M E M O R A N D U M

October 9, 1998

TO: DIVISION OF RECORDS AND REPORTING

FROM: DIVISION OF AUDITING AND FINANCIAL ANALYSIS (VANDIVER)

RE: DOCKET NO. 980214-WS -- UNITED WATER FLORIDA, INC.
AUDIT REPORT - RATE CASE - PROJECTED TEST YEAR 12/31/99
AUDIT CONTROL NO. 98-169-1-1

The above-referenced audit report is forwarded. Audit exceptions document deviations from the Uniform System of Accounts, Commission rule or order, Staff Accounting Bulletin and generally accepted accounting principles. Audit disclosures show information that may influence the decision process.

The audit was prepared using a micro computer and has been recorded on diskette and may be reviewed using IBM compatible equipment and LOTUS 1-2-3 software. There are no confidential working papers associated with this audit.

Please forward a complete copy of this audit report to:

United Water Florida, Inc.
Gary R. Moseley
P.O. Box 8004
Jacksonville, FL 32239-0004

DNV/sp
Attachment
cc: Chairman Johnson
Commissioner Clark
Commissioner Deason
Commissioner Garcia
Commissioner Jacobs
Mary Andrews Bane, Deputy Executive Director/Technical
Legal Services
Division of Auditing and Financial Analysis (Devlin/Causseaux/ File Folder)
Division of Water and Wastewater (Kyle)
Tallahassee District Office (Hicks)

Research and Regulatory Review (Harvey)
Office of Public Counsel

FLORIDA PUBLIC SERVICE COMMISSION

DIVISION OF AUDITING AND FINANCIAL ANALYSIS
BUREAU OF AUDITING

Tallahassee District Office

United Water Florida, Inc.

Rate Case

PROJECTED TEST YEAR ENDED December 31, 1999

DOCKET NO. 980214-WS
AUDIT CONTROL NO. 98-169-1-1

Robert T. Moore, Audit Manager

Chris Holman, Audit Staff

Christine Vendetti, Audit Staff

Rhonda Hicks, Audit Supervisor

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DIVISION OF AUDITING AND FINANCIAL ANALYSIS
AUDITOR'S REPORT

September 4, 1998

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described later in this report to audit the accompanying schedules of Rate Base, Net Operating Income, and Capital Structure for the projected 12-month period ended December 31, 1999, for United Water Florida, Inc. These schedules were prepared by the utility as part of its petition for rate relief in Docket No. 980214-WS. There is no confidential information associated with this audit, and there are no audit staff minority opinions.

This is an internal accounting report prepared after performing a limited scope audit. Accordingly, this report should not be relied upon for any purpose except to assist the Commission staff in the performance of their duties. Substantial additional work would have to be performed to satisfy generally accepted auditing standards and produce audited financial statements for public use.

In our opinion, schedules referred to above present fairly, in all material respects, the utility's books and records, maintained in conformity with the accounting practices prescribed by the Florida Public Service Commission. The attached findings discuss all differences and other matters which were noted during our examination.

SUMMARY OF SIGNIFICANT FINDINGS

The Utility did not provide sufficient documentation to support preparation of schedules in the Minimum Filing Requirements (MFRs). Plant in Service in the MFRs does not reconcile to the books and records. The Utility deducts fully depreciated plant from total plant prior to computing depreciation expense. Retained earnings, Deferred Taxes, and Working Capital Allowance in the MFR's do not reconcile to the Utility's books and records. The utility's projected Purchased Sewage Treatment Expense is overstated. The Allowance for Funds Used During Construction (AFUDC) rate exceeded the Commission allowed rate.

SUMMARY OF SIGNIFICANT PROCEDURES

Our audit was performed by examining, on a test basis, certain transactions and account balances which we believe are sufficient to base our opinion. Our examination did not entail a complete review of all financial transactions of the company. Our more important audit procedures are summarized below. The following definitions apply when used in this report:

Scanned - The documents or accounts were read quickly looking for obvious errors.

Compiled - The exhibit amounts were reconciled with the general ledger, and accounts were scanned for error or inconsistency.

RATE BASE: Attempted to reconcile plant to the books and records of the Company. Tested by judgmental sample closed Construction on Work In Progress (CWTP) additions to Plant in Service (sampled 8 percent of total 1996 and 1997 closed CWIP plant additions totaling $24,180,093). Reconciled prior Order adjustments to the books and records. Scanned 1997 plant in service. Performed analytical review on selected rate base accounts. Scanned selected Capital Expenditure Authorizations for proper AFUDC rates. Compared utility depreciation rates used to rule rates and last order. Investigated debit balances in accumulated depreciation. Attempted to recompute Depreciation Expense. Compiled working capital accounts from the general ledger.

NET OPERATING INCOME: Compiled revenues and expenses. Traced revenues, customers, and bills from MFR schedules to General Ledger and Billing Records. Prepared schedules from the Monthly Revenue Summary schedules and Revenue Journal entries to develop total consumption. Summarized the Sunray customers, revenues, and consumption that were not included in the historic billing records for United Water Florida. Recomputed several utility bills and compared rates to the tariff. Performed analytical review on selected expense accounts. Investigated projections and support for large increases. Determined the proper rates for Purchased Sewage Treatment expense. Studied the detail of rate case expense for prior rate case, limited proceeding, and current rate case. Observed property tax bills for selected systems.

CAPITAL STRUCTURE: Attempted to reconcile capital structure. Reconciled prior order adjustments to the books and records. Performed analytical review on selected capital structure accounts.

EXCEPTIONS

Exception No. I

Subject: **Adequacy of Support Documentation for MFR Schedules**

Statement of Fact: Rule 25-30.450, Florida Administrative Code (F.A.C.) states, "In each instance, the utility must be able to support any schedule submitted, as well as any adjustments or allocations relied on by the utility. The work sheets, etc, supporting the schedules and data submitted must be organized in a systematic and rational manner so as to enable Commission personnel to verify the schedules in an expedient manner and minimum amount of time. The supporting work sheets, etc., shall list all reference sources necessary to enable Commission personnel to trace to original source of entry into the financial and accounting system and ,in addition, verify amounts to the appropriate schedules."

United Water of Florida, Inc. did not provide worksheets and other data supporting its MFR schedules in a systematic and rational manner. In addition, audit staff was unable to verify the MFR schedules in an expedient manner.

The audit staff attempted, numerous times, to obtain supporting documentation for the utility's MFR schedules. The utility, in most cases, insufficiently answered audit document requests. At other times, the utility was late responding or failed to answer document requests until after the end of audit field work. Further, on one occasion, the utility provided the audit staff with copies of MFR schedules in response to requests for worksheets to support other MFR schedules.

A great deal of the problems the utility had in providing documentation was the recent implementation of a new computer system. Utility personnel experienced difficulties in extracting information, in hard copy form, from the computer. The utility was late responding to approximately 25% of the audit document requests.

The audit staff is sympathetic to the utility's frustration with its new computer system. The fact remains that the utility petitioned this Commission for test year approval and subsequently prepared and filed MFRs. Since the MFRs were prepared by utility personnel, it is reasonable to expect the utility would have the worksheets and supporting documentation the utility used to prepare the MFRs. These worksheets and supporting documentation should have been provided to the audit staff. Instead, the utility kept trying to create new or generate reports from its computer system. These newly generated utility reports frequently had conflicting account balances which the utility failed to reconcile. As a result, the effectiveness of the audit has been reduced. Many differences reconciled by the utility can not be verified by the audit staff.

Recommendation: The company did not comply with Rule 25-30.450, F.A.C.

Exception No. 2

Subject: **Plant in Service**

Statement of Fact: Commission Order No. PSC-97-0618-FOF-WS, issued May 3O , 1997 in Docket No. 960451-WS, ordered the utility to

> "comply with Rule 25-30.115(l), Florida Administrative Code, by either keeping its accounts in accordance with the National Association of Regulatory Commissioners' (NARUC) Uniform System of Accounts, or by providing a reliable conversion chart which will map its own accounts to those prescribed by NARUC."

The USOA required by rule 25-30.115(l), Florida Administrative Code also requires:

- "each utility shall keep its books of account, and all other books, records, and memoranda which support the entries in such books of accounts so as to be able to furnish readily full information as to any item included in any account. Each entry shall be supported by such detailed information as will permit a ready identification, analysis, and verification of all facts relevant thereto." (Instruction 2)
- "each utility shall keep its books on a monthly basis." (Instruction 4)
- "each ... account shall be subdivided as shown in the plant account matrix" (i.e. use 300 accounts to subdivide the 101 plant account) (Instruction 32)

The utility maintains a subsidiary ledger for the 300 plant accounts. For the end of the test year, the totals for this ledger do, not agree with the 101 plant account in the general ledger for wastewater plant and the utility was unable to reconcile the differences. The utility was unable to provide support for reconciling monthly balances and the beginning balance. The utility stated that it was in the process of converting to the new system and all entries were not recorded timely but adjustments were made for the MFRs. However, documents supporting these adjustments were not made available to the auditors. Because the utility is unable to reconcile the 300 account subsidiary ledger to the general ledger and the MFRs, staff believes that the utility is not meeting the requirements of Instructions 2 and 32.

	MFR UPIS Total 12/31/97	300 Plant Account Total 12/31/97	Difference
WASTEWATER	$99,672,472	$99,663,698	$8,774

The subsidiary ledger for the 300 accounts does indicate a beginning and ending monthly balance. Staff does not believe that this meets the requirements of the USOA. Staff believes that the requirement that each utility keep books on a monthly basis requires the utility to indicate a beginning and ending monthly balance.

Recommendation: The utility is not in compliance with the NARUC USOA.

Exception No. 3

Subject: Depreciation Expense

Statement of Fact: Rule 25-30.140(3), Florida Administrative Code (F.A.C.) states "average service life depreciation rates based on the guideline lives and salvages shall be used in any preceding before this Commission that involve the setting of rates." The rule also defines Average Service life as the "economic service life that can be reasonably expected from the plant type in question."

United Water Florida, Inc. excludes fully depreciated plant from depreciation calculations. This method is permissible under unit depreciation. However, to follow group depreciation practices, Rule 25-30.140(4), Florida Administrative Code, states that "utilities shall maintain depreciation rates and reserve activity by account." This requirement does not permit the exclusion of fully depreciated plant from depreciation calculations.

The audit staff tried to ascertain which accounts contained fully depreciated plant but was unable to do so. However, audit staff did determine the 1997 ending balances in Flow Measuring Devices (Account 364.2) and Transportation Equipment (Account 391.5) contain fully depreciated plant which the utility excluded from their depreciation calculation.

Recommendation: The Utility does not comply with Rule 25-30.140, F.A.C.

Exception No. 4

Subject: Capital Structure

Statement of Fact: Minimum Filing Requirements (MFR) Schedule D-2a for 1997 reflects an ending balance of $25,991,361 for retained earnings. The General Ledger provided by the utility shows an ending balance of $23,212,430. Staff also found similar differences for the deferred tax balance.

The differences in the ending balances at December 31, 1997 for the MFR schedule compared to the Company's records is shown below:

Account	MFR	General Ledger	Difference
Retained Earnings	$25,911,361	$23,212,430	($2,698,931)
Deferred Taxes Liberalized Depreciation	$1,799,426	$5,456,073	$3,656,.646
Deferred Taxes - Other	$0	$160,398	$160,398

The utility was unable to reconcile the differences.

Recommendation: The utility's MFR balances for retained earnings and deferred taxes do not reconcile to the utility's books and records.

DISCLOSURES

Disclosure No. 1

Subject: Purchased Sewage Treatment --- Projections

Statement of Fact: In 1997, United Water Florida, Inc. recorded $222,590 to NARUC Account 710 for purchased sewage treatment. The utility projected $476,652 for 1998 and $488,233 for 1999. These projections represent an increase over 1997 of $254,062 for 1998 and $265,643 for 1999.

The utilitly, justifies its projection by stating that sewage flows in St Johns, Nassau, and Duval counties are increasing. However, audit review of the historical trends indicates that sewage flows have decreased. In 1996 the flows decreased by 5 percent (7,372,000 gallons) and in 1997, the flows decreased by 10 percent (15,382,000 gallons.)

Projected 1998 and 1999 amounts for Account 710, Purchased Sewage Treatment, should be less than the 1997 recorded costs of $222,590 because the sewage flows have fallen not increased.

Recommendation: The utility's projected sewage treatment expense should not include increased flows.

Disclosure No. 2

Subject: Purchased Sewage Treatment --- Rebates

Statement of Fact: In 1997, the Utility recorded $222,590 in purchased sewage treatment charges to NARUC Account 710, and charges totaling $14,156 were charged to four other accounts. The total purchased sewage treatment expense recorded was $236,744.

Out of 16 invoices, seven invoices contained rebates that totaled $74,916. These rebates were not recorded on the utility's books nor included in test year projections. As an example, Voucher No. 1914 was recorded in Misc. Expense- Sewer Treatment & Pumping, Account 744 for $14,012.15. The invoice indicated a previous balance of $13,798.13 and a rebate for the same amount. Merriam Webster's dictionary defines rebate as "a return of a part of a payment." The utility's position was the rebate was a billing adjustment and should not be recorded.

Recommendation: The utility's test year expense is overstated.

Disclosure No. 3

Subject: Allowance For Funds Used During Construction (AFUDC)

Statement of Fact: The audit staff sampled voucher charges to 26 construction projects in 1996 and 42 projects in 1997. All projects accruing AFUDC that we reviewed were using rates in excess of the Commission authorized rate of 11.12% (monthly discounted rate of .882543%.) Commission Order No. 21492 issued June 30, 1989 in Docket No. 890466-WS established this rate.

The new rate of 9.57% (monthly discounted rate of .79704%) approved in order PSC-97-0618-FOF-WS, issued May 30, 1997, became effective January 1, 1998.

Recommendation: The utility did not use the correct AFUDC rate established by Order No.21492.

Disclosure No. 4

Subject: Sampling Units without Supporting Documentation

Statement of Fact: The audit staff judgementally sampled invoices and vouchers charged to 26 construction projects in 1996 and to 42 projects in 1997.

Thirty-eight percent of the amounts sampled were not supported by documentation. The total amount of unsupported charges booked into plant in service in 1996 are $96,052 and in 1997, are $493,989. Total unsupported invoice/vouchers booked into plant in service equal $590,041.

Recommendation: The utility's plant in service should be reduced by $590,041.

Disclosure No. 5

Subject: Purchased Sewage Treatment --- Incorrect Tariff Projected

Statement of Fact: In 1997, total purchased sewage treatment expense was $236,744.

Schedule G-20 projects 1998 and 1999 purchased sewage treatment charges. This schedule uses a factor for cost per each thousand gallons of sewage of $2.51. The utility derived this cost from an outdated tariff for $1.88 per hundred cubic feet.

The audit staff recalculation of several bills shows JEA billed the utility in 1997 at the rate of $1.74 per hundred cubic fiet The governing tariff shows $1.74 as the current tariff rate. Further, JEA confirmed the current tariff is frozen for 5 years beginning 1997.

Recommendation: Projected purchased sewage treatment expense is overstated.

Disclosure No. 6

Subject: **Historic Test Year revenues**

Statement of Fact: MFR Schedule E-2 includes bills and revenues for the United Water Florida customers during 1997. Commission Order PSC-97-0928-FOF-WS dated August 4, 1997, in Docket No. 970209-WS, approved the transfer of Sunray Utilities, Inc - Nassau and approved implementation of UWF's existing rates and charges. Commission Order PSC-97-0929-FOF-WS, dated August 4, 1997, in Docket No. 970210-WS, approved rates and charges for Sunray Utilities, Inc - St Johns. The utility began including the residential customers of Sunrray as part of it's monthly billing in December, 1997.

Recommendation: The historic test year ended December 31, 1997 did not include customers,
revenues, and consumption in Schedule E-2. The following tables reflect this information for water and wastewater:

WATER

	Bills	Revenues	Consumption (mg)
January 1997	184	10,072	3,995
February 1997	196	13,620	5,090
March 1997	203	13,242	4,743
April 1997	209	16,210	6,647
May 1997	216	16,854	7,009
June 1997	210	16,935	7,142
July 1997	222	16,052	6,428
August 1997	227	16,417	6,655
September 1997	237	15,618	5,983
October 1997	242	17,752	7,398
November 1997	257	17,639	7,188
December 1997	33	12,204	5,523
TOTAL	2,436	182,615	73,801

WASTEWATER

	Bills	Revenues	Consumption (mg)
January 1997	179	14,130	3,625
February 1997	186	11,743	2,480
March 1997	191	11,819	2,272
April 1997	196	12,313	2,900
May 1997	203	12,536	3,082
June 1997	199	12,540	3,242
July 1997	210	12,311	2,767
August 1997	215	12,773	2,921
September 1997	225	13,222	2,921
October 1997	230	13,787	3,644
November 1997	243	14,505	3,739
December	23	13,644	1,763
TOTAL	2,300	155,323	35,356

Disclosure No. 7

Subject: **Investment Tax Credit Cost Rate**

Statement of Fact: The utility includes investment tax credits (ITCs) of $1,141,661, with an associated weighted cost rate of 8.84% in the projected capital structure schedule as part of its minimum filing requirements (MFRs). MFR Schedule C-7, page 3 states that a copy of the utility's election made under Section 46(f), Internal Revenue Code (IRC) will be provided at a later date. A copy of this election would allow the utility to include ITCs in the capital structure with an associated cost rate. In the utility's last rate proceeding (Docket No. 960451 -WS, Order No. PSC-97-0618-FOF-WS), ITCs were included in the capital structure with an associated cost rate of zero.

Recommendation: The utility's capital structure should include ITCs at zero cost unless the utility can provide justification (a copy of the election made under Section 46(f), Internal Revenue Code) for the inclusion of a cost rate for its ITCs.

Disclosure No. 8

Subject: Working Capital Allowance

Statement of Fact: Minimum Filing Requirement (MFR) Schedule A-17 reflects Working Capital to be $4,763,343 for the year ending December 31, 1998. The audit staff noted several differences between the MFR and the General Ledger. These differences are noted below:

Account	Description	MFR	General Ledger	Difference
174	Miscellaneous Current Assets	$98,430	$0	($98,430)
162	Prepayments	$0	$33,393	$33,393
186.601	Deferred Tank Painting Expense	$1,132,413	$202,646	($929,767)

Recommendation: The MFRs do not agree with the General Ledger.

Disclosure No. 9

Subject: Operating Expenses

Statement of Fact: Operating expenses for the historic year ended 1997 were examined. The audit staff scanned the utility's general ledger detail and selected a judgmental sample of entries based on the transaction description. The audit staff found a few items that seemed inappropriate for inclusion in the utility's expenses, but the amounts were immaterial. Large dollar amounts were examined, and the utility was asked to provide supporting documentation. The audit staff examined the transactions along with the supporting documentation and a few discrepancies were noted. The discrepancies are as follows:

Item No.	Co. Account No. (NARUC Acct.)	Period	Journal ID	Transaction Description	Amount
1	904000 (670.7)	07	029A	Uncollectible accounts	$43,740.38
2	905000 (675)	04	AP00008499	None given	$15,487.46
3	921110 (675)	02	AP00004165	None given	$6,875.00
4	921110 (675)	02	AP00004167	NAWC membership dues	$5,771.00
5	921110 (675)	02	AP00004181	AWWA annual subscription	$6,950.00
6	923000 (635.8)	05	AP00009753	Fee for Rep. 97 session	$5,000.00

1. The utility was unable to provide documentation for approximately $26,000 of the $43,740 of uncollectible accounts expense (Item No. 4).

2. This item relates to the company's payment of the Public Service Tax. This tax should be included in the Taxes-Other account.

3. Item Nos. 3 and 4 are expenditures for professional association dues to Florida Waterworks Association (FWWA)and the National Association of Water Companies (NAWC). The invoices state that "lobbying" accounts for approximately 38% and 20% of FWWA's and NAWC's activities, respectively. The utility did not make any adjustment to reduce these dues for the estimated cost of lobbying.

4. Item No. 5 is a payment to the American Water Works Association for a "subscription for research". The total payment was $134,749, with $6,950 allocated to the utility.

5. Item No. 6 is a $5,000 payment to a law firm for "representation during the 1997 Legislative Session."

Recommendation: Operating expenses are overstated

Schedule of Water Rate Base
Company: United Water Florida
Docket No.: 980214 WS
Projected Test Year Ended: 12/31/99
Base Year [x] or Projected [x]

Florida Public Service Commission
Schedule A-1
Page 1 of 1
Preparer: F McGuire

Explanation. Provide the calculation of 13 month average rate base for the test year, showing all adjustments. All non used and useful items should be reported as Plant Held for Future Use. Use the Balance Sheet Method approach to determine working capital.
December 31, 1997

		Historical Base Year			Intermediate Year		Projected Test Year		
Line No.	Description	13 Month Avg. 1997	Balance -12/31/97	Adjustment	Balance 12/31/98	Adjustment	Balance at 12/31/99	13-Month Avg. 1999	Supporting Schedules
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1	Utility Plant in Service	51,136,317	55,619,171	11,701,700	67,320,871	5,155,500	72,476,371	69,607,255	
2	Utility Land & Land Rights	922,868	922,868		922,868	-	922,868	922,868	
3	Total Utility Plant in Svc.	52,059,185	56,619,039	11,701,699	68,320,738	5,155,500	73,476,238	70,530,123	A-3, A-5,
4	Less: Non Used & Useful Plant								
5	Construction Work In Progress	1,284,777	2,895,153	(2,895,153)					
6	Less Accum. Depreciation	(9,238,344)	(10,183,467)	(1,717,945)	(11,901,412)	(1,987,982)	(13,889,394)	(12,922,828)	A-3, A-9, B-13
7	Less CIAC	(23,474,903)	(24,339,330)	(1,880,000)	(26,219,330)	(1,292,000)	(27,511,330)	(26,888,792)	A-3, A12
8	Accumulated Amortiz. of CIAC	5,502,694	5,716,369	588,144	6,304,513	627,809	6,932,322	6,616,037	A-3, A14
9	Acquisition Adjustments	594,326	594,326		594,326	-	594,326	594,326	A-3,
10	Accum. Amort. of Acq. Adjustments	(167,947)	(182,805)	(29,716)	(212,521)	(29,716)	(242,237)	(227,379)	A-3
11	Less Advances for Construction	(142,039)	(259,716)	-	(259,716)	-	(259,716)	(259,716)	
13	Working Capital Allowance	1,060,564	594,768	-	594,768	322,259	917,027	935,163	A-17, A-18, A-19
14	Unfunded OPEB Adjustment	(411,811)	(411,811)	158,923	(252,888)	(152,631)	(405,520)	(329,204)	A-3
15	Total	27,066,501	31,042,526	5,925,952	36,968,478	2,643,238	39,611,716	38,047,730	

Wastewater Rate Base Calculation
Company: United Water Florida
Docket No.: 980214-WS
Projected Test Year Ended: 12/31/99
Base Year [x] or Projected [x]

Explanation: Provide the calculation of 13 month average rate base for the test year, showing all adjustments. All non used and useful items should be reported as Plant Held for Future Use. Use the Balance Sheet Method approach to determine working capital.
December 31, 1997

Florida Public Service Commission
Schedule A-2, Wastewater
Page 1 of 1
Preparer: F McGuire

		Historical Base Year			Intermediate Year		Projected Test Year		
		13-Month Avg 1997	Balance - 12/31/97	Adjustment	Balance 12/31/98	Adjustment	Balance at 12/31/99	13-Month Avg. 1999	Supporting Schedules
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1	Utility Plant in Service	89,906,035	96,680,528	10,248,790	106,929,318	11,094,991	118,024,309	111,996,158	A-6
2	Utility Land & Land Rights	2,991,944	2,991,944	1,171,300	4,163,244	0	4,163,244	4,163,244	A-6
3	Total Utility Plant in Svc	92,897,979	99,672,472	11,420,090	111,092,562	11,094,991	122,187,553	116,159,402	A-3, A-6
4	Less: Non Used & Useful Plant								
5	Construction Work In Progress	1,870,347	5,097,310	(5,097,310)					
6	Less Accum. Depreciation	(20,014,314)	(22,268,834)	(3,611,489)	(25,880,323)	(3,295,158)	(29,175,481)	(27,616,719)	A-3, A-10, B-14
7	Less CIAC	(35,346,854)	(36,561,158)	(3,085,000)	(39,646,158)	(2,230,000)	(41,876,158)	(40,849,312)	A-3, A-12
8	Accumulated Amortiz. of CIAC	11,193,196	11,659,876	1,273,791	12,933,667	1,363,621	14,297,288	13,609,392	A-3, A-14
9	Acquisition Adjustments	897,986	867,986		867,986		867,986	867,986	A-3
10	Accum. Amort. of Acq. Adjustments	(317,096)	(338,795)	(34,636)	(373,431)	(37,556)	(410,987)	(392,209)	A-3
11	Less Advances for Construction	(10,331)	(67,149)		(67,149)		(67,149)	(67,149)	
13	Working Capital Allowance	1,885,447	1,057,366		1,057,366	572,905	1,630,271	1,662,511	A-17, A-18, A-19
14	Unfunded OPEB Adjustment	(732,109)	(732,109)	282,530	(449,579)	(330,701)	(780,281)	(614,930)	A-3
15	Total	52,324,252	58,386,965	1,147,976	59,534,941	7,138,102	66,673,042	62,758,972	

Schedule of Requested Cost of Capital
13-Month Average Balance
Company: United Water Florida
Docket No.: 980214-WS
Projected Test Year ending 12/31/99

Explanation: Provide a schedule which calculates the requested Cost of Capital on a 13-Month average basis.

Line No.	Item	Requested Rate Base 13-Month Average For Year ending 12/31/99	Ratio	Cost Rate	Weighted
1	Long Term Debt	51,921,823	51.50%	7.69%	3.96%
2	Short-Term Debt	-	0.00%		0.00%
3	Preferred Stock	141,837	0.14%	5.00%	0.01%
4	Common Equity (b)	45,795,954	45.43%	10.18%	4.63%
5	Customer Deposits	6,000	0.01%	7.00%	0.00%
6	Investment Tax Credit (a)	1,141,663	1.13%	8.84%	0.10%
7	Deferred Income Taxes	1,799,426	1.79%	0.00%	0.00%
8	Total	100,806,703	100.00%		8.69%

Supporting Schedules: D-2
Recap Schedules A-1, A-2

(a) Reflects United Waterworks cost of capital.

(b) To determine United Water Florida's source and cost of common equity capital, I look to its Parent's (United Waterworks Inc.) capital structure and atendant costs as shown below. For the test year ended 12/31/97 I am using the 13 month average of United Waterworks Inc. capital structure

	United Waterworks Inc (from D-2, Page Item	thousands of dollars	Portion	Cost	Weighted
(Proforma)	Long-term Debt	231,077	53.69%	7.69%	4.13%
	Preferred Stock	627	0.15%	5.00%	0.01%
	Common Equity	198,677	46.16%	10.18%	4.70%
	Total Capital	430,382	100.00%		8.84%

Cost of Equity calculated according to Florida Public Service Commission directive (5/8/97)

Formula:	Given	8.38%
Add	(.832)/(equity ratio)	1.80%
Common Equity cost		10.18%

Supporting Schedules: A-19, C-7, C-8, D-3, D-4, D-5, D-7

Schedule of Water Net Operating Income
Company: United Water Florida
Schedule Year Ended
Projected: 1999

Florida Public Service Commission
Schedule B-1
Page 1 of 6
Docket No. 980214-WS
Preparer: Schreyer

Explanation: Provide the calculation of net operating income for the test year. If amortization (Line 4) is related to any amount other than an acquisition adjustment, submit an additional schedule showing a description and calculation of charge.

LINE NO.	DESCRIPTION	Balance Per Books 1997	Utility Test year Adjustments	Utility Adjusted Test Year 1999	Requested Revenue Adjustment	Requested Annual Revenue	Supporting Schedules
1	OPERATING REVENUES	$9,080,002	$1,363,672	$10,443,674	$2,204,773	$12,648,447	B-4
2	Operation and Maintenance	4,891,881	140,804	$5,032,685	13,721	5,046,406	B-3 & B-5
3	Depreciation, Net of CIAC Amort.	938,042	892,416	$1,830,458		1,830,458	B-13
4	Amortization of Aquisition Adjustment	192,902	(163,185)	$29,717		29,717	G-30
5	Taxes Other Than Income	1,172,757	94,861	$1,267,618	99,215	1,366,833	B-15
	OPERATING EXPENSES	7,195,582	964,896	8,160,478	112,936	8,273,414	
6	Operating Income Before Income Taxes	1,884,420	398,776	2,283,196	2,091,837	4,375,033	
	Income Taxes:						
	State Income Taxes	77,866	(35,182)	42,684	115,051	157,735	
	Federal Income Taxes	444,813	(205,969)	238,844	672,107	910,951	
7	Provision for Income Taxes	522,679	(241,151)	281,528	787,158	1,068,686	C-2
8	Utility Operating Income	$1,361,741	639,927	2,001,668	1,304,679	3,306,347	
9	Rate Base			38,047,730		38,047,730	A-1
10	Rate of Return on Rate Base			5.26%		8.69%	

Requested Revenue Adjustment	$2,204,773	Requested Revenue Adjustment	$2,204,773
Uncollectible Rate (Schedule G-28)	0.62%	PSC Assessment	4.5%
Additional O&M Expenses-Uncollectibles	$ 13,721	Additional Taxes Other-PSC Assmnt	$ 99,215

Schedule of Wastewater Net Operating Income
Company: United Water Florida
Schedule Year Ended
Projected: 1999

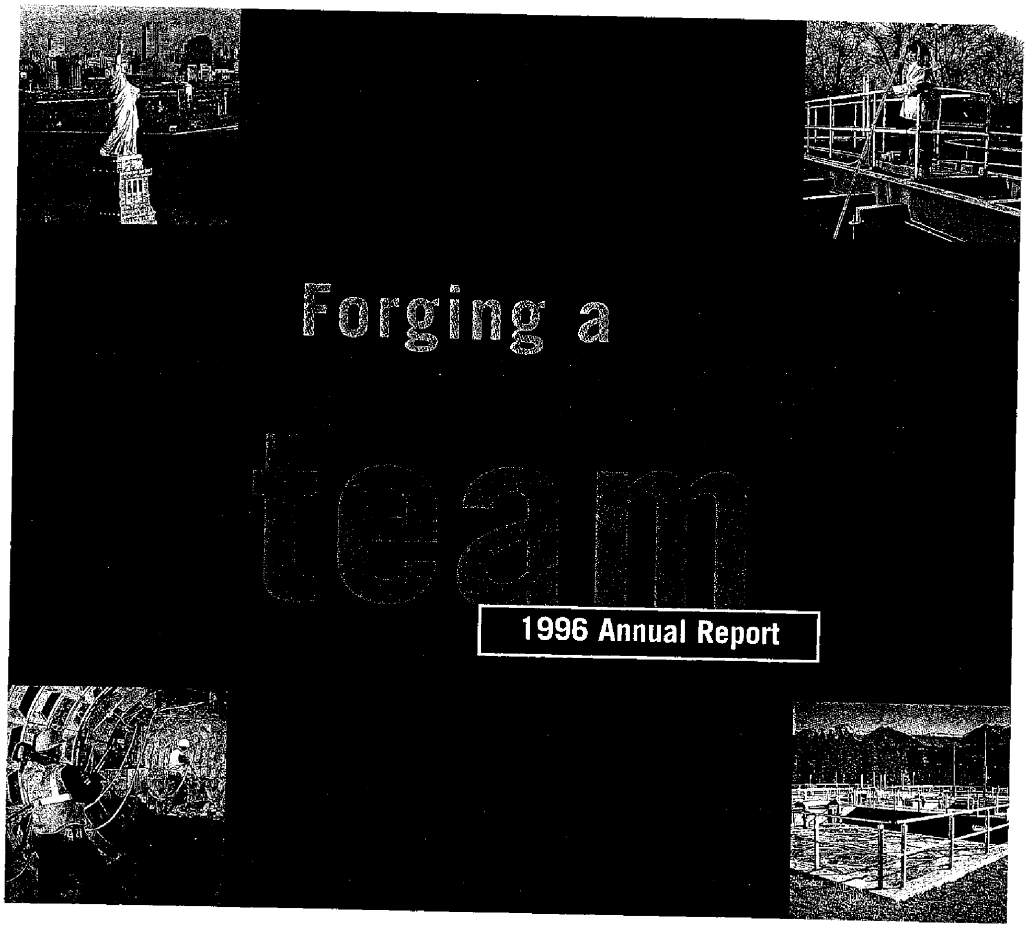
Florida Public Service Commission
Schedule B-2
Page 1 of 3
Docket No.980214-WS
Preparer: Schreyer

Explanation: Provide the calculation of net operating income for the test year. If amortization (Line 4) is related to any amount other than an acquisition adjustment, submit an additional schedule showing a description and calculation of charge.

LINE NO.	DESCRIPTION	Balance Per Books 1997	Utility Test Year Adjustments	Utility Adjusted Test Year 1999	Requested Revenue Adjustment	Requested Annual Revenue	Supporting Schedules
1	OPERATING REVENUES	$16,375,517	$2,332,712	$18,708,229	$3,067,140	$21,775,369	B-4
2	Operation and Maintenance	7,193,716	1,688,677	8 882,393	19,087	8,901,480	B-3 & B-5
3	Depreciation, Net of CIAC Amort.	2,137,289	1,274,053	3,411,342		3,411,342	B-13
4	Amortization of Aquisition Adjustment	343,555	(300,156)	43,399		43,399	G-30
5	Taxes Other Than Income	1,655,315	420,810	2,076,125	138,021	2,214,146	B-15
	OPERATING EXPENSES	11,329,875	3,083,384	14 413,259	157,108	14,570,367	
6	Operating Income Before Income Taxes	5,045,642	(750,672)	4 294 970	2,910,032	7,205,002	
	INCOME TAXES:						
	State Income Taxes	138,432	(38,936)	99,496	160,052	259,547	
	Federal Income Taxes	789,876	(233,169)	556,707	934 993	1,491,700	
7	Provision for Income Taxes	928,308	(272,105)	656,203	1,095 045	1,751 247	C-2
8	Utility Operating Income	$4,117,334	(478,567)	3,638,767	1,814,987	5,453,755	
9	Rate Base			62,758 972		62,758,972	A-1
10	Rate of Return on Rate Base			5 80%		8.69%	

Requested Revenue Adjustment	$3 067 140	Requested Revenue Adjustment	$3,067,140
Uncollectible Rate (Schedule G-28)	0 62%	PSC Assessment	4 50%
Additional O&M Expenses-Uncollectibles	$ 19,087	Additional Taxes Other-PSC Assmnt	$ 138 021

United Water



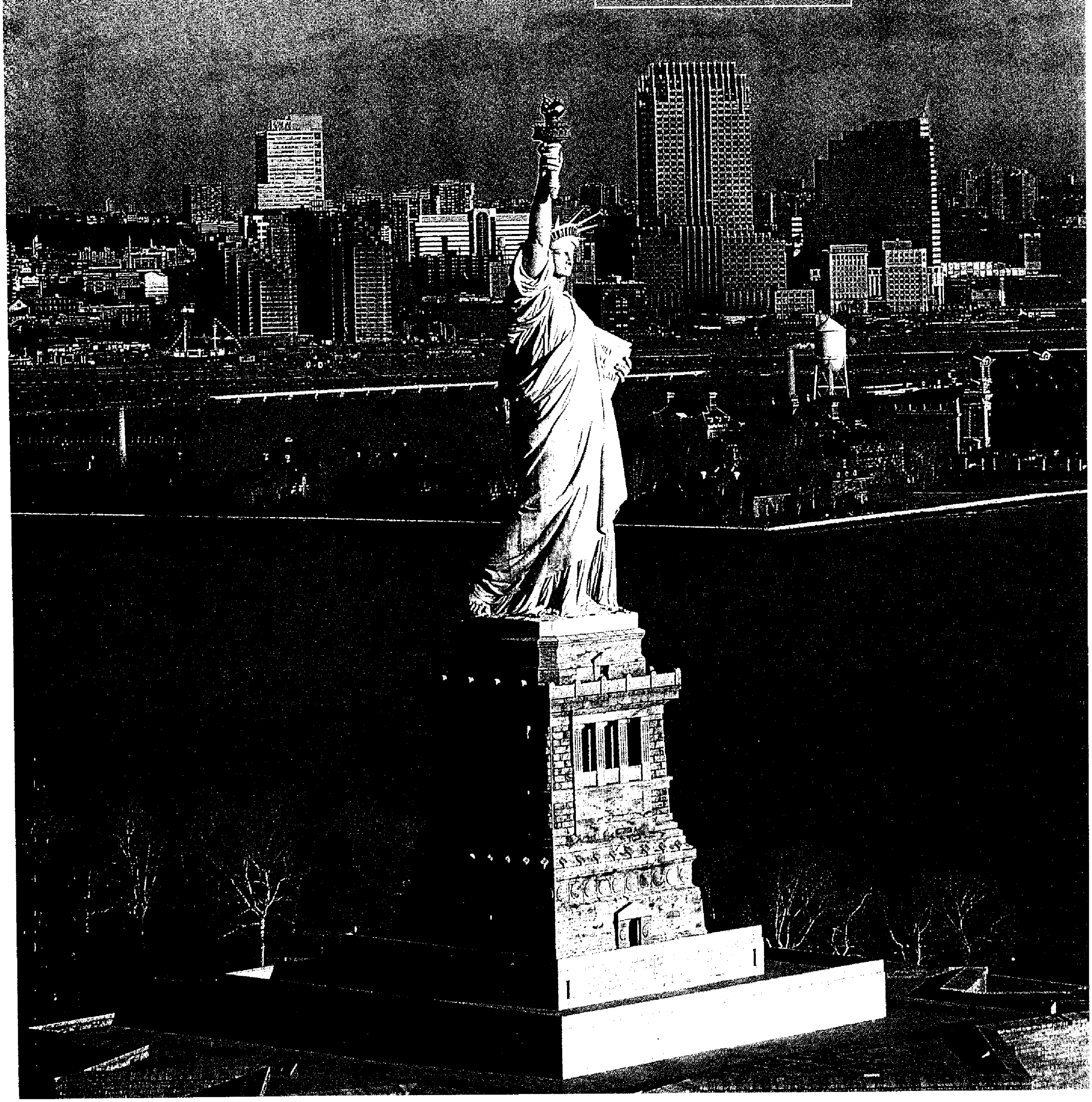
Financial Highlights

(thousands except per share data)	1996	1995	1994
Operating revenues from continuing operations	$332,045	$ 319,536	$284,767
Net income (loss) applicable to common stock			
Continuing operations	$ 38,407	$ 19,965	$ 28,157
Discontinued operations	(4,397)	(2,622)	(270)
	34,010	17,343	27,887
Net income (loss) per common share			
Continuing operations	$ 1.14	$ .62	$ 1.02
Discontinued operations	(.13)	(.08)	(.01)
	1.01	.54	1.01
Dividends paid per common share	$ .92	$ .92	$ .92
Equity per common share	11.33	10.90	11.20
Average shares outstanding	33,728	31,995	27,524

Forging a competitive team through

public/private partnerships

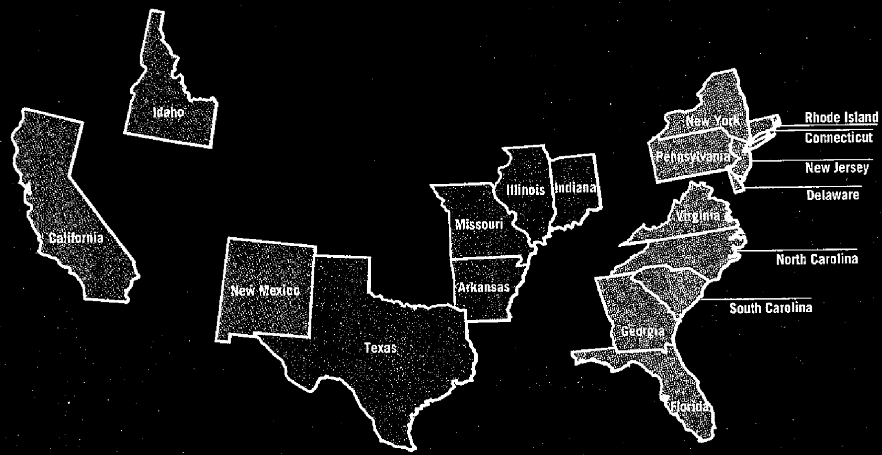
Jersey City, New Jersey

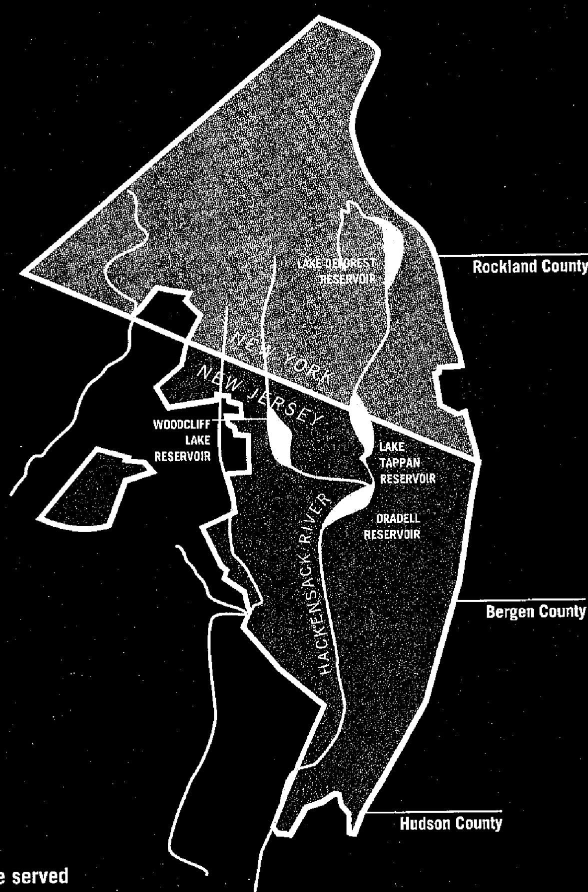


United Water is forging a competitive team through its public-private partnerships, strategic alliances, acquisitions, and core water services utilities. The team's efforts reinforce the company's position of leadership in an increasingly competitive marketplace. Their efforts also advance United Water's aggressive marketing strategy, enhance customer service and increase the company's shareholder value.

Forging a competitive

Service Areas





About half of the people served by United Water utilities live in southern New York State and northern New Jersey.

ARKANSAS
Pine Bluff*

CALIFORNIA
Avalon**
Banning**
Burbank**
El Segundo**

CONNECTICUT
New Milford*
Newtown*
Woodbury*

DELAWARE
Wilmington*

FLORIDA
Jacksonville*
Sarasota*

GEORGIA
Cartersville**
Fulton County**

IDAHO
Boise*

ILLINOIS
Lincoln*
Pekin**

INDIANA
Big Canoe**
Indianapolis**
Mooresville*
Warsaw*
West Lafeyette*
Winchester*

MISSOURI
Jefferson City*
Stoutsville**

NEW JERSEY
Bergen County*
Hoboken***
Hudson County*
Jersey City***
Lambertville*
Manalapan***
Plainsboro Township*
Toms River*
Vernon*

NEW MEXICO
Farmington**

NEW YORK
New Rochelle*
Nichols*
Owego*
Rockland County*

NORTH CAROLINA
Durham County**

PENNSYLVANIA
Bethel Township*
Bloomsburg *
Dallas*
Harrisburg*
Mechanicsburg*

RHODE ISLAND
Wakefield*

SOUTH CAROLINA
Lexington**

TEXAS
Houston**

VIRGINIA
Warsaw*

CANADA
Banff, Alberta**
Fort Saskatchewan, Alberta**

*United Water Location
**JMM Operation
***Public Private Partnership

United Water is a holding company whose subsidiaries are engaged in water-related businesses and real estate. As the nation's second-largest investor-owned water services company, United Water provides water and wastewater services to approximately 2.5 million people in 13 states. Through its partial ownership of JMM Operational Services, which serves an additional 2.5 million people, United Water expands its presence to six more states and Canada. And with its investment in Northumbrian Water Group, which serves another four million people, the company extends its reach overseas to the United Kingdom. The company's common stock trades on the New York Stock Exchange (NYSE) under the symbol UWR. United Water has paid continuous cash dividends on its common stock since 1886.

Contents

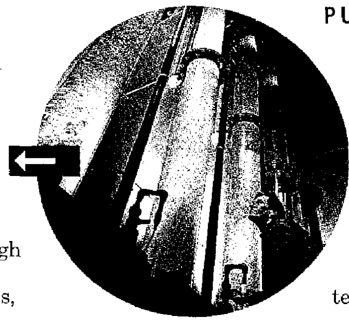
← PLEASE LIFT

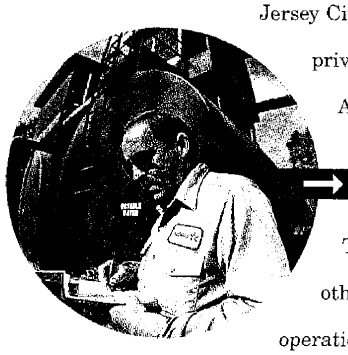
United Water

At A Glance

THE UNITED WATER TEAM

In the 1990's United Water Resources grew from a regional water supplier serving one million people in two contiguous states into a national water and wastewater services company. Today United Water is forging a competitive team through its utility subsidiaries, public-private partnerships, strategic alliances and acquired water services companies. The team forms one of the nation's largest private managers of water supply systems. It also brings together the experience, technical resources and capital to handle virtually any challenge related to water services and wastewater treatment.



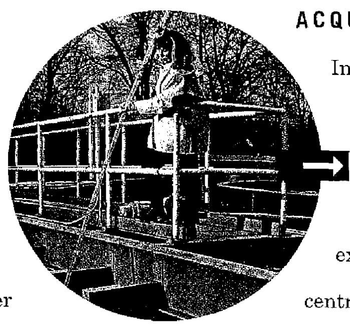


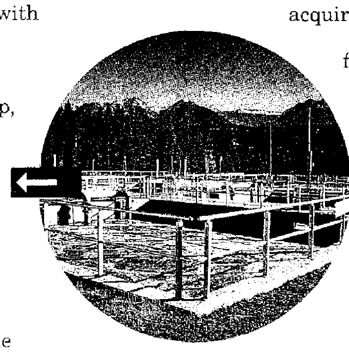
PUBLIC-PRIVATE PARTNERSHIPS

United Water is a leader in forming public-private partnerships with municipalities in which the cities retain ownership of their water systems while the company operates and maintains them. The partnerships extend United Water's service territories, broaden its customer base and increase operating revenues. United Water's 1996 agreement with Jersey City, New Jersey, formed the nation's largest public-private partnership for a municipal water operation. An earlier agreement, which established United Water's partnership with Hoboken, New Jersey, has been adopted as a national model. The company also manages water systems for other communities and water companies through operations and maintenance contracts.

STRATEGIC ALLIANCES

United Water has formed domestic and international strategic alliances to strengthen its capabilities and expand its presence in the United States and abroad. Paris-based Lyonnaise des Eaux (LDE) owns a 27.5 percent interest in United Water. The alliance with LDE, a world leader in water services, expanded United Water's presence into the international arena. United Water's partnership with Lyonnaise Europe, an LDE subsidiary, owns a 20 percent interest in Northumbrian Water Group, a major investor-owned water and wastewater company in the United Kingdom. Denver-based JMM Operational Services, which is 25 percent owned by United Water, is a leading contractor of water and wastewater services in the United States and Canada.





ACQUISITIONS & OPERATIONS

In 1994 United Water doubled its size and established a national presence with the acquisition of GWC Corporation's water and wastewater utilities. In 1996 United Water expanded its operations through acquisitions in central New Jersey and near its Idaho service territory. The company also is seeking regulatory approval to acquire a utility adjacent to its Jacksonville, Florida facilities. United Water continues to explore potential acquisitions of other water and wastewater companies with growth opportunities. In addition to pursuing new sources of growth, United Water upgrades and expands the utility infrastructure in its existing service areas on an ongoing basis.

Dear Fellow

Shareholders

Donald L. Correll

In 1996 United Water Resources significantly advanced its marketing strategy, expanded its earnings base and population served, and positioned itself for strong growth in the years ahead.

United Water formed the nation's largest public-private partnership for a municipal water operation with Jersey City, New Jersey, invested in a major United Kingdom water company through a strategic alliance and broadened our domestic water and wastewater operations through expansions of current service territories and through acquisitions.

New operations generated additional revenues and contributed to earnings in 1996. Our investment in the UK's Northumbrian Water Group, made possible through our strategic alliance with Lyonnaise des Eaux, contributed significantly to United Water's earnings per share.

♦ **"United Water formed the nation's largest public-private partnership for a municipal water operation...invested in a major United Kingdom water company...and broadened our domestic water and wastewater operations."**

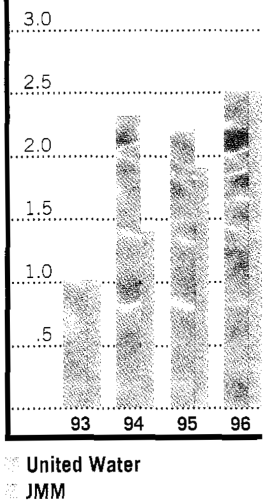
Earnings for the year totaled $34 million, or $1.01 per common share, compared with $17.3 million, or 54 cents per common share in 1995. A gain from the condemnation settlement relating to operations in New Mexico, increased land sales from our real estate subsidiary and the acquisition of two utilities in New Jersey also contributed to the earnings increase in 1996.

The 1996 results were partially offset by a charge to income relating to the discontinuance of our environmental testing business, which had not contributed to our corporate earnings. The 1995 results were affected by the write-down of various assets at our real estate and environmental testing businesses.

FOCUS ON GROWTH Through public-private partnerships, strategic alliances, acquisitions and expanded operations, we are forging a competitive team that is focused on continuing profitable growth and supporting our core water services business and aggressive marketing strategy.

In addition to operating regulated water utilities, we compete in a large and fast-growing non-regulated market for water services, which we believe offers potential for long-term benefits. Our primary focus is on municipalities. We offer them expertise in coping with their ever-increasing water services costs, stricter water quality standards and aging infrastructures. United Water pursues agreements such as our public-private partnership with Jersey City, through which the municipalities retain ownership of the systems, while we operate and manage them. This is where we see our major growth in the future.

GROWTH IN POPULATION SERVED
(in millions)



LONG-TERM OBJECTIVES Our long-term objectives are to grow earnings per share and increase total return to shareholders. We also expect to double the population we serve over the next five years.

To achieve these objectives, we will target areas where we have the best opportunities for success, tailor programs to meet the needs of specific communities and leverage the relationships we have with our affiliates. We have identified a number of opportunities throughout the country that offer significant customer and revenue growth potential.

♦ "Our long-term objectives are to grow earnings per share and increase total return to shareholders. We also expect to double the population we serve over the next five years."

While our expansion will focus on agreements with municipalities, an important part of our strategy is to acquire water and wastewater companies that will contribute to our earnings and increase shareholder value.

STRENGTHENED CAPABILITIES In 1996 we strengthened our capability to achieve continued growth and build our utility operations by expanding the responsibilities of two top executives and adding a new member to our senior management team. Together, these executives provide the company with decades of management experience and the guidance to improve our operations, customer service and shareholder value.

United Water initiated a sweeping information technology program that will enhance our customer service and assist our employees nationwide to carry out their day-to-day activities more efficiently and effectively.

The initiatives we've taken this year—from strengthening our management group to streamlining our business processes—help us build the company's core water services business and provide the foundation for our efforts to form a competitive team.

FORGING A COMPETITIVE TEAM

By working together with our public-private partners and strategic alliances—Lyonnaise des Eaux and JMM Operational Services—United Water is forging a competitive team that will continue to play a leadership role in the years ahead.

> ♦ **"The initiatives we've taken this year—from strengthening our management group to streamlining our business process—help us build the company's core water services business and provide the foundation for our efforts to form a competitive team."**

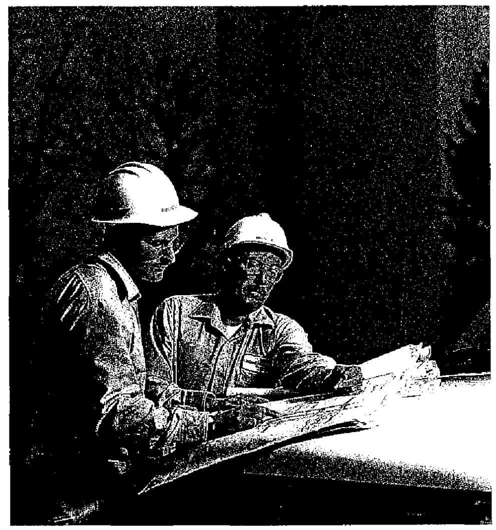
Public-private partnerships broaden United Water's operational, customer and income bases. Strategic alliances strengthen and complement the company's capabilities and expand our presence. And acquisitions create new growth opportunities.

United Water can pursue opportunities that would have been too large for us to handle alone and in new regions where our affiliates have a presence. And we gain a competitive edge when we bid for a municipal contract and use the special expertise of an affiliate to augment our proposal.

We have the team to successfully compete in the years ahead. The key players are the employees of United Water and our affiliates. Their efforts drive the company's competitive spirit, growth initiatives and high customer service standards. The result is improved performance and enhanced shareholder value. We are grateful for the dedication and support from both our employees and our shareholders.

Donald L. Correll
Chairman and Chief Executive Officer
March 6, 1997

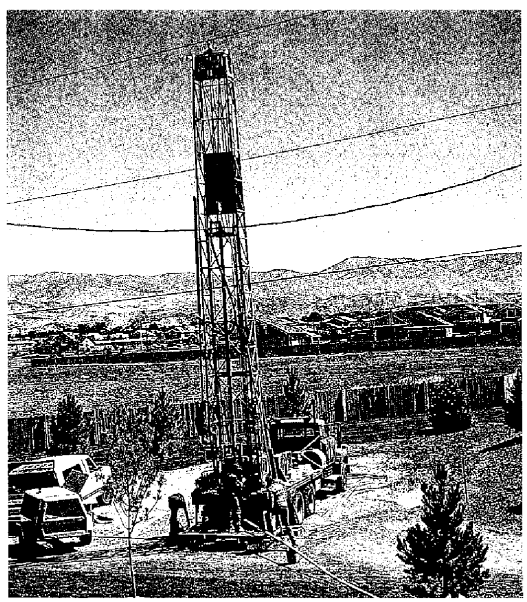
United Water's public-private partnerships with municipalities contribute significantly to its ability to compete. These partnerships increase the company's expertise and visibility and strengthen its financial and operational capabilities. They extend the company's service territories, broaden its customer base and increase its operating revenues. ♦ Public-private partnerships enable municipalities to meet their growing need for expertise to operate and manage their water systems while fulfilling their desire to retain ownership of the systems. United Water set the standard for such partnerships in 1994 with a 10-year agreement with Hoboken, New Jersey, which the city renewed for another 10 years in 1996. ♦ Also in 1996, the company joined with *Jersey City, New Jersey,* to form the nation's largest public-private partnership for a municipal water operation. United Water operates the distribution system, treatment plants, reservoirs and watershed, and manages customer service. *United Water* will receive annual payments which will total approximately $37.4 million in gross revenues over the five-year period of the contract. The company also has the opportunity to receive incentive fees related to increased billing and collections.



Through its public-private partnerships, United Water brings needed expertise to municipal water systems. In this photo, head operator James Mastrokalos and general superintendent John Sniedenbach review maintenance plans for the Manalapan Township, New Jersey, system.

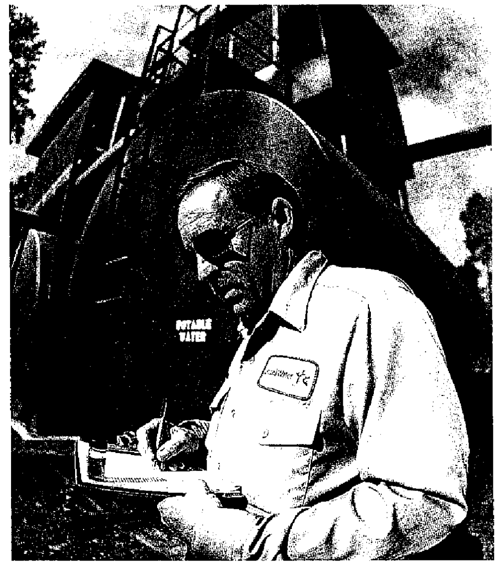
← United Water is a leader in forming public-private partnerships in which a city retains ownership of its water system while the company operates and manages it. United Water formed the nation's largest partnership for a municipal water system with Jersey City, which supplies water to Liberty Island and the Statue of Liberty, as well as to Ellis Island and Jersey City.

♦ In addition to retaining ownership of the water system, Jersey City continues to set water rates, which will be maintained at current levels over the duration of the contract. ♦ The city, which received an up-front concession fee of $2.5 million, will gain an estimated $38.5 million in cost savings and additional revenues through the sale of excess water. ♦ United Water forged a *unique labor agreement* with Jersey City, its labor unions and the New Jersey Department of Personnel. Under the agreement, no water department employee will be laid off. Employees who choose to remain with the city will either continue with the water system or be offered positions with other city agencies. Either way, they retain their salary levels and benefits, including pensions. Eligible employees also can take advantage of early retirement incentives. *Major achievements to date:* United Water introduced an advanced billing system in Jersey City, which after the first nine months has generated $3 million in additional revenues for the city. ♦ The company is upgrading water meters, installing a new water quality monitoring system and helping the city comply with various environmental requirements. In addition, the company has modernized the water services' vehicular fleet, provided standby power at the treatment



United Water assists other water companies through operations and maintenance contracts. In Idaho, United Water's utility helped solve another company's water quality problem by arranging for the redrilling of a well. The project expands United Water's presence in a growing area adjacent to its facilities in Boise.

plant and opened a new operations center in downtown Jersey City. The company also will design and administer the city's watershed recreation program. ♦ In central New Jersey, United Water formed a public-private partnership with Manalapan Township to operate and maintain a water treatment plant that will serve approximately 4,500 new homes under construction in this growing community. ♦ United Water also meets the needs of other water companies through operations and maintenance contracts. For example, in Boise, Idaho, United Water helped solve another company's water quality problem by arranging for the redrilling of a well. In the same general area, a developer asked United Water to operate the wells and distribution system for its residential subdivision. Both projects expand United Water's presence in the growth area southwest of its Boise facilities. ♦ In Jacksonville, Florida, United Water is operating another utility's water and wastewater facilities in adjacent counties. United Water is seeking regulatory approval to acquire the company. ♦ In selecting United Water over other bidders to operate and manage their water systems, these cities and companies recognize United Water's expertise and track record. This enhances the company's reputation and competitive position.

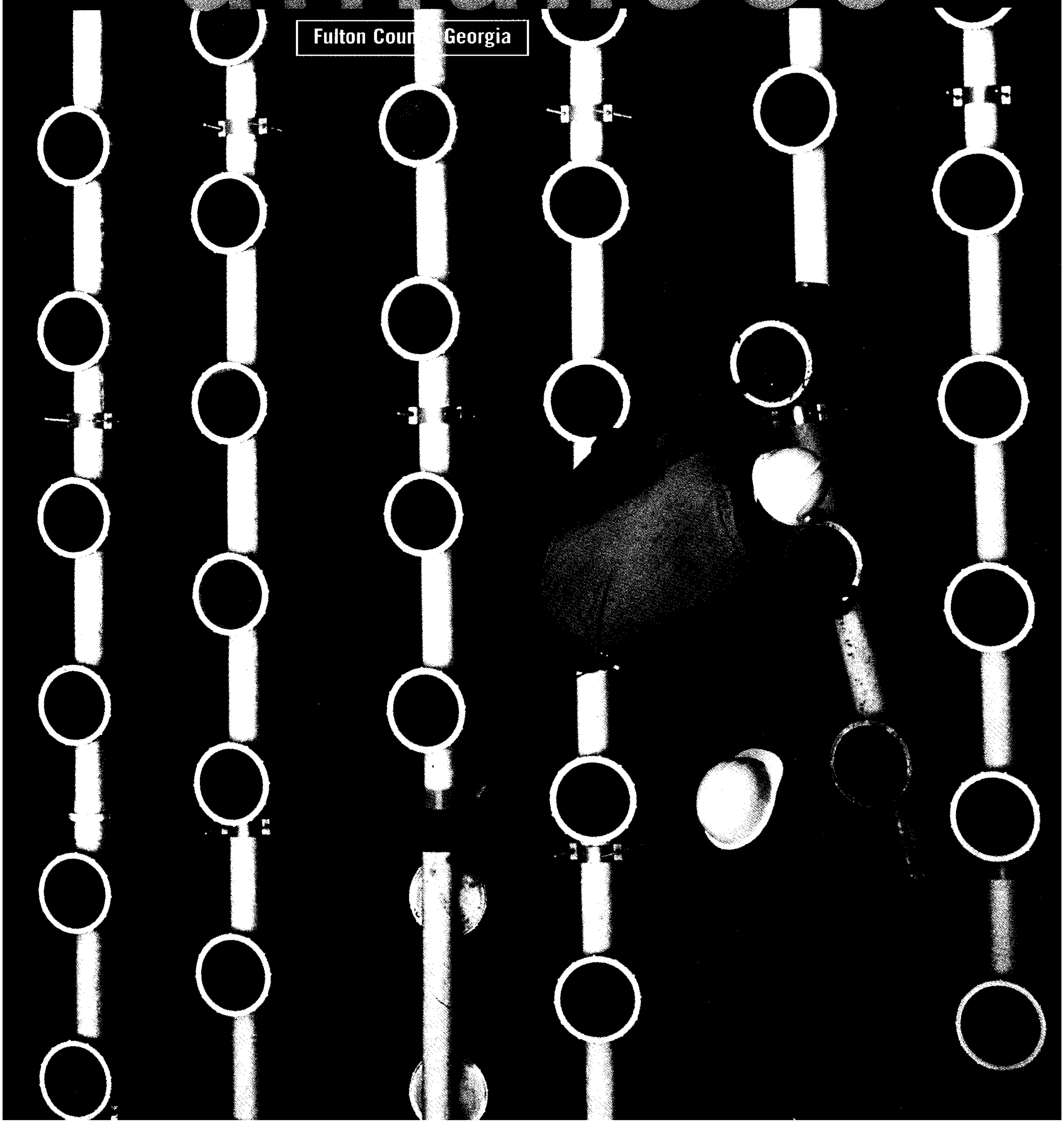


In Florida, United Water operates several water and wastewater treatment plants for a company with facilities near Jacksonville. United Water's Jacksonville utility is seeking to acquire the company and expand its service to the growing region. Plant operator Ken Snyder checks the operation of new storage tanks.

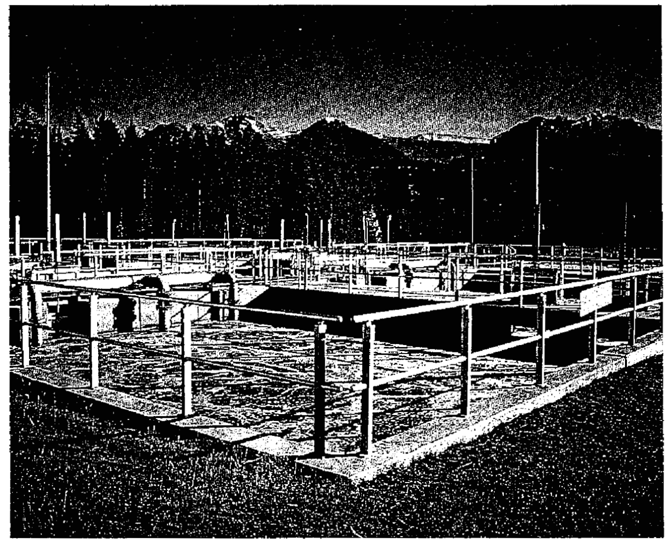
Forging a competitive team through

strategic alliances

Fulton Coun Georgia



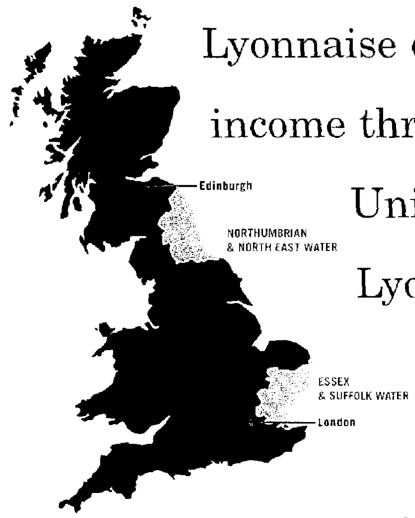
United Water's strategic alliances strengthen the company's capabilities and expand its presence across the country and around the world. ♦ The alliances join United Water with two leaders in their fields, JMM Operational Services (JMM) and Lyonnaise des Eaux. ♦ In 1996 the city of Houston acknowledged JMM's position as an industry leader in contract operations by awarding the company one of the nation's largest water-related operations and maintenance contracts with a municipality. ♦ As the operator of the city's Southeast Water Purification Plant, JMM serves 700,000 people in the Houston metropolitan area. JMM expects to achieve operating efficiencies that will save the city $12.7 million over the next five years. ♦ For the past four years, JMM has operated and maintained two advanced wastewater treatment facilities and 28 pumping stations for ***Fulton County, Georgia.*** During this period, the company saved the county more than $6 million. In 1996 the county renewed and expanded its contract with JMM to include operation



JMM Operational Services instituted a quality assurance and control program to ensure that the wastewater treatment plant at the popular ski resort in Banff, Canada, is meeting the highest operating standards. JMM is responsible for all plant management, operations and maintenance.

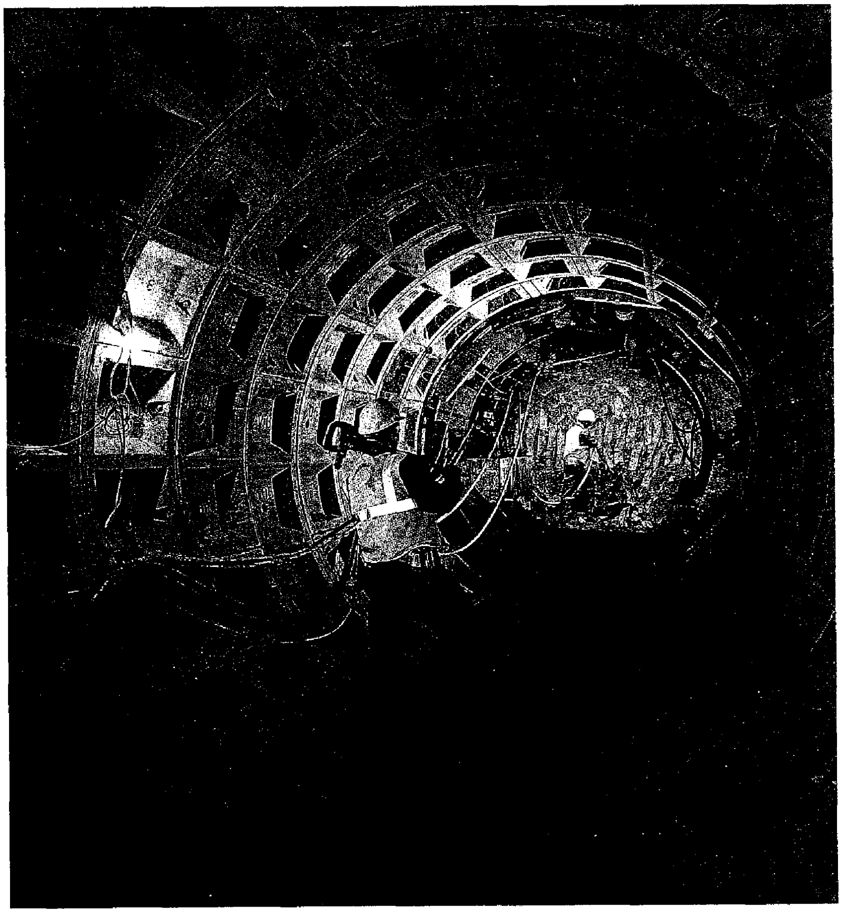
←JMM Operational Services, a United Water affiliate, brings the expertise and capital needed to operate water and wastewater treatment plants for communities across the United States and in Canada. JMM's operation of this reclamation plant and other facilities for Fulton County, Georgia, saved the county more than $6 million over the past four years.

and maintenance of a third treatment facility and sludge-handling services for all three facilities. ♦ Also in 1996 Indianapolis awarded JMM a contract to manage the city's storm and wastewater collection systems. With JMM operating these systems, the city expects to save $13 million over five years. The contract was awarded to JMM after the company saved the city more than $24 million during the first two years it operated the city's wastewater treatment plants. ♦ In 1996 United Water expanded into the international arena. The strategic alliance with Lyonnaise des Eaux (LDE) produced a new source of income through an investment in the United Kingdom. United Water formed a partnership with Lyonnaise Europe, an LDE subsidiary, that acquired a 20 percent ownership interest in Northumbrian Water Group, one of the UK's major investor-owned water and wastewater companies. ♦ The partnership immediately generated contributions to United Water's earnings per share and is expected to continue contributing to the company's earnings. Northumbrian serves more than four million people and has total revenues of approximately $840 million.



United Water expanded into the international market through a partnership that acquired a 20 percent ownership interest in Northumbrian Water Group (shown in blue), a major water company in the United Kingdom. The partnership is with a subsidiary of Lyonnaise des Eaux, a United Water affiliate.

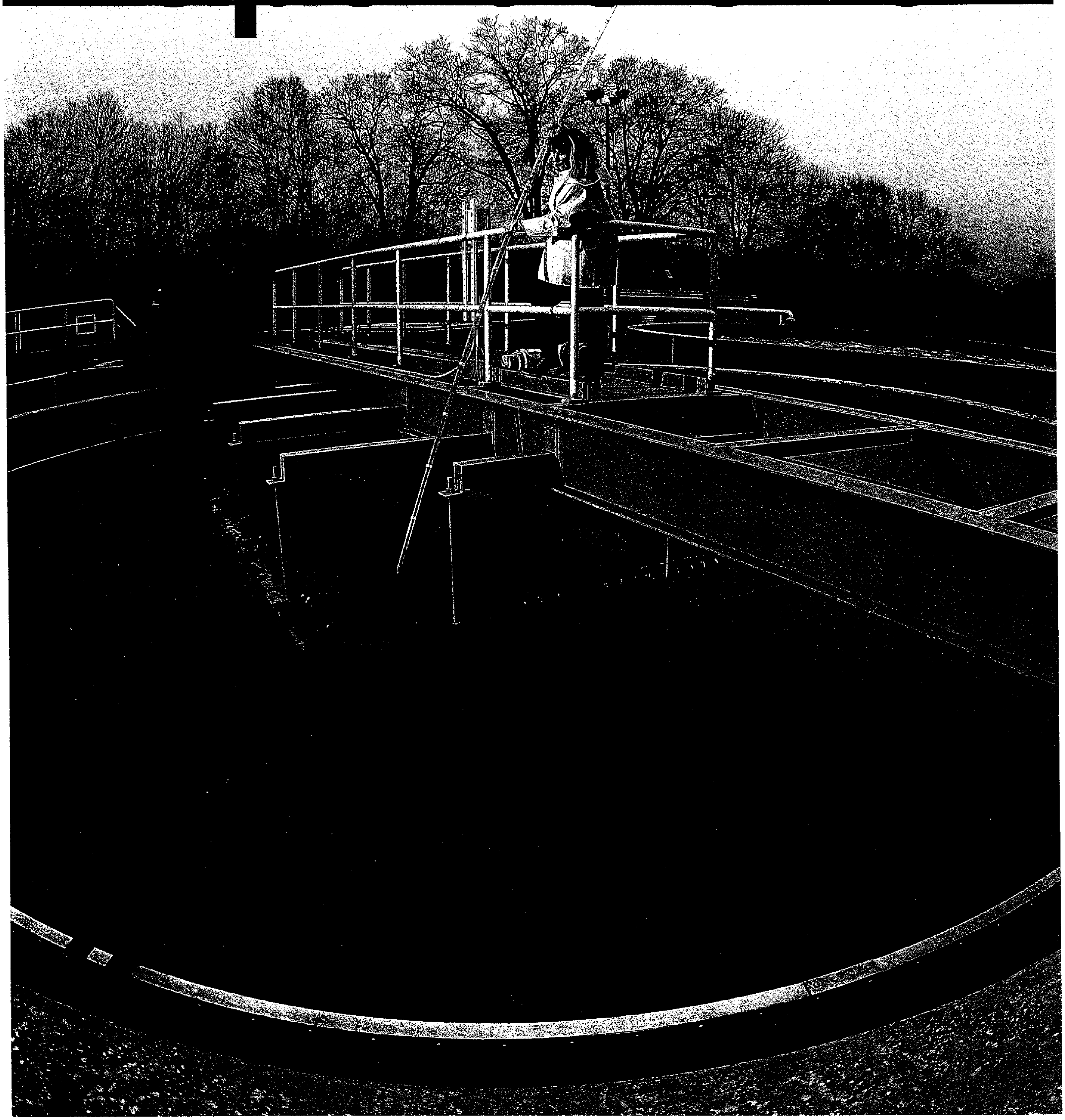
♦ Paris-based Lyonnaise des Eaux is a world leader in the water and wastewater industries, as well as in water quality research. LDE's water and wastewater operations serve more than 50 million people worldwide and account for $4.6 billion in revenues. The company also engages in energy supply, solid waste management, construction, and communications.



Northumbrian Water Group (NWG) helps meet clean sea water standards by constructing systems that include huge sewers beneath sea fronts. This sewer, built by an NWG subsidiary, is being inspected before going into service at Saltburn-by-the-Sea on the northeast coast of the United Kingdom.

♦ Through its alliances with JMM Operational Services and Lyonnaise des Eaux, United Water strengthens its position across the country and around the world. The alliances also increase United Water's visibility, both in the United States and overseas, and heighten the company's ability to compete and grow.

acquisitions &

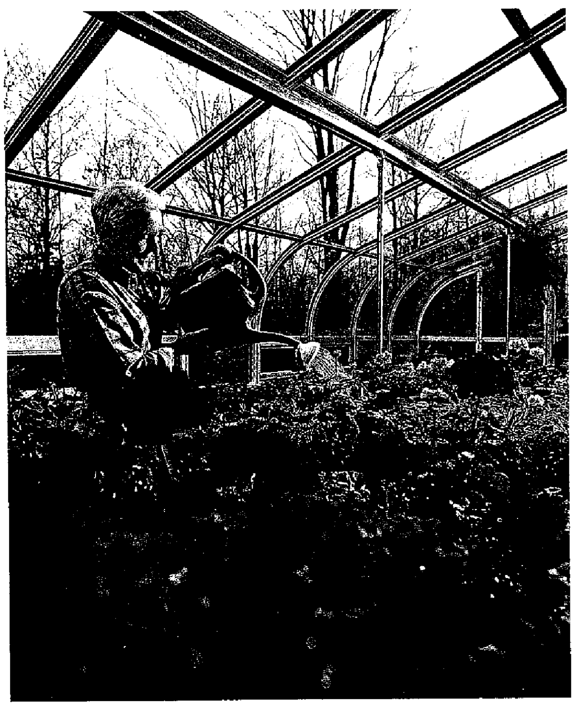


Acquisitions of water and wastewater services companies offer United Water opportunities to expand current operations or to enter new markets. This enhances the ability of United Water's team to compete for new business. ♦ In 1996 United Water made two acquisitions that broadened the company's presence in central New Jersey. ♦ The company acquired the ***Princeton Meadows Utility Company,*** which provides wastewater collection and treatment services to approximately 15,000 residents in Plainsboro Township. As part of the purchase, United Water acquired a wastewater treatment plant. ♦ United Water also acquired ***Matchaponix Water Supply,*** of Manalapan, a wholesale supplier of water to about 25,000 residents in Freehold and Manalapan. The purchase included a water treatment plant. ♦ These two acquisitions, combined with a public-private partnership formed with Manalapan Township, created a new base of operations for United Water in a growing region. ♦ With the acquisition of the Warm Springs Mesa Water Company in ***Boise, Idaho,*** United Water extended its service into a new area located near its existing service territory.

United Water pioneers water and wastewater treatment through innovative technologies such as ozone treatment, an advanced drinking water purification process. United Water, which operates a state-of-the-art ozone plant in New Jersey, is evaluating the ozone process in New York.

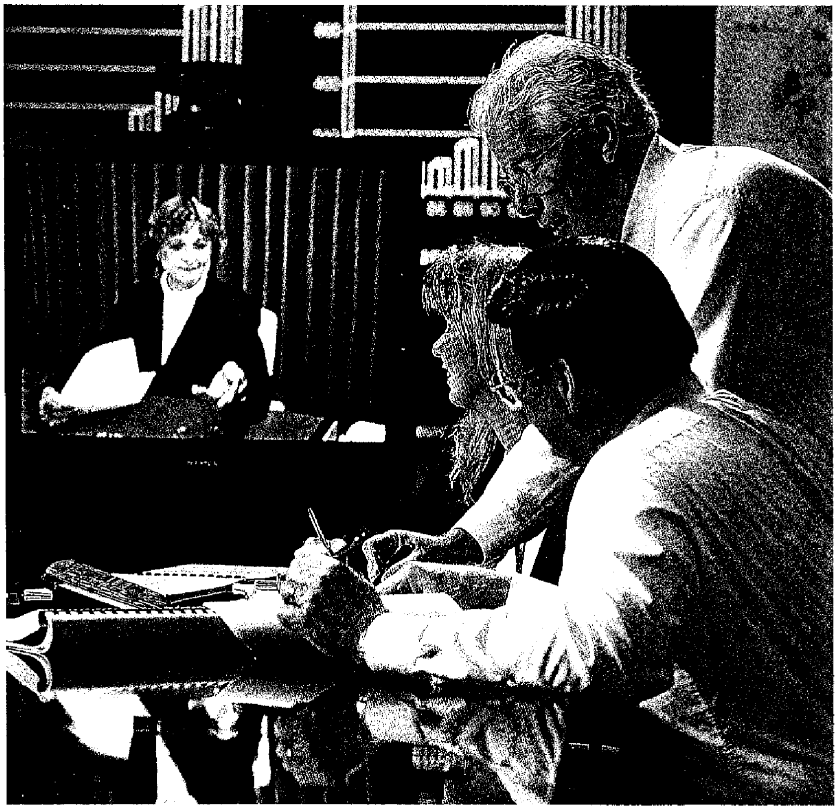
← United Water expands its presence and operations through acquisitions of companies such as the Princeton Meadows Utility Company in central New Jersey. Superintendent Theresa Sudnik takes a water sample for testing to ensure that the utility's wastewater treatment process is properly maintained.

The acquisition added new customers, several wells, a reservoir, and a distribution system to United Water's operation in Boise. The acquisition will facilitate the company's further expansion in this high-growth area. ♦ United Water also increases service within its current territories, as well as in new areas outside its existing territories. The company built a water and wastewater utility in ***West Milford, New Jersey,*** that will serve new customers in more than 500 condominium suites and townhouses currently under construction in an adjacent housing development. ♦ United Water also completed a major upgrade to its water treatment facility in ***Wilmington, Delaware,*** and doubled the capacity of a water treatment plant in ***Pine Bluff, Arkansas.*** ♦ In addition to strengthening its operations, United Water has initiated a nationwide ***information technology program*** that enhances its support services. The company is instituting uniform computerized systems, to be used throughout United Water, that will increase its financial, operational and customer-service capabilities. ♦ A major component is the Integrated Financial Management System, which provides a uniform approach



In a greenhouse at the Bald Eagle Commons subdivision in West Milford, New Jersey, George DeGange tends his geraniums with water supplied by United Water. The company built a water and wastewater treatment facility to serve the subdivision, which will have more than 500 condominium suites and townhouses when completed.

to all financial information across the company. Another major component is the Customer Information System, which will enhance customer service and provide the ability to share a common customer information database among all United Water companies.



United Water can link employees of the company and its affiliates across the country and overseas through video conferences from its headquarters in Harrington Park, New Jersey. The system facilitates communication among members of United Water's competitive team.

♦ Other components include human resources information, as well as payroll, legal management and operations database systems. ♦ United Water also is centralizing procurement and the awarding of contracts, to increase the company's purchasing power and ability to gain the best prices for goods and services. ♦ The new information technology program and operational expansions will help United Water build its competitive team.

By working together with its public-private partnerships, strategic alliances and newly acquired companies, the United Water team will be well positioned to meet the challenges of the 21st century.

current & projected

If you were to purchase a share of United Water stock today, you would be investing in three distinct business segments:

- Regulated water and wastewater utilities, the company's traditional business.
- Non-regulated water and wastewater services, primarily public-private partnerships or operations and maintenance contracts with municipalities.
- Real estate operations.

♦ Between 1997 and 2001 the company will continue to make significant capital improvements in regulated utilities and it anticipates that equity investment in non-regulated water services will represent an increasing proportion of the company's total investment. ♦ Over the next five years, we expect that revenues from water utilities will remain strong while revenues from non-regulated water services will increase dramatically. ♦ During the same period, real estate revenues will continue to grow, but their contribution in proportion to total revenues will decline slightly as the company focuses its capital on the water services business. ♦ United Water believes that by the year 2001, non-regulated water services will comprise a significant percentage of the company's total net income.

Management's Discussion and Analysis

Merger

On April 22, 1994, United Water Resources (United Water, or the Company) completed a merger (the Merger) with GWC Corporation (GWC) in which United Water was the surviving corporation. GWC's principal assets included 100% of the stock of General Waterworks Corporation (now known as United Waterworks), which currently owns regulated water and wastewater utilities operating in 13 states, and a 25% indirect investment in JMM Operational Services, Inc. (JMM). JMM provides operations and management services to government and industry for water and wastewater treatment facilities. See Note 2 to the consolidated financial statements for Merger discussion.

United Water's 1994 results include the operations of United Waterworks for the nine months from April to December 1994. It should be noted that the results of operations for those nine months include the warmer, high-demand summer months and therefore represent a significant portion of the total 1994 earnings of United Waterworks' operating utilities. Results for 1995 and 1996 include a full year of combined operations.

Transfer of New Mexico Operations

United Waterworks owned a utility subsidiary which provided water and wastewater services to customers in Rio Rancho, New Mexico. In April 1995, the city of Rio Rancho (the City) and the Company's utility subsidiary entered into an original stipulation in settlement of a condemnation action and on June 30, 1995, the City assumed possession of the operations of the utility subsidiary. The original stipulation was contested by various parties, but the City retained possession of the utility's operations.

On March 29, 1996, the Company fully settled the condemnation proceeding with the City. Under the terms of the agreement, the Company accepted $67 million for the water and wastewater systems of its New Mexico operations (including capital expenditures incurred in 1995). This transaction resulted in an after-tax gain of $4.3 million which is included in the Company's 1996 earnings.

Investment in Northumbrian Partnership

On June 28, 1996, United Water and Lyonnaise Europe formed the Northumbrian Partnership (the Partnership), an equal partnership which has acquired a 20% interest in Northumbrian Water Group, a major investor-owned water and wastewater company in the United Kingdom. United Water's initial $62 million investment in the Partnership was made through its wholly-owned subsidiary in the United Kingdom, United Water UK Limited. United Water's share of the Partnership's earnings, which totaled $6 million in 1996, is included in other income in the accompanying statement of consolidated income.

Discontinued Operations

In December 1996, the Company announced its intention to dispose of its environmental testing business, Laboratory Resources, a wholly-owned subsidiary of the Company, closing its operations in Teterboro, New Jersey. Subsequently, in January 1997, it sold its laboratory facility in Brooklyn, Connecticut. The Company has accounted for this disposal in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual, and Infrequently Occurring Events and Transactions." The subsidiary had been operating in a very competitive environment over a prolonged period of time and had not contributed to the Company's earnings, with net losses of $1.5 million, $2.6 million and $270,000 in 1996, 1995 and 1994, respectively. The Company recorded an impairment loss of $1.5 million net of income taxes for its investment in the environmental testing business, which was included in the net loss for the year ended December 31, 1995 (see "Impairment of Long-Lived Assets" below). The operating results of Laboratory Resources prior to the date of discontinuance are shown separately in the accompanying statement of consolidated income and all of the financial statements of prior periods have been restated to reflect the discontinuance of Laboratory Resources' operations. See Note 14 to the consolidated financial statements for further details.

Impairment of Long-Lived Assets

During 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," effective for financial statements for fiscal years beginning after December 15, 1995. The statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable and specifies the criteria for the determination and measurement of an impairment loss. United Water adopted SFAS No. 121 during 1995 and, as a result of changes in market conditions, development plans, projections of cash flows and other considerations, recorded a $12.1 million pre-tax impairment loss for various parcels of land held by its real estate subsidiary and for its investment in the environmental testing business for the year ended December 31, 1995. See Note 1 to the consolidated financial statements for further details.

Liquidity and Capital Resources

As shown in the consolidated statement of cash flows, the Company's major uses of cash in 1996 included: $79.6 million of capital expenditures; a $61.8 million investment in the Northumbrian Partnership; and $35.6 million of common, preferred and preference dividends paid to shareholders. The major sources of funds to meet these cash needs included: a $49.7 million increase in short-term notes payable; $45.4 million of cash provided by operations; $31.7 million from the condemnation settlement of its New Mexico operations; $30.5 million of additional long-term debt; and $18.8 million of proceeds from the issuance of additional shares of common stock.

Capital expenditures are generally incurred by United Water's utility subsidiaries in connection with the normal upgrading and expansion of existing water and wastewater facilities and to comply with existing environmental regulations. United Water considers its utility plant to be adequate and in good condition. These capital expenditures are necessary to meet growth requirements and to comply with environmental laws and regulations. Excluding the effects of inflation, the capital expenditures of United Water's utility subsidiaries are projected to aggregate $297 million over the next five years, including $63 million and $61 million in 1997 and 1998, respectively. This total includes $204 million for United Waterworks and $88 million for United Water New Jersey and United Water New York. The expenditures related to compliance with environmental laws and regulations are estimated to be approximately 25% of the projected capital expenditures over the 1997-2001 period. To the best of management's knowledge, the Company is in compliance with all major environmental laws and regulations.

United Water anticipates that its future capital expenditures will be funded by internally generated funds, external debt financings and the issuance of additional common and preferred stock, including shares issued to existing shareholders, bondholders, customers and employees under the Company's dividend reinvestment and stock purchase plans. In addition, United Waterworks and United Water New York participate in a number of tax-exempt financings to fund capital expenditures. The companies draw down funds on these financings as qualified capital expenditures are made. As of December 31, 1996, $27.2 million of proceeds from these financings had not yet been disbursed to the Company and are included in the consolidated balance sheet as restricted cash. The amount and timing of the use of these proceeds and of future financings will depend on actual capital expenditures, the timeliness and adequacy of rate relief, the availability and cost of capital and the ability to meet interest and fixed charge coverage requirements.

In January 1995, United Water New York issued $12 million of 8.98% senior notes and used these proceeds to reduce short-term borrowings.

In February 1995, United Waterworks issued $10 million of notes under a $75 million private placement medium-term note program, at a rate of 8.84%, with the full amount maturing in 2025. The proceeds were used to redeem outstanding notes payable.

In June 1995, United Waterworks issued $25 million of 6.20% tax-exempt Water Revenue Bonds, due 2025, through the Delaware Economic Development Authority. The proceeds are being used to fund capital improvements of United Water Delaware (a subsidiary of United Waterworks) over the next three years.

In August 1995, United Waterworks issued $20 million of 6.35% tax-exempt Water and Sewer Revenue Bonds, due 2025, through the city of Jacksonville, Florida. The proceeds are being used to fund capital improvements of United Water Florida (a subsidiary of United Waterworks).

In June 1996, United Water entered into a $30 million long-term note agreement with Credit Lyonnais to partially fund its investment in the Northumbrian Partnership. The loan bears interest at a LIBOR-based floating rate and is payable in annual installments through June 2006. The Company purchased an offsetting interest rate cap to limit its exposure under this financing to a maximum interest rate of 8.6%. The remainder of the investment was funded through borrowings on United Water's various short-term bank lines of credit.

In November 1996, United Water New Jersey issued three series of Variable Rate Demand Water Facilities Revenue Refunding Bonds (the Bonds) aggregating $130 million ($50 million due 2025 and $80 million due 2026), through the New Jersey Economic Development Authority (the EDA). Proceeds from the Bonds were used to refund an equal aggregate principal amount of 6%-7% bonds issued by the EDA in 1987 to finance or refinance a portion of the costs of acquiring and constructing certain water transmission, transportation, storage and distribution facilities located in Bergen, Passaic and Hudson counties in New Jersey. In December 1996, the Company purchased a five-year interest rate cap to limit its exposure under this financing to a maximum interest rate of 7%.

At December 31, 1996, United Water had cash and cash equivalents of $9 million (excluding restricted cash) and unused short-term bank lines of credit of $133.2 million. Management expects that cash flows provided by operations, unused credit lines currently available and cash generated from the dividend reinvestment and stock purchase plans will be sufficient to meet anticipated future operational needs.

Rate Matters

The profitability of United Water's regulated utilities is, to a large extent, dependent upon adequate and timely rate relief. The Company anticipates that the regulatory authorities that have jurisdiction over its utility operations will allow the Company's regulated utilities to earn a reasonable return on their utility investments.

The Company continues to follow SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," for its regulated utilities. SFAS No. 71 provides for the recognition of regulatory assets and liabilities as allowed by state regulators that are considered probable of recovery. See Note 1 to the consolidated financial statements.

During 1996, the Company's regulated utilities received ten rate awards with an aggregate annual rate revenue increase of $11.1 million. An estimated $4.2 million of this amount was reflected in 1996's revenues while the remaining $6.9 million is expected to increase revenues in 1997. Current year revenues also reflect the carryover impact of the rate awards granted in 1995 in the amount of $2.4 million. See Note 11 to the consolidated financial statements for further details.

At the end of January 1997, there were six rate cases pending in which the Company has requested an aggregate annual rate increase of $13.3 million. The most significant rate cases pending were filed by United Water Florida and United Water Delaware. In July 1996, United Water Florida filed for rate relief in the amount of $3.3 million, or 45.9%, in water revenues and $5.1 million, or 32.6%, in wastewater revenues. The increases were requested primarily to fund capital investments. As part of the proposal, the Company requested that it be permitted to place into effect on an interim basis $1.1 million, or 16.8%, of the proposed water increase and $1.1 million, or 7.9%, of the proposed wastewater increase. On November 15, 1996, the Florida Public Service Commission granted United Water Florida interim rate increases subject to refund of $725,000, or 10.6%, for water and $238,000, or 1.7%, for wastewater. A final decision on the Company's rate request is not anticipated until the second quarter of 1997.

In August 1996, United Water Delaware filed for rate relief in the amount of $3.7 million, or a 24.6% increase in revenues. A petition to place $2.2 million, or 15%, in effect subject to refund was filed in September 1996 and was approved by the Delaware Public Service Commission on October 15, 1996 for rates to become effective on October 26, 1996. A final decision on the Company's rate request is not anticipated until the second quarter of 1997.

Generally, the rate awards actually received by the Company's operating utilities are less than the amounts requested, primarily due to circumstances that change while the rate case is being processed.

Real Estate Activities

United Properties Group (United Properties) owns a portfolio of real estate located in New Jersey, New York, Pennsylvania, Delaware, Idaho and Florida, consisting of commercial properties, golf courses and land available for development. United Properties is pursuing joint ventures, sales or direct development opportunities for the various properties in its portfolio. In December 1995, United Properties recorded a $9.4 million pre-tax impairment loss (which was included in the $12.1 million impairment loss recorded by the Company) for various parcels of land located in Orange and Rockland counties, New York, in accordance with SFAS No. 121.

United Properties expects to spend $24.9 million over the next five years for capital expenditures on its existing real estate portfolio, including $11.8 million and $2.4 million in 1997 and 1998, respectively. Funding for United Properties' activities is anticipated to come from sales of properties, operations of existing commercial properties and golf courses, and proceeds of new financings. The timing of these expenditures will depend upon market conditions and the attainment of necessary approvals.

RESULTS OF OPERATIONS

Overview

United Water's net income applicable to common stock for 1996 was $34 million, or $1.01 per common share, as compared to $17.3 million, or $.54 per common share, earned in 1995. These increases were primarily attributable to $6 million of equity earnings from a June 1996 investment in Northumbrian Water Group in the United Kingdom, a one-time, after-tax gain of $4.3 million resulting from the settlement of condemnation proceedings associated with the Company's utility operations in Rio Rancho, New Mexico, and increased land sales at United Properties Group partially offset by the effect of a 5% increase in the average number of shares outstanding for the period. Net income in 1995 included the incurrence of non-cash, pre-tax charges of $12.1 million relating to the write-down of various assets at the Company's real estate and environmental testing businesses, a pre-tax charge of $1.5 million for costs associated with an unconsummated business development proposal and a 16% increase in the average number of common shares outstanding. The Merger contributed positively to the Company's earnings per share in both 1996 and 1995 even though United Water issued an additional 9.3 million shares of common stock to effect the Merger.

Operating Revenues

Operating revenues increased $12.5 million, or 3.9%, in 1996 and $34.8 million, or 12.2%, in 1995 from the prior years, as follows:

(thousands of dollars)	1996 vs. 1995 Increase (Decrease)		1995 vs. 1994 Increase (Decrease)	
Utilities:				
Merger	$ —	—	$30,357	10.6%
Rate awards	6,591	2.1%	7,097	2.5%
Consumption	(3,060)	(0.9%)	2,218	0.8%
Growth	4,559	1.4%	1,454	0.5%
Transfer of New Mexico operations	(5,990)	(1.9%)	(6,076)	(2.1%)
Real estate	3,336	1.0%	(1,421)	(0.5%)
Other operations	7,073	2.2%	1,140	0.4%
	$12,509	3.9%	$34,769	12.2%

1996 versus 1995

The 2.1% increase in revenues from rate awards in 1996 includes the impact of eleven 1995 and ten current year increases for the Company's operating utilities. The increase in revenues due to growth is partially attributable to the acquisitions of two utilities in New Jersey in the second quarter of 1996. The transfer of utility operations in Rio Rancho, New Mexico, and a 0.9% decrease in consumption due to unfavorable weather conditions in several service areas partially offset these revenue increases. Real estate revenues were higher as compared to 1995, primarily due to a $3 million increase in property sales in addition to higher golf course revenues and rental income. The $7.1 million increase in operating revenues from other operations was primarily attributable to the commencement of the public-private partnership with Jersey City, New Jersey, in May 1996, as well as higher revenues from meter installation contracts for the city of New York.

1995 versus 1994

The increased revenues for the year ended December 31, 1995, fully reflect the Merger with GWC as compared to only nine months of combined operations in 1994. The 2.5% increase in revenues from rate awards includes the impact of current year increases for eleven of the Company's operating utilities, as well as the full year effect of a 3.8% rate increase in July 1994 for United Water New York. Higher consumption due to the hot, dry summer in northeast service areas resulted in an increase in revenues of $2.2 million in 1995. The transfer of utility operations in Rio Rancho partially offset these revenue increases. Real estate revenues were lower as compared to 1994 primarily due to a $2.2 million decrease in property sales partially offset by increases in revenues from golf course operations and rental properties. The $1.1 million increase in operating revenues from other operations was primarily attributable to the service contract with the city of Hoboken, New Jersey, which commenced in July 1994.

Operating Expenses

The changes in operating expenses in 1996 as compared to 1995 were as follows:

(thousands of dollars)	Total Increase (Decrease)		New Mexico	Net of New Mexico Increase (Decrease)	
Operation and maintenance	$(3,675)	(2.3%)	$(2,957)	$ (718)	(0.5%)
Depreciation and amortization	1,572	5.4%	(776)	2,348	8.0%
General taxes	1,096	2.3%	(235)	1,331	2.7%

Operation and maintenance expenses in 1995 included a $12.1 million unusual non-cash charge relating to the write-down of various assets at the Company's real estate and environmental testing businesses. The decrease was offset by an $11.4 million increase in operation and maintenance expenses in 1996 due primarily to $4.5 million in additional operating expenses in connection with the public-private partnership with Jersey City, a $1.8 million increase in the operation and maintenance expenses of the Company's utility subsidiaries due to higher purchased water and chemical costs and $1 million relating to the acquisitions of two utilities in New Jersey in May 1996. Higher cost of meter installations and property sales also contributed to this increase.

The $2.3 million increase in depreciation and amortization was primarily attributable to utility plant additions by United Waterworks' utility subsidiaries, as well as amortization attributable to the service contract in Jersey City.

General taxes increased $1.3 million, or 2.7%, in 1996 primarily due to higher real estate and franchise taxes in utility operations.

The changes in operating expenses in 1995 as compared to 1994 were as follows:

(thousands of dollars)	Total Increase		Effect of Merger	Net of Merger Increase	
Operation and maintenance	$25,700	19.2%	$16,162	$9,538	7.1%
Depreciation and amortization	4,894	20.1%	3,704	1,190	4.9%
General taxes	5,835	13.7%	3,753	2,082	4.9%

The increase in operation and maintenance expenses, excluding the impact of the Merger, was primarily due to the incurrence of $12.1 million of non-cash charges relating to the write-down of various assets at the Company's real estate and environmental testing businesses, a $2.6 million increase in the operation and maintenance expenses of the Company's utility subsidiaries due to the higher level of consumption and $1.2 million of costs related to the service contract with the city of Hoboken. These charges were offset in part by a $2.3 million decrease due to the transfer of New Mexico operations in June 1995 and a $2.3 million decrease in the cost of real estate properties sold in 1995.

The increase in depreciation and amortization was primarily due to amortization attributable to the service contract in Hoboken and a one-time reduction in depreciation in 1994 on contributed plant.

The increase in general taxes of $2.1 million, or 4.9%, in 1995 was primarily attributable to higher real estate and franchise taxes in utility operations due to increased property tax assessments and the settlement of an outstanding real estate tax matter at United Water New Jersey.

Interest Expense

Interest expense increased $2.4 million, or 5.6%, predominantly due to additional long-term debt in 1996 as compared to 1995. The additional debt was incurred to finance the Partnership in the United Kingdom as well as to fund capital expenditures at the utility operations. Consolidated interest expense increased 18.9% in 1995 as compared to 1994, primarily due to the Merger and additional long-term debt.

Other Income

Other income increased $5.7 million primarily due to $6 million of earnings from the Partnership in the United Kingdom and the absence of $1.5 million of costs associated with an unconsummated business development proposal through the Company's participation in a partnership with Lyonnaise des Eaux in 1995. These were partially offset by $838,000 of interest income generated by the remaining $34 million escrow deposit on the transfer of New Mexico operations and a favorable settlement of a $584,000 legal dispute at United Water Toms River in 1995.

Other income was $4.4 million lower in 1995 as compared to 1994, primarily due to the award of $2.8 million in escrow monies to United Properties following a foreclosure settlement in 1994, a $1.5 million non-recurring gain from the sale of a wastewater transmission facility in Pine Bluff, Arkansas, in 1994 and the write-off of $1.5 million of costs associated with an unconsummated business venture in 1995. These were offset in part by $838,000 of interest income generated by the remaining $34 million escrow deposit on the transfer of New Mexico operations and a $584,000 legal settlement at United Water Toms River.

Income Taxes

The effective income tax rates on income before preferred and preference stock dividends were 36.5% in 1996, 36.8% in 1995 and 38% in 1994. The decrease in the effective rate in 1995, as compared to the preceding year, resulted from the impact of the deferred tax benefit related to the write-down of various assets at the Company's real estate and environmental testing businesses. An analysis of income taxes is included in Note 12 to the financial statements.

Effects of Inflation

Operating income from utility operations is normally not materially affected by inflation because cost increases generally lead to proportionate increases in revenues allowed through the regulatory process. However, there is a lag in the recovery of higher expenses through the regulatory process, and therefore, high inflation could have a detrimental effect on the Company until rate increases are received. Conversely, lower inflation and lower interest rates tend to result in reductions in the rates of return allowed by the utility commissions, as has occurred over the last several years.

Prospective Information

In addition to the historical information contained herein, this report contains a number of "forward-looking statements," within the meaning of the Securities Exchange Act of 1934. Such statements address future events and conditions concerning the adequacy of water supply and utility plant, capital expenditures, earnings on assets, resolution and impact of litigation, liquidity and capital resources and accounting matters. Actual results in each case could differ materially from those projected in such statements, by reason of factors including, without limitation, general economic conditions, competition, actions by regulators and other governmental authorities, and technological developments affecting the Company's operations, markets, services and prices, and other factors discussed in the Company's filings with the Securities and Exchange Commission, including this report.

Report of Management

United Water Resources and Subsidiaries

The consolidated financial statements included in this annual report have been prepared by and are the responsibility of management. The statements were prepared in conformity with generally accepted accounting principles considered appropriate in the circumstances and include amounts based on necessary judgments and estimates which management considers to be reasonable and appropriate. The financial statements of the company have been audited by its independent accountants, Price Waterhouse LLP. This audit, in the opinion of Price Waterhouse LLP, has been made in accordance with generally accepted auditing standards and their report on the fairness of the financial statements is included herein.

The company maintains a system of internal accounting controls designed to produce reliable financial statements and to provide reasonable assurance that the assets of the company are safeguarded from loss and unauthorized use. This system includes a program of internal audits to assure management that proper procedures and methods of operation are used to implement the plans, policies and directives of management.

The board of directors, through its audit committee, consisting of outside directors of the company, is responsible for reviewing the company's financial reporting and accounting practices. This committee meets periodically with management, internal auditors and the independent accountants to review their respective activities and the discharge of their responsibilities.

John J. Turner

John J. Turner
Treasurer
February 20, 1997

Report of Independent Accountants

Price Waterhouse LLP

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF UNITED WATER RESOURCES

In our opinion, the accompanying consolidated balance sheet and statement of consolidated capitalization and the related statements of consolidated income, common equity and cash flows present fairly, in all material respects, the financial position of United Water Resources and its subsidiaries at December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles. These financial statements are the responsibility of United Water Resources' management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

As discussed in Note 1 to the consolidated financial statements, during the year ended December 31, 1995, the company adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of."

Price Waterhouse LLP

New York, New York
February 20, 1997

Consolidated Balance Sheet

United Water Resources and Subsidiaries

December 31, (thousands of dollars)	1996	1995
ASSETS		
Utility plant, including $27,947 and $19,899 under construction	$1,348,391	$1,334,807
Less accumulated depreciation	266,836	253,529
	1,081,555	1,081,278
Utility plant acquisition adjustments, Less accumulated amortization of $7,922 and $2,955	64,710	71,898
Real estate and other investments, Less accumulated depreciation of $9,890 and $14,626	83,340	90,468
Equity investments	82,433	7,614
	165,773	98,082
Current assets:		
Cash and cash equivalents	8,961	4,529
Restricted cash	27,203	52,677
Accounts receivable and unbilled revenues, less allowance of $2,549 and $1,299	65,911	62,627
Prepaid and other current assets	11,668	15,103
	113,743	134,936
Deferred charges and other assets:		
Regulatory assets	74,062	67,914
Prepaid employee benefits	16,139	12,319
Unamortized debt expense	30,695	26,242
Other deferred charges and assets	34,303	24,039
	155,199	130,514
	$1,580,980	$1,516,708
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock and retained earnings	$ 391,490	$ 358,302
Preferred stock without mandatory redemption	9,000	9,000
Preferred stock with mandatory redemption	53,978	54,397
Preference stock, convertible, with mandatory redemption	39,283	43,694
Long-term debt	558,093	558,658
	1,051,844	1,024,051
Current liabilities:		
Notes payable	93,225	43,500
Preferred stock and long-term debt due within one year	29,547	13,575
Accounts payable and other current liabilities	38,008	32,943
Accrued taxes	17,320	25,678
Accrued interest and dividends	7,479	7,953
	185,579	123,649
Deferred credits and other liabilities:		
Deferred income taxes and investment tax credits	174,530	155,258
Customer advances for construction	25,259	27,804
Contributions in aid of construction	126,395	132,836
Other deferred credits and liabilities	17,373	53,110
	343,557	369,008
Commitments and contingencies (Note 6)		
	$1,580,980	$1,516,708

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

Statement of Consolidated Income

United Water Resources and Subsidiaries

Years ended December 31, (thousands of dollars except per share data)	1996	1995	1994
Operating revenues	$332,045	$319,536	$284,767
Operating expenses:			
Operation and maintenance	155,848	159,523	133,823
Depreciation and amortization	30,833	29,261	24,367
General taxes	49,661	48,565	42,730
Total operating expenses	236,342	237,349	200,920
Operating income	95,703	82,187	83,847
Interest and other expenses:			
Interest expense, net of amount capitalized	44,951	42,548	35,792
Allowance for funds used during construction	(3,355)	(1,855)	(1,247)
Preferred stock dividends of subsidiaries	2,277	2,297	2,318
Gain on New Mexico settlement	(10,372)	—	—
Other income, net	(6,696)	(1,002)	(5,444)
Total interest and other expenses	26,805	41,988	31,419
Income from continuing operations before income taxes	68,898	40,199	52,428
Provision for income taxes	25,878	15,439	20,817
Income from continuing operations	43,020	24,760	31,611
Preferred and preference stock dividends	4,613	4,795	3,454
Net income applicable to common stock from continuing operations	$ 38,407	$ 19,965	$ 28,157
Discontinued operations:			
Loss from discontinued operations, net of income tax benefit of $824 in 1996, $1,235 in 1995 and $146 in 1994	(1,532)	(2,622)	(270)
Loss on disposal of discontinued business, net of income tax benefit of $1,543	(2,865)	—	—
Loss from discontinued operations	(4,397)	(2,622)	(270)
Net income applicable to common stock	$ 34,010	$ 17,343	$ 27,887
Average common shares outstanding	33,728	31,995	27,524
Net income (loss) per common share			
Continuing operations	$ 1.14	$ .62	$ 1.02
Discontinued operations	$ (.13)	$ (.08)	$ (.01)
Total	$ 1.01	$ .54	$ 1.01

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

Statement of Consolidated Common Equity

United Water Resources and Subsidiaries

(thousands)	Common Stock Number of Shares	Common Stock Amount	Cumulative Translation Adjustment	Retained Earnings
Balance at December 31, 1993	20,216	$138,456	—	$ 63,654
Dividend reinvestment and stock purchase plans	1,769	23,158	—	—
Common stock issued in connection with merger	9,296	123,170	—	—
Net income applicable to common stock	—	—	—	27,887
Cash dividends paid on common stock, $.92 per share	—	—	—	(25,830)
Balance at December 31, 1994	31,281	284,784	—	65,711
Dividend reinvestment and stock purchase plans	1,599	19,879	—	—
Net income applicable to common stock	—	—	—	17,343
Cash dividends paid on common stock, $.92 per share	—	—	—	(29,415)
Balance at December 31, 1995	32,880	304,663	—	53,639
Dividend reinvestment and stock purchase plans	1,375	18,845	—	—
Cumulative translation adjustment	—	—	$6,703	—
Conversion of 5% preference stock	294	4,624	—	—
Net income applicable to common stock	—	—	—	34,010
Cash dividends paid on common stock, $.92 per share	—	—	—	(30,994)
Balance at December 31, 1996	34,549	$328,132	$6,703	$ 56,655

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

Statement of Consolidated Cash Flows

United Water Resources and Subsidiaries

Years ended December 31, (thousands of dollars)	1996	1995	1994
Operating activities:			
Net income	$ 38,623	$ 22,138	$ 31,341
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	32,068	30,922	26,347
Deferred income taxes and investment tax credits, net	18,399	(7,762)	5,865
Gain on New Mexico settlement	(10,372)	—	—
Equity earnings of affiliates	(4,617)	2,087	(105)
Gain from release of security deposit on real estate settlement	—	—	(2,811)
Gain on foreign currency exchange	(368)	—	—
Loss on disposal of discontinued operations	4,408	—	—
Impairment loss	—	12,105	—
Allowance for funds used during construction	(3,355)	(1,855)	(1,247)
Changes in assets and liabilities, net of effect of Merger:			
Accounts receivable and unbilled revenues	(3,729)	(3,335)	(9,412)
Prepayments	3,346	(954)	4,146
Prepaid employee benefits	(3,757)	(861)	(4,404)
Regulatory assets	(7,704)	3,771	(9,290)
Accounts payable and other current liabilities	3,652	(4,647)	6,479
Accrued taxes	(6,454)	(2,774)	3,356
Accrued interest and dividends	(494)	(1,923)	(2,734)
Other, net	(14,221)	(8,087)	(5,206)
Net cash provided by operating activities	45,425	38,825	42,325
Investing activities:			
Additions to utility plant (excludes allowance for funds used during construction)	(74,569)	(70,227)	(57,592)
Additions to real estate and other properties	(5,047)	(7,958)	(9,317)
Investment in Northumbrian Partnership	(61,792)	—	—
Acquisitions, net of cash received	(6,794)	—	(5,059)
Proceeds from New Mexico settlement	31,670	35,330	—
Investments in service contracts	(5,500)	—	(5,500)
Change in restricted cash	25,474	(22,450)	510
Net cash used in investing activities	(96,558)	(65,305)	(76,958)
Financing activities:			
Change in notes payable	49,725	(32,950)	37,050
Additional long-term debt	30,538	67,000	88,648
Reduction in preferred stock and long-term debt	(15,550)	(10,299)	(90,123)
Issuance of common stock	18,845	19,879	23,158
Dividends on common stock	(30,994)	(29,415)	(25,830)
Dividends on preferred and preference stock	(4,613)	(4,795)	(3,454)
Net contributions and advances for construction	7,614	11,749	6,091
Net cash provided by financing activities	55,565	21,169	35,540
Net increase (decrease) in cash and cash equivalents	4,432	(5,311)	907
Cash and cash equivalents at beginning of year	4,529	9,840	8,933
Cash and cash equivalents at end of year	$ 8,961	$ 4,529	$ 9,840

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

Statement of Consolidated Capitalization

United Water Resources and Subsidiaries

December 31, (thousands of dollars)	1996	1995
Common stock and retained earnings:		
Common stock, no par value—authorized 50,000,000 shares	$ 344,687	$ 321,234
Less treasury shares, at cost	(16,555)	(16,571)
Retained earnings	56,655	53,639
Cumulative translation adjustment	6,703	—
Total common stock and retained earnings	391,490	358,302
Cumulative preferred stock without mandatory redemption:		
United Water New Jersey, authorized 2,000,000 shares, stated value— $100 per share, issuable in series:		
4½% Series, authorized and outstanding 30,000 shares	3,000	3,000
4.55% Series, authorized and outstanding 60,000 shares	6,000	6,000
Total preferred stock without mandatory redemption	9,000	9,000
Cumulative preferred and preference stock with mandatory redemption, net of amount due in one year:		
United Water New Jersey:		
5% Series, authorized and outstanding 7,200 shares	660	720
7⅜% Series, authorized and outstanding 150,000 shares	15,000	15,000
United Water New York:		
Authorized 100,000 shares, stated value—$100 per share issuable in series:		
$8.75 Series, authorized and outstanding 26,000 shares	2,400	2,600
$9.84 Series, authorized and outstanding 50,000 shares	5,000	5,000
United Water Idaho: 5%, authorized and outstanding 7,901 shares	654	797
United Water Resources:		
7⅝% Series B, authorized and outstanding 300,000 shares	30,264	30,280
5% Series A, convertible preference, authorized and outstanding 2,988,156 shares	39,283	43,694
Total preferred and preference stock with mandatory redemption	93,261	98,091
Long-term debt, net of amount due in one year:		
United Water New Jersey:		
First mortgage bonds, 5.8%-5.9%, due 2024 (weighted average 5.85%)	40,000	75,000
Unsecured promissory notes, variable rates, due 2025-2026 (weighted average 4.7%)	130,000	100,000
United Water New York:		
First mortgage bonds, 9⅜%, due 2001	1,200	5,500
Unsecured promissory notes, 5.65%-8.98%, due 1998-2025 (weighted average 6.78%)	52,100	52,650
United Water Resources:		
Promissory notes, 9.38%, due 2019	25,000	25,000
Promissory notes, floating LIBOR-based interest rate, due 2006	28,000	—
United Waterworks:		
Unsecured debt, 6.15%-10.2%, due 1998-2025 (weighted average 7.78%)	246,630	264,151
United Properties Group:		
Mortgage notes, 8%-10%, due 1999-2006 (weighted average 9.94%)	17,153	17,526
Floating rate LIBOR-based term loan, due 2000	7,399	7,565
New Jersey Wastewater Treatment Loans, 0%-4.8%, due 2013 (weighted average 2.35%)	2,036	2,141
United Water Services: Promissory note with JMM, 8%, due 1999	5,000	5,000
United Water Mid-Atlantic: Promissory note at floating interest rate, due 2004	3,575	4,125
Total long-term debt	558,093	558,658
Total capitalization	$1,051,844	$1,024,051

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

Notes to Consolidated Financial Statements

United Water Resources and Subsidiaries

One / Summary of Significant Accounting Policies

Principles of consolidation: The consolidated financial statements include the accounts of United Water Resources (United Water, or the Company) and the subsidiaries in which it has more than 50% ownership. The Company accounts for investments in which it has significant influence under the equity method of accounting. 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 and disclosures of contingent 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 these estimates. Certain prior year amounts have been reclassified to conform with current year presentation.

Description of business: United Water's principal utility subsidiaries include United Water New Jersey, United Water New York and United Waterworks. These subsidiaries provide water and wastewater services to approximately two million people in 13 states. Other significant wholly-owned subsidiaries of United Water include: United Properties Group (United Properties), which is engaged in real estate activities including commercial rentals, land development and sales, golf course operations and consulting services; United Water UK, an equal partner with Lyonnaise Europe in the Northumbrian Partnership, which has acquired a 20% interest in Northumbrian Water Group, a major investor-owned water and wastewater company in the United Kingdom; and United Water Mid-Atlantic, which owns and operates water and wastewater systems. In addition, the Company has entered into public-private partnerships with the cities of Hoboken and Jersey City, New Jersey, whereby the municipalities retain ownership of their systems while the Company operates and maintains them.

United Water's utility subsidiaries are subject to regulation by the public utility commissions of the states in which they operate. Their accounting must comply with the applicable uniform system of accounts prescribed by these regulatory commissions and must also conform to generally accepted accounting principles as applied to rate-regulated public utilities. This accounting allows, among other things, the recognition of intercompany profit in situations where it is probable such profit will be recovered in the ratemaking process and the recording of assets and liabilities not generally recorded by non-regulated enterprises. The Company continues to follow Statement of Financial Accounting Standards (SFAS) No. 71 "Accounting for the Effects of Certain Types of Regulation" for its regulated utilities. SFAS No. 71 provides for the recognition of regulatory assets and liabilities as allowed by state regulators that are considered probable of recovery.

Equity investments: The Company holds an indirect investment in Northumbrian Water Group and has representation on its board of directors. As a result of the merger (the Merger) with GWC Corporation in April 1994, the Company acquired an indirect 25% interest in JMM Operational Services, which provides contract operations and maintenance services for water and wastewater facilities. These investments totaled $74.9 million and $7.3 million, respectively, at December 31, 1996 and are included in equity investments in the consolidated balance sheet.

Foreign currency translation: Financial statements for United Water UK are translated into U.S. dollars at year-end exchange rates for assets and liabilities and weighted average exchange rates for income and expenses. The resulting cumulative translation adjustment is recorded as a separate component of stockholders' equity in the Company's statement of consolidated common equity.

Utility plant: Utility plant is recorded at original cost, which includes direct and indirect labor and material costs associated with construction activities, related operating overheads and an allowance for funds used during construction (AFUDC). AFUDC is a non-cash credit to income and includes both the cost of borrowed funds and a return on equity funds attributable to plant under construction.

The original cost of utility property retired or otherwise disposed of in the normal course of business is charged to accumulated depreciation, and salvage (net of removal cost) is credited thereto; no gain or loss is recognized. The costs of property repairs, replacements and renewals of minor property items are included in maintenance expense when incurred.

Utility plant acquisition adjustments: Utility plant acquisition adjustments represent the difference between the purchase price and the book value of net assets acquired, and are amortized, generally, on a straight-line basis over a 40-year period. Utility plant acquisition adjustments include a premium paid to acquire the operating utilities of GWC Corporation in the Merger (see Note 2). At each balance sheet date, the Company evaluates the realizability of utility plant acquisition adjustments on the basis of expected future undiscounted cash flows. Based on its most recent evaluation, the Company believes that no impairment of utility plant acquisition adjustments exists at December 31, 1996.

Advances and contributions in aid of construction: When required by the public utility commissions of the states in which the Company's utility subsidiaries operate, outside parties, generally customers and developers, make payments to the Company to fund certain utility capital expenditures to provide water or wastewater service to new customers. Nonrefundable amounts received by the Company are recorded as contributions in aid of construction, except where the Company is required to record such amounts directly as a reduction to utility plant. Refundable amounts received are recorded as advances, and are refundable, for limited periods of time, generally as new customers begin to receive service. The remaining balance of any advances received, after the Company has made all required refunds of such advances, is transferred to contributions in aid of construction.

The balances of advances and contributions are used to reduce utility plant in determining rate base, and plant funded by advances and contributions is generally not depreciated. However, the public utility commissions in several of the states in which the Company operates permit the depreciation of plant funded by contributions in aid of construction, but also require that contributions be amortized, so that there is no net effect on income from the depreciation of the contributed plant. For income tax purposes, advances and contributions received after 1986 and through June 1996 are included as taxable income, and the related plant is depreciated for tax purposes. In accordance with changes in the tax law, effective June 12, 1996, advances and contributions are no longer included in taxable income, nor is the related plant depreciated for tax purposes.

Jointly owned facilities: Utility plant includes United Water New Jersey's 50% interest in the Wanaque South Water Supply Project, the net book value of which was $43.6 million and $44.4 million at December 31, 1996 and 1995, respectively. United Water New Jersey's share of the project's operating expenses is included in operation and maintenance expenses.

Regulatory assets: Included in deferred charges and other assets are regulatory items that are expected to be recognized when included in future rates and recovered from customers as directed by the state public utility commissions. These regulatory assets include items that the public utility commissions have ordered the Company's regulated utilities to defer and prudently incurred costs where the Company expects that recovery is probable because of the past practices of the public utility commissions.

Regulatory assets consisted of the following at December 31:

(thousands of dollars)	1996	1995
Recoverable income taxes	$40,398	$39,013
Deferred employee benefits	21,347	17,792
Tank painting	2,731	2,354
Other	9,586	8,755
Total regulatory assets	$74,062	$67,914

Real estate: Real estate properties are carried at the lower of cost, which includes original purchase price and direct development costs, or fair value. Real estate taxes and interest costs are capitalized during the development period. The amount of interest capitalized was $620,000 in 1996, $1.4 million in 1995 and $2.7 million in 1994. Real estate operating revenues include rental income from commercial properties, proceeds from the disposition of real estate properties, revenues from golf course operations and fees from consulting services.

Unamortized debt expense: Debt premium, debt discount and deferred debt expenses are amortized to income or expense over the lives of the applicable issues.

Revenues from utility operations: United Water New Jersey and United Waterworks recognize as revenues billings to customers, plus estimated revenues for consumption for the period from the date of the last billing to the balance sheet date. United Water New York recognizes revenues as bills are rendered to customers and does not accrue for unbilled revenues. United Water New York and United Water New Rochelle have been directed by the New York Public Service Commission (PSC) to institute a Revenue Reconciliation Clause, which requires the reconciliation of billed revenues with pro forma revenues that were used to set rates. Any variances outside a threshold range are accrued or deferred for subsequent recovery from or refund to customers. At December 31, 1996, United Water New York and United Water New Rochelle had $1.1 million of net unamortized revenue accruals, resulting from revenues which were less than the amounts used to set rates. These amounts are expected to be recovered over a three-year period.

Revenues from real estate activities: Revenues from real estate sales are recognized when the transaction is consummated and title has passed. Revenues from real estate transactions were $5.4 million, $2.4 million and $4.6 million in 1996, 1995 and 1994, respectively.

United Properties owns several office buildings, with an aggregate net book value of $44.2 million (net of accumulated depreciation of $8.4 million), which are leased to tenants under various operating leases. The following is a schedule, by year, of the minimum future rental income on non-cancelable operating leases outstanding at December 31, 1996:

(thousands of dollars)	
1997	$ 6,360
1998	5,800
1999	4,565
2000	2,865
2001	728
Thereafter	50
Total minimum future rental income	$20,368

Revenues from public-private partnerships: United Water entered into a five-year contract with Jersey City to operate its municipal water system. This contract provides for monthly service fees which are recorded as revenues when billed. Additionally, certain incentives based on collection and marketing goals are recognized when earned. Service fee revenues for the eight months ended December 31, 1996 were $4.7 million.

The Company entered into a twenty-year contract with the city of Hoboken to operate, maintain and manage its municipal water system. Under this contract, revenues are recorded monthly based upon customer billings. Revenues for the years ended December 31, 1996 and 1995 were $3.5 million and $3.2 million, respectively.

Depreciation: Depreciation of utility plant and real estate properties is recognized using the straight-line method over the estimated service lives of the properties. Utility plant depreciation rates are prescribed by the public utility commissions. The provision for depreciation was equivalent to 2.1% of average depreciable utility plant in service in 1996, 1995 and 1994. Real estate properties are depreciated over estimated lives ranging between 25 and 50 years. For federal income tax purposes, depreciation is computed using accelerated methods and, in general, shorter depreciable lives as permitted under the Internal Revenue Code.

Income taxes: The Company and its eligible subsidiaries file a consolidated federal income tax return. Federal income taxes are deferred under the liability method in accordance with SFAS No. 109, "Accounting for Income Taxes." Under the liability method, deferred income taxes are provided for all differences between financial statement and tax basis of assets and liabilities. Additional deferred income taxes and offsetting regulatory assets or liabilities are recorded to recognize that income taxes will be recoverable or refundable through future revenues.

Investment tax credits arising from property additions are deferred and amortized over the estimated service lives of the related properties.

Statement of cash flows: United Water considers all highly liquid investments with original maturities of three months or less to be cash equivalents. The Company made cash payments for interest (net of amounts capitalized) and federal and state income taxes as follows:

(thousands of dollars)	1996	1995	1994
Interest, net of amounts capitalized	$44,573	$43,701	$37,386
Income taxes	11,921	15,415	11,205

The following is a supplemental schedule of non-cash transactions in 1996:

(thousands of dollars)	1996
New Mexico settlement:	
Liabilities transferred to Rio Rancho	$20,244
Cumulative translation adjustment	6,703
Conversion of 352,922 shares of 5% preference stock	4,869
Acquisition of Princeton Meadows and Matchaponix:	
Note receivable forgiven	5,000
Liabilities assumed	5,172

The following is a supplemental schedule of non-cash transactions related to the Merger (see Note 2):

(thousands of dollars)	1994
Fair value of assets purchased	$667,435
Less:	
Liabilities assumed	464,749
Common stock issued	123,170
Fair value of preferred stock assumed	31,135
Fair value of preference stock issued	43,322
Cash paid for GWC, net of cash received	$ 5,059

Asset impairment: During 1995, as a result of changes in market conditions, development plans, projections of cash flows and other considerations, the Company revalued certain investments in its real estate and environmental testing subsidiaries. Measurements of value used by the Company included market prices and the use of discounted cash flows. The Company recorded a $12.1 million non-cash impairment loss during 1995, included as part of operation and maintenance expenses in the statement of consolidated income, in accordance with the provisions of SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of."

Two / Merger

On April 22, 1994, United Water completed the Merger with GWC Corporation (GWC), in which United Water was the surviving corporation. GWC's principal assets included 100% of the stock of General Waterworks Corporation (presently known as United Waterworks), which currently owns regulated water and wastewater utilities operating in 13 states, and a 25% indirect investment in JMM Operational Services, Inc. (JMM). JMM provides operations and management services to government and industry for water and wastewater treatment facilities. The Merger was accounted for under the purchase method and resulted in the recording of a utility plant acquisition adjustment of $67 million. In exchange for the common stock of GWC that was issued and outstanding immediately preceding the Merger, United Water (i) issued 9,295,860 shares of United Water common stock, (ii) issued 3,341,078 shares of United Water 5% cumulative convertible preference stock, with a liquidation price of $13.794 per share, and (iii) paid former shareholders of GWC $8.9 million in cash. In addition, each share of GWC 7⅝% cumulative preferred stock outstanding at the time of the Merger was converted into one fully paid non-assessable share of United Water 7⅝% cumulative preferred stock, with equal stated dividends and substantially similar rights, privileges, qualifications and restrictions.

Prior to the Merger, Lyonnaise American Holding, Inc. (LAH), a Delaware corporation and a wholly-owned subsidiary of Lyonnaise des Eaux, a French societe anonyme, owned approximately 81.9% of GWC's common stock. The remaining 18.1% of GWC's common stock was publicly traded. On the date of the Merger, LAH converted 70% of its shares of GWC common stock into United Water common stock and the remainder of its shares of GWC common stock into United Water 5% cumulative convertible preference stock. Immediately after the Merger, LAH owned approximately 25.4% of the issued and outstanding United Water common stock and approximately 97.7% of the issued and outstanding United Water 5% cumulative convertible preference stock. A twelve-year Governance Agreement between LAH and United Water contains a number of restrictions, including restrictions on when LAH can convert its preference shares into United Water common stock and on LAH's ability to buy or sell United Water common stock or preference stock. As of December 31, 1996, LAH owned approximately 27.5% of the issued and outstanding United Water common stock and approximately 98.3% of the issued and outstanding United Water 5% cumulative convertible preference stock.

The financial results of the former subsidiaries of GWC are included in United Water's financial results beginning April 1, 1994. The following unaudited pro forma condensed income statement information gives effect to the Merger as if it had occurred at the beginning of 1994. Pro forma results are not necessarily indicative of what actually would have occurred had the acquisition been in effect for the periods presented. In addition, the pro forma results are not intended to be a projection of future results.

(thousands of dollars except per share data)	1996	1995	1994 Unaudited
Operating revenues	$332,045	$319,536	$313,963
Operating income	95,703	82,187	89,854
Net income applicable to common stock	34,010	17,343	27,724
Net income (loss) per common share:			
Continuing operations	$ 1.14	$ .62	$ .92
Discontinued operations	$ (.13)	$ (.08)	$ (.01)
Total	$ 1.01	$ .54	$ .91

As disclosed in Note 1, the Company recorded a $12.1 million non-cash, pre-tax impairment loss in the fourth quarter of 1995 for various parcels of land held by its real estate subsidiary and for its investment in the environmental testing business.

As disclosed in Note 3, the Company settled the condemnation proceedings with the city of Rio Rancho. As a result, an after-tax gain of $4.3 million is included in 1996 first quarter earnings.

Three / New Mexico Settlement

On March 29, 1996, the Company settled the condemnation proceeding with the city of Rio Rancho, New Mexico (the City). The agreement was approved on the same day by the Thirteenth Judicial District Court in New Mexico. Under the terms of the agreement, the Company agreed to accept $67 million for the water and wastewater systems of its United Water New Mexico operations (including capital expenditures incurred in 1995). Results of this transaction are included in the Company's first quarter 1996 earnings. The Company lost revenues since June 30, 1995 when the City took possession of the utility's operations. For the first six months of 1995, the Company's Rio Rancho utility had revenues of $6 million.

Four / Notes Payable

United Water and its subsidiaries have a number of credit lines with banks. Borrowings under these credit lines generally bear interest at rates between the London Interbank Offered Rate (LIBOR) and the prime lending rate. United Water pays commitment fees under arrangements with certain of these banks to compensate them for services and to support these lines of credit. There are no legal restrictions placed on the withdrawal or other use of these bank balances.

The total credit lines available, the amounts utilized and the range of interest rates at December 31 were as follows:

(thousands of dollars)	1996	1995
Total credit lines available	$229,500	$208,500
Utilized:		
Drawn	93,225	43,500
Pledged	3,055	3,805
Interest rates	5.5% to 8.3%	5.8% to 6.4%

During 1996, the Company utilized approximately $30 million of its various short-term lines of credit to fund its investment in the Northumbrian Partnership.

Five / Long-term Debt

The long-term debt repayments over each of the next five years are as follows: 1997—$20.3 million; 1998—$23.9 million; 1999—$30 million; 2000—$74 million and 2001—$13.9 million. Substantially all of the utility plant of United Water New Jersey and United Water New York is subject to first mortgage liens, and both companies, as well as United Waterworks and other subsidiaries of United Water, are subject to certain restrictive covenants related to debt issued by those subsidiaries.

In June 1996, United Water entered into a $30 million long-term note agreement with Credit Lyonnais to partially fund the investment in the Northumbrian Partnership. The loan bears interest at a LIBOR-based floating rate (5.9% at December 31, 1996) and is payable in annual installments through June 2006. The Company purchased an offsetting interest rate cap for $576,000 to limit its exposure under this financing to a maximum interest rate of 8.6%. The cost of the interest rate cap is being amortized over the life of the debt.

In November 1996, United Water New Jersey issued three series of Variable Rate Demand Water Facilities Revenue Refunding Bonds (the Bonds) aggregating $130 million, through the New Jersey Economic Development Authority (the EDA). The interest rates on these Bonds ranged from 4.65% to 4.8% at December 31, 1996. Proceeds from the Bonds were used to refund an equal aggregate principal amount of 6%-7% bonds issued by the EDA in 1987 to finance or refinance a portion of the costs of acquiring and constructing certain water transmission, transportation, storage and distribution facilities located in Bergen, Passaic and Hudson counties in New Jersey. In December 1996, the Company purchased a five-year interest rate cap requiring annual payments of $149,000 to limit its exposure under this financing to a maximum interest rate of 7%.

Six / Commitments and Contingencies

The future capital expenditures of the Company's utility subsidiaries are projected to aggregate $297 million over the next five years, including $63 million and $61 million in 1997 and 1998, respectively. United Properties currently projects spending $24.9 million over the next five years for capital expenditures on its existing real estate portfolio, including $11.8 million and $2.4 million in 1997 and 1998, respectively.

United Water's total consolidated rental expense was approximately $5.1 million in 1996, $4.1 million in 1995 and $2.9 million in 1994. The minimum future lease payments under all non-cancelable operating leases, which consist primarily of buildings and automobiles, at December 31, 1996 are as follows:

(thousands of dollars)

1997	$ 4,199
1998	2,947
1999	1,743
2000	977
2001	354
Thereafter	1,021
Total minimum future lease payments	$11,241

The Company has various purchase commitments for materials, supplies and other services incidental to the ordinary conduct of business. In addition, the Company is routinely involved in legal actions arising in the ordinary course of its utility operations. In the opinion of management, none of these matters will have a material adverse impact on the Company.

Seven / Preferred and Preference Stock

The utility subsidiaries of the Company have issued and outstanding cumulative preferred stock, generally with mandatory redemption provisions requiring annual sinking fund payments. These sinking fund requirements total $260,000 in 1997 and $2,073,000 in 1998 through 2001. The redemption of cumulative preferred stock was $260,000 in each of the years 1996, 1995 and 1994. In addition, except as described in the next paragraph, optional sinking fund provisions can be exercised and redemptions made at specific prices for all preferred stock issues. Redemptions require payment of accrued and unpaid dividends up to the date fixed for redemption.

As discussed in Note 2, the Merger resulted in the issuance by United Water of 3,341,078 shares ($46 million par value) of 5% Series A cumulative convertible preference stock, valued at $43.3 million at the time of the Merger and $30 million of 7⅝% Series B cumulative preferred stock, valued at $31.1 million at the time of the Merger. LAH owned 97.7% of the Series A preference stock outstanding. The Series B preferred stock has a $1.5 million mandatory annual redemption commencing in 1998. Shares of the Series B preferred stock may not be redeemed by the Company prior to September 1, 1997.

Each share of the Series A preference stock outstanding may be converted into .83333 shares of United Water common stock at any time commencing April 22, 1996. However, under the Governance Agreement between United Water and LAH, LAH may convert 10% of the Series A preference stock it owns during the year commencing April 22, 1996, and an additional 10% cumulatively per year thereafter until April 22, 2003, at which time these conversion restrictions end. During 1996, 352,922 shares of the Series A preference stock with a value of $4.9 million were converted into 294,006 shares of United Water common stock with a value of $4.6 million. United Water may not redeem any of the outstanding, unconverted Series A preference stock prior to maturity on April 22, 2004.

Eight / Incentive Stock Plans

Under the Company's management incentive plan, the following options have been granted to key employees:

	Number of Options	Weighted Average Exercise Price Per Option
Outstanding at December 31, 1993	534,563	$15.153
Granted	183,910	13.848
Exercised	(2,900)	11.375
Canceled or expired	(10,781)	15.087
Outstanding at December 31, 1994	704,792	$14.829
Granted	210,020	13.250
Exercised	(12,047)	11.501
Canceled or expired	(88,095)	14.491
Outstanding at December 31, 1995	814,670	$14.508
Granted	204,300	12.250
Exercised	(120,813)	12.965
Canceled or expired	(10,340)	14.703
Outstanding at December 31, 1996	887,817	$14.196

All options are currently exercisable and represent the only stock options outstanding at December 31, 1996. A total of 1,140,625 common shares are reserved for issuance under the management incentive plan.

In May 1993, the shareholders approved the creation of dividend units to be issued in conjunction with stock options granted under the management incentive plan. One dividend unit may be attached to each unexercised option to purchase a share of United Water common stock, which entitles the option holder to accrue, as a credit against the option exercise price, the aggregate dividends actually paid on a share of United Water common stock while the dividend unit is in effect. The dividend units are designed to create an incentive for option holders to exercise their options and tie that incentive to the dividend payments on the common stock. United Water recorded compensation expense of $2.5 million in 1996, $228,000 in 1995 and $274,000 in 1994 with respect to the management incentive plan. The increase in compensation expense in 1996 is attributable to stock appreciation.

In October 1995, the Financial Accounting Standards Board issued SFAS No. 123, "Accounting for Stock-Based Compensation," which establishes financial accounting and reporting standards for stock-based employee compensation plans. The statement defines a fair value based method of accounting for employee stock options and similar equity instruments and encourages the use of that method of accounting for all employee stock compensation plans. However, SFAS No. 123 also permits the measurement of compensation costs using the intrinsic value based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." The Company has elected to account for its employee stock compensation plans under the guidance prescribed by APB Opinion No. 25 and has made the required pro forma disclosures of net income and earnings per share as if the fair value based method of accounting defined in SFAS No. 123 had been applied as indicated below:

(thousands of dollars except per share data)	1996	1995
Net income:		
As reported	$34,010	$17,343
Pro forma	34,079	17,160
Earnings per common share:		
As reported	$ 1.01	$ .54
Pro forma	1.01	.54

The fair value for these options was estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions for the years ended December 31, 1996 and 1995, respectively: expected volatility of 21.46% and 21.48%; risk-free interest rates of 5.47% and 7.85%; expected life of 6 years and dividend yields of 0.0% for both years. The weighted average fair value of each option granted during the years ended December 31, 1996 and 1995 was $4.30 and $5.52, respectively. The Black-Scholes option-pricing model requires the input of highly subjective assumptions including the expected stock price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate. In management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

In May 1988, the shareholders approved a restricted stock plan for certain key employees. United Water issued 1,250 shares in 1996, 2,500 shares in 1995 and 3,750 shares in 1994 in connection with the restricted stock plan. Such shares are earned by the recipients over a 5-year period. United Water recorded compensation expense of $69,000 in 1996, $67,000 in 1995 and $93,000 in 1994 with respect to this restricted stock plan.

Nine / Shareholder Rights Plan

In July 1989, the board of directors of United Water approved a Shareholder Rights Plan designed to protect shareholders against unfair and unequal treatment in the event of a proposed takeover. It also guards against partial tender offers and other hostile tactics to gain control of United Water without paying all shareholders a fair price. Under the plan, each share of United Water's common stock also represents one Series A Participating Preferred Stock Purchase Right (Right) until the Rights become exercisable. The Rights attach to all of United Water's common stock outstanding as of August 1, 1989, or subsequently issued, and expire on August 1, 1999.

The Rights would be exercisable only if a person or group acquired 20% or more of United Water's common stock or announced a tender offer that would lead to ownership by a person or group of 20% or more of the common stock.

In certain cases where an acquirer purchased more than 20% of United Water's common stock, the Rights would allow shareholders (other than the acquirer) to purchase shares of United Water's common stock at 50% of market price, diminishing the value of the acquirer's shares and diluting the acquirer's equity position in United Water. If United Water were acquired in a merger or other business combination transaction, under certain circumstances the Rights could be used to purchase shares in the acquirer at 50% of the market price. Subject to certain conditions, if a person or group acquired 20% or more of United Water's common stock, United Water's board of directors may exchange each Right held by shareholders (other than the acquirer) for one share of common stock or 1/100 of a share of Series A Participating Preferred Stock. If an acquirer successfully purchased 80% of United Water's common stock after tendering for all of the stock, the Rights would not operate. If holders of a majority of the shares of United Water's common stock approved a proposed acquisition under specified circumstances, the Rights would be redeemed at one cent each. They could also be redeemed by United Water's board of directors for one cent each at any time prior to the acquisition of 20% of the common stock by an acquirer.

On September 15, 1993, United Water's Shareholder Rights Plan was amended in connection with United Water's execution of a merger agreement with GWC Corporation. The amendment generally excepts the majority stockholder of GWC Corporation and its affiliates and associates from triggering the Rights through the execution of the merger agreement, the performance of the transactions contemplated therein or otherwise.

Ten / Employee Benefits

Postretirement benefit plans other than pensions: The Company sponsors a defined benefit postretirement plan that covers hospitalization, major medical benefits and life insurance benefits for salaried and non-salaried employees. The Company is funding a portion of its postretirement health care benefits through contributions to Voluntary Employees' Beneficiary Association (VEBA) Trusts.

Effective January 1, 1995, the Company made a number of changes to its medical plan for active employees and retirees. These amendments include the requirement that active employees and retirees pay a greater share of the cost of their medical coverage.

The following sets forth the plan's funded status and reconciles that funded status to the amounts recognized in the Company's balance sheet as of December 31:

(thousands of dollars)	1996	1995
Accumulated postretirement benefit obligation (APBO):		
Retirees	$(13,484)	$(13,967)
Fully eligible actives	(12,729)	(15,122)
Other actives	(16,690)	(18,980)
Total	(42,903)	(48,069)
Plan assets at fair value	16,696	12,320
Funded status	(26,207)	(35,749)
Unrecognized transition obligation	23,351	25,018
Unrecognized gain	(11,426)	(1,801)
Accrued postretirement benefit cost	$(14,282)	$(12,532)

Net periodic postretirement benefit cost components were as follows:

(thousands of dollars)	1996	1995	1994
Service cost	$ 2,404	$2,521	$1,362
Interest cost	3,095	3,578	3,226
Actual return on plan assets	(1,887)	88	103
Amortization of transition obligation	1,441	1,453	1,512
Amortization of gain	(114)	—	—
Net amortization and deferral	789	(649)	(476)
Net periodic postretirement benefit cost	$ 5,728	$6,991	$5,727

The assumed discount rate and expected return on assets used in determining the APBO were as follows:

	1996	1995	1994
Assumed discount rate	8.0%	7.375%	9.0%
Expected return on assets	9.5%	8.25%	8.25%

The associated health care cost trend rate used in measuring the postretirement benefit obligation at December 31, 1996 was 10.7%, gradually declining to 5.0% in 2002 and thereafter. Increasing the assumed health care cost trend rate by one percentage point in each year would increase the APBO as of December 31, 1996, by $5.9 million, to a total of $48.8 million, and the aggregate net periodic postretirement benefit cost for 1996 by $1.2 million, to a total of $6.9 million. Postretirement health care costs in excess of those currently included in rates have been deferred in those jurisdictions where their recovery is deemed probable. At December 31, 1996 and 1995, United Water had regulatory assets relating to deferred employee benefits of $21.3 million and $17.8 million, respectively, for recovery in future rates.

Defined benefit pension plans: Most of United Water's employees are covered by trusteed, non-contributory, defined benefit pension plans. Benefits under these plans are based upon years of service and the employee's compensation during the last five years of employment. United Water's policy is to fund amounts accrued for pension expense to the extent deductible for federal income tax purposes. It is expected that no funding will be made for 1996.

The components of net periodic pension income for the Company's qualified and supplemental defined benefit plans were as follows:

(thousands of dollars)	1996	1995	1994
Current year service cost	$ 3,945	$ 2,959	$ 3,456
Interest cost	9,379	9,144	7,829
Actual return on plan assets	(20,442)	(32,235)	818
Net amortization and deferral	4,382	19,632	(12,552)
Net periodic pension income	$ (2,736)	$ (500)	$ (449)

The status of the funded plans at December 31 was as follows:

(thousands of dollars)	1996	1995
Accumulated benefit obligation:		
Vested	$102,964	$104,832
Non-vested	2,608	6,010
Total	$105,572	$110,842
Fair value of plan assets (primarily stocks and bonds, including $8.9 million and $6.9 million, respectively, in common stock of United Water)	$174,561	$160,391
Projected benefit obligation (PBO)	124,342	133,670
Plan assets in excess of PBO	50,219	26,721
Unrecognized prior service cost	2,185	2,121
Unrecognized net gain	(31,442)	(11,073)
Remaining unrecognized net transition asset from applying the standard in 1987 (amortized over 18 years)	(4,823)	(5,450)
Prepaid pension cost recognized in the consolidated balance sheet	$ 16,139	$ 12,319

The major actuarial assumptions used in the foregoing calculations were as follows:

	1996	1995	1994
Assumed discount rate	7.75%	7.25%	9.0%
Assumed range of compensation increase	3.75-4.5%	3.75-5%	4.5-5%
Expected long-term rate of return on plan assets	9.5%	8.75%	8.75%

Supplemental benefit plans: Certain categories of employees are covered by non-funded supplemental plans. The projected benefit obligations of these plans at December 31, 1996 totaled $6.5 million. The unfunded accumulated benefit obligation of $5.8 million has been recorded in other deferred credits and liabilities and an intangible pension asset of $851,000 is included in deferred charges and other assets at December 31, 1996.

United Water maintains defined contribution savings plans which permit employees to make voluntary contributions with Company matching as defined by the plan agreements. United Water made contributions of $1,167,000, $1,093,000 and $921,000 in 1996, 1995 and 1994, respectively, to defined contribution savings plans.

Eleven / Rate Matters

The following rate increases were awarded to United Water's regulated utilities during 1996:

(thousands of dollars)	Effective Date	Allowed ROE	Annual Increase	% Increase
New Jersey	6/04	11.25	$ 5,000	4.5
Florida—Water	6/20	—	116*	1.7
—Wastewater	6/20	—	134*	1.0
New York	6/21	11.00	1,003	2.4
Idaho	11/07	11.25	764	3.6
New Rochelle	11/19	10.70	786	4.0
Bethel	12/31	—	102	14.4
Delaware	10/26	—	2,237**	15.0
Florida—Water	11/15	—	725**	10.6
—Wastewater	11/15	—	238**	1.7
Totals			$11,105	

*Rate awards represent annual adjustment clause increases based on inflation and other factors.

**Interim increases, granted subject to refund.

The most significant rate cases pending were filed by United Water Florida and United Water Delaware. In July 1996, United Water Florida applied to the Florida Public Service Commission for rate relief in the amount of $3.3 million, or 45.9%, in water revenues and $5.1 million, or 32.6%, in wastewater revenues. The increases were requested primarily to fund capital investments and meet higher operation and maintenance costs. In November 1996, the Company was granted interim rate increases subject to refund of $725,000, or 10.6%, for water and $238,000, or 1.7%, for wastewater. A decision on this application is expected before the end of the second quarter of 1997.

In August 1996, United Water Delaware applied to the Public Service Commission of Delaware for a $3.7 million, or a 24.6% increase in annual revenues to meet increased investments in utility plant, higher operation and maintenance costs, as well as a proposed change in depreciation rates. In October 1996, the Company was granted $2.2 million, or 15%, subject to refund. A decision on this application is expected before the end of the second quarter of 1997.

Generally, the rate awards the Company's operating utilities actually receive are less than the amounts requested, primarily due to circumstances that change while the rate case is being processed.

Twelve / Income Taxes

Deferred income tax assets and liabilities: Deferred tax liabilities (assets) and deferred investment tax credits consisted of the following at December 31:

(thousands of dollars)	1996	1995
Basis differences of property, plant and equipment	$122,410	$106,764
Real estate transactions and capitalized costs	15,886	15,845
Other liabilities	33,279	26,260
Gross deferred tax liabilities	171,575	148,869
Alternative minimum tax credit carryforwards	(9,716)	(8,975)
Other assets	(10,335)	(8,141)
Gross deferred tax assets	(20,051)	(17,116)
Deferred investment tax credits	23,006	23,505
Total deferred income taxes and investment tax credits	$174,530	$155,258

Income tax provision: A reconciliation of income tax expense at the statutory federal income tax rate to the actual income tax expense for 1996, 1995 and 1994 is as follows:

(thousands of dollars)	1996	1995	1994
Statutory tax rate	35%	35%	35%
Federal taxes at statutory rates on pretax income before preferred stock dividends of subsidiaries	$22,544	$13,523	$19,015
Utility plant acquisition adjustment	1,725	682	644
State income taxes, net of federal benefit	1,823	290	521
Deferred investment tax credits	(499)	(489)	(477)
Equity in foreign investments	(2,476)	—	—
Other	394	198	968
Provision for income taxes	$23,511	$14,204	$20,671

Income tax expense for 1996, 1995 and 1994 consisted of the following:

(thousands of dollars)	1996	1995	1994
Current:			
Federal	$ 5,919	$11,518	$ 9,897
State	1,310	1,731	890
Total current	$ 7,229	$13,249	$10,787
Deferred (prepaid):			
Accelerated depreciation	$ 7,612	$ 8,420	$ 7,779
Contributions and advances for construction	(1,855)	(3,228)	(4,148)
Prepaid employee benefits	1,931	1,626	1,775
UWNJ debt refinancing	3,053	—	—
Real estate transactions and capitalized costs	64	(3,383)	1,466
Alternative minimum tax	(741)	(1,007)	(1,261)
Investment tax credits	(499)	(489)	(477)
State income taxes, net of federal benefit	972	(718)	37
Transfer of New Mexico operations	5,365	—	—
Other	380	(266)	4,713
Total deferred	$16,282	$ 955	$ 9,884
Total provision for income taxes	$23,511	$14,204	$20,671

The Company considers the undistributed earnings of United Water UK to be permanently reinvested and has not provided deferred taxes on these earnings. These additional earnings could become subject to additional tax if remitted, or deemed remitted, as a dividend. Management believes it is not practicable to determine the amount of the unrecognized deferred tax liability.

Thirteen / Fair Value of Financial Instruments

The carrying amounts at December 31, 1996 and 1995, of those current assets and liabilities that are considered financial instruments approximates their fair values at those dates because of the short maturity of those instruments. Such current assets and liabilities include cash and cash equivalents, restricted cash, accounts receivable and unbilled revenues, notes payable, accounts payable and other current liabilities, and accrued interest and dividends. Real estate and other investments consist primarily of real estate and equity investments in affiliates and are not financial instruments. The Company understands that there are no quoted market prices for the Company's preferred stock, preference stock or long-term debt. The fair values of the Company's long-term debt and preferred and preference stock have been determined by discounting their future cash flows using approximate current market interest rates for securities of a similar nature and duration.

The estimated fair values of United Water's financial instruments at December 31 were as follows:

(thousands of dollars)	Carrying Amount	Fair Value
1996		
Long-term debt	$558,093	$573,230
Preferred and preference stock with mandatory redemption	93,261	96,832
1995		
Long-term debt	$558,658	$639,311
Preferred and preference stock with mandatory redemption	98,091	102,837

The Company's customer advances for construction have a carrying value of $25.3 million and $27.8 million at December 31, 1996 and 1995, respectively. Their relative fair values cannot be accurately estimated since future refund payments depend on several variables, including new customer connections, customer consumption levels and future rate increases. The fair values and carrying amounts of interest rate instruments were not material at December 31, 1996.

Fourteen / Discontinued Operations

In December 1996, the Company announced its intention to dispose of its environmental testing business, closing its Laboratory Resources' operation in Teterboro, New Jersey. Subsequently, in January 1997, it sold its laboratory facility in Brooklyn, Connecticut. The subsidiary had been operating in a very competitive environment over a prolonged period of time and had not contributed to the Company's earnings, with net losses of $1.5 million, $2.6 million and $270,000 in 1996, 1995 and 1994, respectively. The Company recorded an impairment loss of $1.5 million net of income taxes for its investment in the environmental testing business in accordance with the provisions of SFAS 121, which was included in the net loss for the year ended December 31, 1995. The Company recorded an estimated provision of $1.1 million, net of income taxes, for severance, future lease obligations and other related costs, included in the loss on disposal of discontinued business in the accompanying statement of consolidated income. The operating results of Laboratory Resources prior to the date of discontinuance are shown separately in the accompanying statement of consolidated income and all of the financial statements of prior periods have been restated to reflect the discontinuance of Laboratory Resources' operations. Assets of $1.4 million, consisting primarily of cash and accounts receivable, and $5.1 million are included in the consolidated balance sheet at December 31, 1996 and 1995, respectively.

Notes to Consolidated Financial Statements

United Water Resources and Subsidiaries

Fifteen / Segment Information

(thousands of dollars)	Utilities	Real Estate	Parent, Non-Regulated Water Services and Eliminations	Consolidated
1996				
Operating revenues	$ 299,283	$ 13,769	$ 18,993	$ 332,045
Income before income taxes	69,905	2,576	(3,583)	68,898
Depreciation and amortization	28,126	1,297	1,410	30,833
Capital expenditures	75,726	2,817	1,073	79,616
Identifiable assets	1,384,331	90,212	106,437	1,580,980
1995				
Operating revenues	$ 297,183	$ 10,433	$ 11,920	$ 319,536
Income before income taxes	55,084	(7,228)	(7,657)	40,199
Depreciation and amortization	27,148	1,299	814	29,261
Capital expenditures	70,854	3,789	3,542	78,185
Identifiable assets	1,361,492	92,265	62,951	1,516,708
1994				
Operating revenues	$ 262,133	$ 11,854	$ 10,780	$ 284,767
Income before income taxes	51,035	3,552	(2,159)	52,428
Depreciation and amortization	22,522	1,210	635	24,367
Capital expenditures	57,959	6,828	2,122	66,909
Identifiable assets	1,328,020	97,555	31,852	1,457,427

Operating revenues, income before income taxes and depreciation and amortization represent results from continuing operations. Prior year amounts have been restated to conform with current year presentation.

Quarterly Financial Information (unaudited)

United Water Resources and Subsidiaries

(thousands of dollars except per share data)	Quarter First	Second	Third	Fourth
1996				
Operating revenues	$69,759	$82,581	$97,871	$81,834
Operating income	14,092	24,417	33,922	23,272
Net income applicable to common stock	4,881	7,363	15,521	6,245
Net income per common share	$ .15	$ .22	$ .46	$ .18
1995				
Operating revenues	$69,323	$81,257	$94,215	$74,741
Operating income	14,286	24,289	35,213	8,399
Net income applicable to common stock	831	7,571	14,394	(5,453)
Net income per common share	$ .03	$ .24	$ .45	$ (.17)
1994				
Operating revenues	$37,453	$80,269	$91,384	$75,661
Operating income	7,567	23,688	33,599	18,993
Net income applicable to common stock	2,367	7,739	14,094	3,687
Net income per common share	$ .12	$ .28	$ .46	$ .12

Operating revenues and income represent results from continuing operations. Prior year amounts have been restated to conform with current year presentation.

As disclosed in Note 3 to the consolidated financial statements, the Company settled the condemnation proceeding with the city of Rio Rancho. As a result, an after tax gain of $4.3 million is included in the Company's 1996 first quarter earnings.

As disclosed in Note 1 to the consolidated financial statements, the Company recorded a $12.1 million non-cash, pre-tax impairment loss in the fourth quarter of 1995 for various parcels of land held by its real estate subsidiary and for its investment in the environmental testing business.

Record of Progress 1986-1996

United Water Resources and Subsidiaries

As of and for the years ended December 31, (thousands except statistical and per share data)	1996	1995	1994	1993	1992	1991	1986
Selected Operating and Financial Data							
Operating revenues	$ 332,045	$ 319,536	$ 284,767	$191,703	$155,131	$151,469	$117,342
Operating expenses	236,342	237,349	200,920	135,203	107,399	105,579	72,727
Operating income	95,703	82,187	83,847	56,500	47,732	45,890	44,615
Total interest and other expenses	26,805	41,988	31,419	22,488	22,382	20,243	17,187
Income from continuing operations before income taxes	68,898	40,199	52,428	34,012	25,350	25,647	27,428
Provision for income taxes	25,878	15,439	20,817	13,089	8,568	8,483	11,931
Income from continuing operations	43,020	24,760	31,611	20,923	16,782	17,164	15,497
Preferred and preference dividends	4,613	4,795	3,454	—	—	—	—
Net income applicable to common stock from continuing operations	$ 38,407	$ 19,965	$ 28,157	$ 20,923	$ 16,782	$ 17,164	$ 15,497
Loss from discontinued operations	(4,397)	(2,622)	(270)	(945)	(998)	(722)	(157)
Net income applicable to common stock	$ 34,010	$ 17,343	$ 27,887	$ 19,978	$ 15,784	$ 16,442	$ 15,340
Effective income tax rate	36.5%	36.8%	38.0%	36.0%	31.1%	31.3%	40.9%
Utility plant	$1,348,391	$1,334,807	$1,272,446	$606,102	$569,364	$556,229	$409,009
Accumulated depreciation	266,836	253,529	235,962	103,557	95,203	85,803	65,061
Net utility plant	1,081,555	1,081,278	1,036,484	502,545	474,161	470,426	343,948
Real estate and other properties	165,773	98,082	107,315	96,312	111,720	109,099	20,873
Total assets	$1,580,980	$1,516,708	$1,457,427	$740,526	$691,659	$667,933	$429,374
Capitalization							
Common equity	$ 391,490	$ 358,302	$ 350,495	$202,110	$179,529	$163,518	$130,925
Preferred and preference stock	102,261	107,091	107,173	32,840	33,100	18,360	20,407
Long-term debt	558,093	558,658	505,204	276,753	294,169	301,730	189,640
Total capitalization	$1,051,844	$1,024,051	$ 962,872	$511,703	$506,798	$483,608	$340,972
Notes payable	$ 93,225	$ 43,500	$ 76,450	$ 15,500	$ 19,000	$ 20,250	$ —
Capitalization ratios							
Common equity	37.2%	35.0%	36.4%	39.5%	35.4%	33.8%	38.4%
Preferred and preference stock	9.7%	10.4%	11.1%	6.4%	6.5%	3.8%	6.0%
Long-term debt	53.1%	54.6%	52.5%	54.1%	58.1%	62.4%	55.6%
Average cost of long-term debt	7.8%	7.5%	7.7%	7.7%	7.4%	8.2%	10.2%
Coverages (SEC method)							
Utility coverages							
Earnings to fixed charges	2.85x	2.48	2.62	2.50	2.27	2.25	2.47
Earnings to fixed charges and preferred stock dividends	2.28x	1.96	2.09	2.23	2.09	2.17	2.25
United Water coverage Earnings to fixed charges	1.92x	1.43	1.84	2.01	1.70	1.76	2.17
Utility plant additions*	$ 74,569	$ 70,227	$ 57,592	$ 15,986	$ 14,066	$ 16,079	$ 45,153
Utility plant additions as percent of total capitalization*	7.1%	6.9%	6.0%	3.1%	2.8%	3.3%	13.2%
Internally generated cash after dividends as percent of utility plant additions*	56.5%	39.3%	49.5%	130.1%	137.0%	85.3%	39.0%
AFUDC as percent of utility net income	8.0%	5.5%	3.8%	3.4%	3.4%	5.0%	14.3%

*Utility plant additions are net of AFUDC.

	1996	1995	1994	1993	1992	1991	1986
Common Stock Data							
Net income per share	$ 1.01	$ .54	$ 1.01	$ 1.03	$ .87	$ .96	$ .99
Dividends paid per share	.92	.92	.92	.92	.92	.91	.71
Dividend rate at year end	.92	.92	.92	.92	.92	.92	.74
Equity per common share	11.33	10.90	11.20	10.00	9.55	9.33	8.05
Market value							
High	17.500	14.125	14.750	15.875	16.625	16.625	18.100
Low	12.000	11.750	12.250	14.000	13.000	10.875	11.600
Close	15.500	12.000	12.625	14.000	14.750	16.375	14.300
Market to book ratio	137%	110%	113%	140%	154%	176%	178%
Dividend yield							
Market value (average)	6.2%	7.1%	6.8%	6.2%	6.1%	6.7%	5.0%
Book value	8.1%	8.4%	8.2%	9.2%	9.6%	9.9%	9.2%
Dividend payout ratio	91.1%	170.4%	91.1%	89.5%	105.8%	94.8%	71.7%
Price/earnings ratio	15.3	22.2	12.5	13.6	17.0	17.1	14.4
Internally generated dividend coverage	2.4x	1.9	2.2	2.2	2.2	1.9	2.6
Return on average common equity	9.3%	4.9%	9.4%	10.5%	9.2%	10.4%	13.4%
Shareholders of record	18,651	18,980	19,602	18,729	17,037	14,131	11,173
Shares outstanding (thousands)							
Average	33,728	31,995	27,524	19,428	18,178	17,076	15,448
Year end	34,549	32,880	31,281	20,216	18,798	17,523	16,254
Selected Utility Data							
Water customers							
Residential	527,765	489,025	496,400	210,464	209,031	207,837	199,125
Commercial	52,783	52,132	51,981	23,962	23,753	23,443	21,525
Industrial	8,237	6,558	3,340	1,563	1,574	1,577	1,627
Total water customers	588,785	547,715	551,721	235,989	234,358	232,857	222,277
Wastewater customers	26,347	22,220	34,660	1,315	1,225	1,198	—
Utility revenues							
Residential	$179,077	$180,844	$160,318	$ 99,862	$ 92,374	$ 94,438	$ 73,523
Commercial	80,672	76,769	66,761	38,395	36,201	37,321	30,100
Industrial	22,033	22,030	17,510	6,253	6,347	6,554	6,401
Public fire protection	12,360	11,859	10,733	8,007	7,718	7,596	6,850
Total utility revenues	$294,142	$291,502	$255,322	$152,517	$142,640	$145,909	$116,874
Metered water sales (millions of gallons)							
Residential	49,212	52,439	49,141	27,818	25,977	27,342	23,152
Commercial	22,933	25,138	22,206	10,517	9,813	10,691	9,363
Industrial	10,703	11,899	7,597	1,957	2,113	2,214	2,367
Total metered water sales	82,848	89,476	78,944	40,292	37,903	40,247	34,882
Miles of water mains	7,314	7,174	7,472	2,981	2,968	2,981	2,855
Utility employees	1,119	1,140	1,282	567	570	563	554

Common Stock Data

(dollars) Quarter	Stock Price High	Low	Dividend
1996			
Fourth	$16.625	$14.625	$.23
Third	17.500	12.750	.23
Second	13.500	12.000	.23
First	13.250	12.000	.23
1995			
Fourth	13.000	11.750	.23
Third	13.500	12.500	.23
Second	14.125	12.875	.23
First	14.125	12.500	.23
1994			
Fourth	14.000	12.250	.23
Third	14.250	13.000	.23
Second	14.625	12.875	.23
First	14.750	12.875	.23

The high and low stock prices from January 1 to February 28, 1997 were 18.125 and 15.000.

Shareholder Information

CORPORATE HEADQUARTERS
United Water Resources
200 Old Hook Road
Harrington Park, NJ 07640
201 784 9434

INVESTOR RELATIONS SUPERVISOR
Cheryl L. DeMallie
201 767 2811

FORM 10-K
The annual report filed with the Securities and Exchange Commission is available to shareholders without charge upon request to Allan D. Shakley, Assistant Secretary, at the company's headquarters.

STOCK TRANSFER AND DIVIDEND DISBURSING AGENT AND REGISTRAR
Dividend Reinvestment and Stock Purchase Plan Inquiries and Correspondence:
ChaseMellon Shareholder Services, L.L.C.
Reinvestment Department
PO Box 750
Pittsburgh, PA 15230-9625

All Other Inquiries and Correspondence:
ChaseMellon Shareholder Services, L.L.C.
85 Challenger Road
Ridgefield Park, NJ 07660
Attention: Strategic Business Unit
Telephone toll-free for all inquiries 800 230 2685

1997 ANNUAL MEETING
United Water's 1997 annual meeting will be held on Monday, May 12, at 9:30 a.m., at the Montvale Inn, in Montvale, NJ.

AGENT FOR ACCEPTANCE OF STOCK
ChaseMellon Shareholder Services, L.L.C.
120 Broadway
13th Floor
New York, NY 10271

INDEPENDENT ACCOUNTANTS
Price Waterhouse LLP
1177 Avenue of the Americas
New York, NY 10036

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Directors

Donald L. Correll (E)
Chairman and Chief Executive Officer
United Water Resources

Edward E. Barr (A, E)
President and Chief Executive Officer
Sun Chemical Corporation

Frank J. Borelli (C)
Senior Vice President and
Chief Financial Officer
Marsh & McLennan Companies

Thierry Bourbie (E, P)
President
International Water Division
Lyonnaise des Eaux
(Appointed to the board September 1996)

Philippe Brongniart (P)
Executive Vice President
Lyonnaise des Eaux
(Resigned from the board July 1996)

Lawrence R. Codey (E)
President and Chief Operating Officer
Public Service Electric & Gas Co.

Peter Del Col (P)
Partner
Colson Investments

Allan R. Dragone (A, C)
Self-employed
(Retired December 1996)

Robert L. Duncan, Jr., Esq. (A)
Member
DeForest & Duer

Jon F. Hanson (C, E)
Chairman
Hampshire Management Company

George M. Haskew, Jr. (A, P)
Former President
United Water New Jersey

Douglas W. Hawes, Esq. (E)
Member
LeBoeuf, Lamb, Greene & MacRae, L.L.P.

George Keane (A,C)
Chairman of the Board
Trigen Energy Corporation
(Appointed to the board January 1997)

Dennis M. Newnham (A, P)
President and Chief Executive
Officer, Tsumuru International

Jacques Petry (C)
Chairman and Chief Executive
Officer, SITA

Marcia L. Worthing (C, P)
Senior Vice President
Human Resources and
Corporate Affairs
Avon Products, Inc.

Committees
A) Audit
C) Compensation
E) Executive
P) Pension

Officers

UNITED WATER RESOURCES

Donald L. Correll
Chairman, President and
Chief Executive Officer

Douglas W. Hawes, Esq.
Secretary

Richard B. McGlynn, Esq.
General Counsel

John J. Turner
Treasurer

Allan D. Shakley
Assistant Secretary

UNITED WATER MANAGEMENT AND SERVICES

Donald L. Correll
Chairman and Chief Executive Officer

Joseph Simunovich
President

David E. Chardavoyne
Frank J. De Micco
Ronald S. Dungan
(Retired December 1996)
Senior Vice Presidents

Richard B. McGlynn, Esq.
Vice President and General Counsel

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William C. Linam
John J. Turner
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John T. Marino
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Allan D. Shakley
Secretary

UNITED WATER NEW JERSEY

Frank J. De Micco
President

UNITED WATERWORKS

David E. Chardavoyne
President

UNITED PROPERTIES GROUP

Michael C. J. Fallon
President

Exceptions