	17,224
Other long-term debt-		
7.72% to 8.50%, promissory note payable to bank due in 1999	<u>2,325,000</u>	<u>-</u>
TOTAL LONG-TERM DEBT	\$ 46,739,964	\$ 46,317,224
Notes payable to banks, 7.25% to 8.50% at December 31, 1997	<u>7,231,000</u>	<u>-</u>
TOTAL DEBT	\$ 53,970,964	\$ 46,317,224
Less-Current maturities	<u>10,633,390</u>	<u>1,902,260</u>
TOTAL LONG-TERM DEBT, NET	<u>\$ 43,337,574</u>	<u>\$ 44,414,964</u>
CAPITALIZATION, exclusive of short term financing	<u>\$ 84,719,186</u>	<u>\$ 87,744,370</u>

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

UTILITIES, INC. AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31

	<u>1997</u>	<u>1996</u>
<u>UTILITY OPERATIONS</u>		
OPERATING REVENUES:		
Water	\$ 21,237,742	\$ 19,837,632
Wastewater	19,834,533	19,265,656
Miscellaneous	<u>1,072,260</u>	<u>963,023</u>
TOTAL OPERATING REVENUES	<u>\$ 42,144,535</u>	<u>\$ 40,066,311</u>
OPERATING EXPENSES:		
Operation and maintenance	\$ 24,323,724	\$ 26,912,143
Depreciation and amortization	3,003,614	3,029,847
Taxes-		
Property and other general taxes	3,304,855	3,167,594
Income taxes	<u>2,598,594</u>	<u>941,171</u>
TOTAL OPERATING EXPENSES	<u>\$ 33,230,787</u>	<u>\$ 34,052,755</u>
INCOME AFTER OPERATING EXPENSES	<u>\$ 8,913,748</u>	<u>\$ 6,013,556</u>
OTHER (INCOME) DEDUCTIONS:		
Interest expense	\$ 4,191,707	\$ 3,959,579
Allowance for funds used during construction-equity	(103,645)	(104,764)
Allowance for funds used during construction-borrowed	(133,583)	(112,635)
Other, net	<u>(609,673)</u>	<u>464,868</u>
TOTAL OTHER (INCOME) DEDUCTIONS	<u>\$ 3,344,806</u>	<u>\$ 4,207,048</u>
INCOME FROM UTILITY OPERATIONS	<u>\$ 5,568,942</u>	<u>\$ 1,806,508</u>
INCOME FROM NON-UTILITY OPERATIONS	<u>\$ 132,756</u>	<u>\$ 88,645</u>
NET INCOME FROM UTILITY AND NON-UTILITY OPERATIONS	<u>\$ 5,701,698</u>	<u>\$ 1,895,153</u>
GAIN ON DISPOSITION OF ASSETS	\$ 2,112,990	\$ 2,060,114
Less-Income taxes applicable to disposition of assets	<u>696,549</u>	<u>764,327</u>
GAIN ON DISPOSITION OF ASSETS, NET	<u>\$ 1,416,441</u>	<u>\$ 1,295,787</u>
NET INCOME	<u>\$ 7,118,139</u>	<u>\$ 3,190,940</u>
Average common shares outstanding	<u>3,203,248</u>	<u>3,382,804</u>
Basic earnings per share	<u>\$ 2.22</u>	<u>\$ 0.94</u>
Diluted earnings per share	<u>\$ 2.19</u>	<u>\$ 0.91</u>

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

UTILITIES, INC. AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF CASH FLOW

FOR THE YEARS ENDED DECEMBER 31

	<u>1997</u>	<u>1996</u>
Cash Flows From Operating Activities:		
Net income	\$ 7,118,139	\$ 3,190,940
Net non-cash charges (credits) to net income:		
Depreciation and amortization	3,003,614	3,029,847
Deferred income taxes & investment tax credits, net	1,173,578	(773)
Deferred charges being amortized	(1,290,923)	(1,152,118)
Amortization of deferred charges	679,610	1,423,982
Equity component of allowance for funds used during construction	(103,645)	(104,764)
Gain on disposition of assets	(1,416,441)	(1,295,787)
	<u>\$ 9,163,932</u>	<u>\$ 5,091,327</u>
Change in certain current assets and certain current liabilities:		
Receivables	(119,650)	(1,429,830)
Prepayments	(57,744)	(590,868)
Accounts payable and accrued liabilities	405,663	420,489
Accrued taxes and interest	(834,726)	(518,809)
Customer deposits	24,416	38,305
Other	36,226	50,812
	<u>\$ 8,618,117</u>	<u>\$ 3,061,426</u>
Net Cash Provided by Operating Activities		
Cash Flows From Investing Activities:		
Construction expenditures	\$(10,414,184)	\$(7,831,377)
Equity component of allowance for funds used during construction	103,645	104,764
Contributions in aid of construction, net	2,803,938	2,142,880
Acquisition expenditures	(1,953,055)	(2,055,266)
Proceeds from disposition of assets	2,421,317	4,540,591
Notes Receivable	283,766	343,146
Other	136,423	618,948
	<u>\$ (6,618,150)</u>	<u>\$ (2,136,314)</u>
Net Cash Used by Investing Activities		
Cash Flows From Financing Activities:		
Purchase of common shares	\$(11,600,337)	\$(1,808,645)
Dividends paid on common shares	-	(1,011,149)
Issuance of common and treasury shares	2,534,404	2,015,380
Issuance of long-term debt	2,325,000	-
Retirement of long-term debt	(1,902,260)	(979,800)
Increase in short-term borrowing	7,231,000	-
Increase (Decrease) in payable to developers	(365,586)	511,177
	<u>\$ (1,777,779)</u>	<u>\$ (1,273,017)</u>
Net Cash Used by Financing Activities		
Net Increase (Decrease) in Cash	222,188	(347,945)
Cash at Beginning of Year	<u>940,667</u>	<u>1,288,592</u>
Cash at End of Year	<u>\$ 1,162,855</u>	<u>\$ 940,647</u>
Supplemental cash flow information:		
Interest paid (net of amounts capitalized)	\$ 4,176,381	\$ 3,982,956
Income taxes paid	\$ 1,477,789	\$ 2,533,872

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

UTILITIES, INC. AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF COMMON SHAREHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 1997 AND 1996

	<u>Common Shares</u>		<u>Treasury Shares and Other</u>	<u>Paid-In Capital</u>	<u>Retained Earnings</u>
	<u>Shares</u>	<u>Amount</u>			
Balance at December 31, 1995	3,380,077	\$ 318,008	\$ -	\$ 15,167,312	\$ 25,437,540
Net Income					3,190,940
Dividend on Common Shares, Cash					(1,011,149)
Issuance of Common Shares	42,700	4,270		372,801	
Purchase of 101,680 Common Shares			(1,808,645)		
Retirement of Common Shares	(5,280)	(528)	105,336	(23,871)	(80,937)
Issuance of 86,400 Treasury Shares			1,560,809	77,500	
Balance at December 31, 1996	3,417,497	\$ 341,750	\$ (142,500)	\$ 15,591,762	\$ 27,536,394
Net Income					7,118,139
Issuance of Common Shares	14,300	1,430		124,909	
Purchase of 466,283 Common Shares			(11,600,337)		
Retirement of Common Shares	(308,179)	(30,818)	7,699,360	(1,406,744)	(6,261,748)
Issuance of 108,740 Treasury Shares, includes 10,417 shares of restricted stock			2,325,565	82,500	
Balance at December 31, 1997	3,123,618	\$ 312,362	\$ (1,717,912)	\$ 14,994,711	\$ 28,992,785

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - Summary of Significant Accounting Policies

NATURE OF BUSINESS

Utilities, Inc. is a holding company which, at December 31, 1997, owned and operated approximately 350 water and wastewater utility systems through 63 subsidiary operating companies. The Company also owns certain land application facilities and provides services on a fee basis. Operating results for these entities are included in the consolidated statements of income under utility operations. The primary areas served include North Carolina, Florida, South Carolina, Illinois and Louisiana. Non-utility operations consist of a solid waste-collection billing service and management services provided on a contractual basis. In 1997, the Company divested itself of its full service travel agency. The results from the travel agency are included in non-utility operations.

PRINCIPLES OF CONSOLIDATION

Common expenses of Utilities, Inc. and Water Service Corporation, an affiliated service company, are charged at cost to all affiliated operating companies. In the consolidated financial statements, all significant intercompany transactions have been eliminated.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

INCOME TAXES

Utilities, Inc. and its subsidiaries file a consolidated Federal income tax return.

Deferred income taxes are recorded for differences that result from accelerated depreciation, contributions in aid of construction for certain contributions received from 1986 to 1996, investment tax credits, certain deferred charges and certain other differences in the recognition of income and expense for tax and financial reporting purposes.

Investment tax credits are deferred and are being amortized over the book lives of the related properties.

Deferred tax liabilities and assets are recorded for all temporary differences between the tax basis of assets and liabilities and the amounts reported in the financial statements, measured at the currently enacted statutory income tax rate. As a result of rate-making practices, certain temporary differences have not been recognized as deferred income tax expense for rate-making purposes. In such situations, when the differences reverse, the Company believes it will recover the higher income taxes then currently payable. A net regulatory asset has been established to recognize this expected regulatory treatment.

DEPRECIATION

Property in service is depreciated using the straight-line method. The depreciation rate generally ranges from 1.5% to 5.0% based on the estimated useful life of the property. Provision for depreciation on property contributed is generally not permitted.

REVENUES

Residential water and wastewater charges are billed monthly, bimonthly or quarterly on either a usage or availability charge basis. Revenues for such services are recognized as earned. Certain availability charges are billed in advance, and the portion of such billings applicable to periods subsequent to December 31 is included in deferred revenue.

PLANT ACQUISITION ADJUSTMENT AND BOOK VALUE OF OPERATING COMPANIES IN EXCESS OF INVESTMENT

In accordance with prescribed regulatory accounting practices, Plant Acquisition Adjustment, (representing the amount by which the original cost of assets acquired, less accumulated depreciation, contributions in aid of construction and advances in aid of construction, exceeds the purchase price) is being amortized as a reduction of depreciation expense over the average life of the plant in service to which it relates.

The Book Value of Operating Companies in Excess of Investment (representing the amount by which the book values of the companies acquired exceed the investment by Utilities, Inc.) is also being amortized over the average life of the plant in service to which it relates.

ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION

The cost of debt and equity funds used to finance construction (AFUDC) is capitalized as a cost element of property, with an offsetting credit to other income. The inclusion of AFUDC in plant enables the fair return on, and the recovery of, these capitalized costs by inclusion in rate base and depreciation. The AFUDC rates, on a before-tax basis, ranged from 8.61% to 10.43% at both December 31, 1997 and December 31, 1996. AFUDC is a non-cash income item.

ACQUISITIONS AND SALES

Legal and professional fees and executive time incurred in connection with acquisitions of new water and wastewater systems is capitalized as a cost of the specific acquisition. A similar policy is followed for sales, whereby any such costs associated with sales of existing systems are allocated to specific system sales. Costs incurred in unsuccessful acquisition or disposition activities are written off as operating expenses in the period in which such determination is made.

STOCK-BASED COMPENSATION

Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS 123) encourages but does not require companies to record compensation cost for stock-based employee compensation plans at a fair value. The Company has chosen to continue to account for stock-based compensation using Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees". Accordingly, compensation cost for stock options is measured as the excess, if any, of the fair market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock.

REGULATORY ASSETS AND LIABILITIES

The Company is subject to the provisions of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation." Regulatory assets represent probable future revenue to the Company associated with certain costs which will be recovered from customers through the ratemaking process. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are to be credited to customers through the ratemaking process.

LONG-LIVED ASSETS

During 1996, the Company adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of" (SFAS 121). The new accounting standard sets guidelines to be used for determining and measuring impairment of certain assets. Measurement of the impairment loss is based on the fair value of an asset.

RESERVATION OF CAPACITY FEES

The Company has received fees from potential customers to reserve capacity on its systems for a period of time. The capacity fees received are amortized over the period that such capacity is required to be kept available, principally seven years. The unamortized balance is included in Other Deferred Credits.

NOTE 2 - Deferred Charges and Regulatory Assets

	<u>1997</u>	<u>1996</u>
Deferred Charges include the following:		
Debt acquisition expense	\$ 487,978	\$ 555,920
Maintenance and testing	221,166	82,702
Sludge hauling expenses	145,923	162,976
Other	<u>363,907</u>	<u>255,752</u>
Total Deferred Charges	\$ 1,218,974	\$ 1,057,350
Regulatory Assets include the following:		
Deferred Income Tax Asset	\$ 1,674,248	\$ 1,768,355
Regulatory Expenses, primarily rate cases	<u>1,211,967</u>	<u>762,278</u>
Total Regulatory Assets	\$ 2,886,215	\$ 2,530,633

The regulatory asset for deferred income taxes will be adjusted as the amounts reverse and are included in tax expense for regulatory purposes. Other regulatory assets and deferred charges are being amortized to expense generally over periods from 3 to 15 years, corresponding to the period of rate recovery.

NOTE 3 - Current Maturities of Long-term Debt

Scheduled maturities of long-term debt outstanding at December 31, 1997 for each of the next five years are as follows:

<u>Year</u>	<u>Maturities</u>
1998	\$3,402,390
1999	\$5,727,527
2000	\$3,402,673
2001	\$3,402,826
2002	\$3,402,989

NOTE 4 - Stock Plans

The Company has stock option plans under which certain directors, officers and employees have been awarded stock options. During 1997, the shareholders approved the 1997 Stock Option Plan which reserved an additional 100,000 shares for issuance.

The Company has adopted the disclosure-only provisions SFAS 123. Accordingly, no compensation cost has been recognized for the stock option plan. Had the Company adopted the fair value provisions consistent with SFAS 123, compensation expense would have been recognized and the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

		<u>1997</u>	<u>1996</u>
Net Income	As reported	\$7,118,139	\$3,190,940
	Pro forma	\$6,623,406	\$3,152,216
Basic Earnings Per Share	As reported	\$ 2.22	\$.94
	Pro forma	\$ 2.07	\$.93
Diluted Earnings Per Share	As reported	\$ 2.19	\$.93
	Pro forma	\$ 2.04	\$.92

The exercise price of each option equals the market price of the Company's shares on the date of grant. The vesting period ranges from the grant date up to 4 years. However, options are not exercisable more than 10 years after grant date. The fair value of each option granted in 1997 is estimated by comparing the grant price to the discounted exercise price over the life of the option. The discount rate is the risk-free rate of 5.78%, based on 10 year zero coupon governmental bonds. Information regarding these option plans for 1997 and 1996 is as follows:

	<u>1997</u>		<u>1996</u>	
	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Shares</u>	<u>Weighted Average Exercise Price</u>
Outstanding at beginning of year	78,300	\$ 10.48	129,000	\$ 9.83
Granted	131,400	22.50	-	
Exercised	14,300	8.83	42,700	8.83
Repurchase of unexercised options	-	-	<u>8,000</u>	8.83
Outstanding at end of year	<u>195,400</u>	\$ 18.68	<u>78,300</u>	\$ 10.48
Options available for grant at end of year	68,600		100,000	
Options exercisable at end of year	133,788		73,300	
Weighted average fair value of options granted during the year		\$ 9.88		-

The following table summarizes information about the options outstanding at December 31, 1997:

Range of Exercise Prices	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>Number Outstanding at 12/31/97</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Weighted Average Exercise Price</u>	<u>Number Exercisable at 12/31/97</u>	<u>Weighted Average Exercise Price</u>
\$8 to \$9	40,000	2.6 years	\$ 8.83	40,000	\$ 8.83
\$10 to \$11	9,000	4.7 years	10.67	9,000	10.67
\$16 to \$17	15,000	7.6 years	16.33	15,000	16.33
\$22 to \$23	<u>131,400</u>	9.1 years	22.50	<u>62,788</u>	22.50
\$8 to \$23	<u>195,400</u>	<u>7.5 years</u>	<u>\$18.68</u>	<u>133,788</u>	<u>\$16.93</u>

Under the provisions of a Long-term Incentive Plan adopted during 1997, 10,417 common shares were issued as restricted shares to certain officers. These shares remain restricted at December 31, 1997 and are included in the Treasury Shares and Other deduction to Common Shareholders' Equity as unearned compensation at a cost of \$234,383.

NOTE 5 - Notes Receivable and Advances

Under certain loan agreements, aggregate loans and advances to officers are limited to \$750,000. At both December 31, 1997 and 1996, loans of \$2,500 were outstanding bearing interest at 8%. In connection with these same loan agreements the Board of Directors has approved a program whereby loans of up to \$3,000,000 in aggregate principal value can be made to certain officers and non-officer employees for the purchase of equity interests in the Company. At December 31, 1997, \$2,790,585 was outstanding under this program bearing interest at a rate of 1% over the prime rate. In addition, there is accrued interest of \$708,500 in connection with this program.

Loans to officers of \$29,873 have been made under the normal provisions of the Pension Plan. These loans bear an interest rate based upon the Standard & Poors Bond Index on AA rated bonds.

NOTE 6 - Pledged Collateral

The common stock and indebtedness of subsidiary companies have been pledged as collateral for the collateral notes.

NOTE 7 - Employee Benefit Plans

A Money Purchase Pension Plan (Plan) is available to all employees meeting certain minimum eligibility requirements. Under this Plan, the Company contributes an amount based on a percentage of an eligible employee's salary. The contribution is invested, by a professional money manager, on behalf of the participants who, upon retirement, will receive the amount accumulated in their individual investment accounts, subject to the provisions of the Plan. Pension cost amounted to \$232,198 and \$231,286, in 1997 and 1996, respectively.

An Employee Stock Ownership Plan (ESOP) is available for eligible employees. Under this plan, contributions to a trust are made for the benefit of eligible employees in the form of cash or common shares of the Company. The amount of the annual contribution is determined by the Board of Directors and is discretionary. The Company contributions to the plan were \$286,306 and \$286,123, in 1997 and 1996, respectively. As of December 31, 1997, the ESOP Trust held 239,705 common shares.

Trustees for the Pension Plan and the ESOP are key officers and directors of the Company.

NOTE 8 - Income Taxes

Income tax expense includes a provision for deferred taxes to reflect the tax effect of temporary differences between the time certain costs are recorded for financial reporting purposes and when they are included on the income tax return.

Accumulated deferred income taxes include \$1,674,248 and \$1,768,355, at December 31, 1997 and 1996, respectively, with offsetting amounts recorded as regulatory assets to reflect the probable future regulatory treatment afforded certain temporary differences such as state deferred taxes, the tax effect of investment tax credits and construction overheads, and tax rate differentials which had been previously provided in accordance with prior regulatory actions.

Income tax expense of \$68,390 and \$45,665, at December 31, 1997 and 1996, respectively, has been recorded in determining income from non-utility operations.

A reconciliation of the statutory Federal income tax rate to the effective Federal and state income tax rate for 1997 and 1996 follows:

	<u>1997</u>	<u>1996</u>
Statutory Federal income tax rate	34.0%	34.0%
Equity component of AFUDC, not subject to taxation	(.3)	(.7)
Amortization of book value of operating companies in excess of investment, not subject to taxation	(.6)	(1.3)
Amortization of investment tax credits	(.3)	(.7)
State income taxes, net of Federal tax benefit	.6	.3
Tax adjustment on disposition of assets	(.2)	2.2
Other, net	<u>(1.1)</u>	<u>(1.2)</u>
Effective Federal and state income tax rate	<u>32.1%</u>	<u>32.6%</u>

A summary of the components of the Federal and state income tax expense for 1997 and 1996 follows:

	<u>1997</u>	<u>1996</u>
Federal Income Tax Expense		
Related to Operations:		
Current	\$ 440,170	\$ 739,643
Deferred, net	1,940,503	56,275
Deferred investment tax credits, net	<u>(35,522)</u>	<u>(35,522)</u>
Total	<u>\$ 2,345,144</u>	<u>\$ 760,389</u>
Federal Income Tax Expense Related to Disposition of Assets:		
Current	\$ 684,850	\$ -
Deferred	<u>(104,988)</u>	<u>603,021</u>
Total	<u>\$ 579,862</u>	<u>\$ 603,021</u>
Total Federal Income Tax Expense	<u>\$ 2,925,006</u>	<u>\$ 1,363,410</u>
State Income Tax Expense		
Related to Operations:		
Current	\$ 92,724	\$ 178,780
Deferred	<u>229,116</u>	<u>(155,372)</u>
Total	<u>\$ 321,840</u>	<u>\$ 23,408</u>
State Income Tax Expense Related to Disposition of Assets:		
Current	\$ 116,687	\$ -
Deferred	<u>-</u>	<u>161,306</u>
Total	<u>\$ 116,687</u>	<u>\$ 161,306</u>
Total State Income Tax Expense	<u>\$ 438,527</u>	<u>\$ 184,714</u>
Total Income Tax Expense	<u>\$ 3,363,533</u>	<u>\$ 1,548,124</u>

NOTE 9 - Contingencies

In connection with certain properties, the Company has agreed to make payments of up to \$1,904,425 to developers of those properties. Payments are contingent upon the number of customers added to the systems of the various operating companies. In the opinion of management, payments will be made from amounts collected from additional customers.

The Company is subject to legal proceedings and claims arising out of the ordinary course of its business. One such suit was brought by an individual seeking \$6,000,000 in the South Carolina Court of Common Pleas alleging libel. The Company has turned the suit over to its insurance carrier.

NOTE 10 - Other, net

In 1997, Other, net in the consolidated statements of income included approximately \$500,000 of gain related to the sale of a non-utility investment.

NOTE 11 - Stock Repurchase Program

The Board of Directors has authorized a stock repurchase program whereby the Company can purchase and retire up to \$10,000,000 of outstanding common shares. During 1997, the Company purchased and retired 308,179 shares at a cost of \$7,699,360. In addition, 48,706 treasury shares held at December 31, 1997, at a cost of \$1,223,738, were retired in January, 1998. The total cost of shares purchased and retired under this program, including these treasury shares, is \$9,403,031. In 1998, the Board of Directors increased the total capacity of this program to \$20,000,000.

NOTE 12 - Earnings per Share

The Company became subject to the provisions of Statement of Financial Accounting Standards No. 128, "Earnings per Share" in 1997. The Statement sets new standards for the computation and disclosure of earnings per share.

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period.

Diluted earnings per share is calculated by including all potential dilutive common shares such as stock options. Potential dilutive common shares were 43,762 and 59,453 for 1997 and 1996, respectively. No adjustment to reported net income is required when computing diluted earnings per share.

NOTE 13 - Unusual Charges

The Company has incurred certain unusual and/or nonrecurring charges due to a management transition, a re-evaluation of the Company's strategic direction and the adoption of a new accounting standard which took place during 1996. The charges against income include the following:

1997

- Operation and maintenance expenses in the consolidated statements of income include net charges of approximately \$250,000 related to the management transition that occurred in 1996.

1996

- Approximately \$1,760,000 for management transition costs associated with executives who left the Company during the year. These costs, included in operation and maintenance expenses in the consolidated statements of income, include severance, legal, accounting, post-retirement benefits and other costs associated with these individuals leaving the Company.

- Approximately \$700,000 as a result of management's decision to exit the laboratory business. This charge represents the resulting write-down of the Company's investment in the laboratory operations of Land & Lab Technology, Inc. to its estimated net realizable value. This write-down on a net of tax basis of \$494,961 is included under Other, net, in the consolidated statements of income.
- Approximately \$530,000 due primarily to the adoption of a new accounting standard, SFAS 121. This Statement became effective in 1996, and requires companies to evaluate long-lived assets for potential impairment, and imposes a higher standard for any regulatory assets to be carried on a company's balance sheet. Approximately \$440,000 of this charge consists of regulatory assets deemed no longer probable of recovery and is included in operation and maintenance expenses. The balance, included in depreciation in the consolidated statements of income, consists of miscellaneous property, plant and equipment items.
- Approximately \$1,060,000 associated with property sales consummated in prior years, which has been reflected as a charge against gains from system sales in 1996 (presented as gain on disposition of assets in the consolidated statements of income). The majority of this charge represents the estimated cost of \$740,000 to remediate certain wastewater properties which were sold in a prior year. This estimate is greater than amounts estimated in prior years and adjusts the previously recognized gain on sale as a result of the Company receiving an order to fully remediate the location. The remaining \$320,000 of the charge resulted from writing down to net realizable value a specialized piece of water treatment equipment. This equipment was originally purchased for a system that was subsequently sold. The Company has not been successful in disposing of the equipment over the past several years.
- Approximately \$230,000 less executive time was capitalized in 1996 compared to 1995, primarily as a result of the reduced level of executive time devoted to acquisitions of new water and wastewater systems and sales of existing systems in 1996. Further, approximately \$180,000 associated with potential acquisitions and system sales that did not materialize was expensed in 1996. Both of these items are included in operation and maintenance expenses in the consolidated statements of income.
- Approximately \$190,000 due primarily to miscellaneous adjustments to write down certain other assets to their net realizable value is included in operation and maintenance expenses in the consolidated statements of income.