Kentucky-American Water Company

Financial Statements

December 31, 2003 and 2002

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
Two Commerce Square, Suite 1700
2001 Market Street
Philadelphia PA 19103
Telephone (267) 330 3000
Facsimile (267) 330 3300

Report of Independent Auditors

To the Board of Directors and Stockholders
Kentucky-American Water Company

In our opinion, the accompanying balance sheets and the related statements of income, of capitalization, of retained earnings and stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Kentucky-American Water Company (a wholly-owned subsidiary of American Water Works Company, Inc.) at December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, 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 our opinion.

As discussed in Note 2 to the financial statements, the Company adopted Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations*, in 2003.

PricewaterhouseCoopers LLP

February 27, 2004

KENTUCKY-AMERICAN WATER COMPANY
Balance Sheet
December 31, 2003 and 2002
(Dollars in thousands)

Assets

	December 31, 2003	December 31, 2002
Property, plant and equipment		
Utility plant - at original cost less accumulated depreciation	$ 214,834	$ 206,485
Utility plant acquisition adjustments, net	428	450
Non-utility property	250	250
	215,512	207,185
Current assets		
Cash and cash equivalents	1,002	699
Customer accounts receivable	1,851	1,799
Allowance for uncollectible accounts	(71)	(67)
Unbilled revenues	2,466	2,118
Accounts receivable - associated companies	118	207
Other accounts receivable	1,052	523
Federal income tax refund due from affiliated company	2,251	-
Materials and supplies	443	465
Deferred vacation pay	471	320
Other	146	312
	9,729	6,376
Regulatory and other long-term assets		
Deferred programmed maintenance expense	2,396	2,741
Regulatory asset-income taxes recoverable through rates	4,785	4,697
Debt and preferred stock expense	692	786
Deferred business service project expense	1,334	1,455
Deferred security costs	2,655	1,703
Preliminary survey & investigation	147	150
Other	6,223	6,601
	18,232	18,133
	$ 243,473	$ 231,694

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

KENTUCKY-AMERICAN WATER COMPANY
Balance Sheet
December 31, 2003 and 2002
(Dollars in thousands)

Capital and Liabilities

	December 31, 2003	December 31, 2002
Capitalization		
Common stock	$ 36,569	$ 36,569
Paid in capital	30	21
Retained earnings	26,305	25,178
Total common stockholder's equity	62,904	61,768
Preferred stock without mandatory redemption requirements	1,553	1,570
Preferred stock with mandatory redemption requirements	4,500	5,340
Long-term debt	68,500	68,500
Total capitalization	137,457	137,178
Current liabilities		
Notes payable-associated companies	15,995	14,649
Accounts payable	2,734	421
Accounts payable - associated companies	1,238	110
Accrued interest	1,457	1,457
Accrued taxes	2,186	283
Tax/sewer collections payable	439	315
Accrued vacation pay	471	320
Other	352	1,388
	24,872	18,943
Regulatory and other long-term liabilities		
Deferred income taxes	32,547	31,233
Customer advances for construction	12,507	11,047
Deferred investment tax credits	1,556	1,642
Accrued pension expense	2,368	1,675
Accrued postretirement benefit expense	498	300
Other	415	539
	49,891	46,436
Contributions in aid of construction	31,253	29,137
Commitments and contingencies	-	-
	$ 243,473	$ 231,694

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

KENTUCKY-AMERICAN WATER COMPANY
Statement of Income
December 31, 2003 and 2002
(Dollars in thousands)

	December 31, 2003	December 31, 2002
Operating revenues	$ 42,800	$ 43,627
Operating expenses		
Operation and maintenance	22,089	21,302
Depreciation and amortization	5,223	5,117
General taxes	2,596	2,201
	29,908	28,620
Utility operating income	12,892	15,007
Other income (deductions)		
Allowance for other funds used during construction	445	441
Gain on disposition of property	1	-
Other income (deductions), net	(327)	(548)
	119	(107)
Income before interest charges and income taxes	13,011	14,900
Interest charges		
Interest on long-term debt	4,447	4,691
Interest on short-term debt	181	252
Amortization of debt expense	78	87
Other interest	-	14
Allowance for borrowed funds used during construction	(210)	(211)
	4,496	4,833
Income before income taxes	8,515	10,067
Provision for income taxes	3,474	4,045
Net income	5,041	6,022
Dividends on preferred stock	513	534
Net income to common stock	$ 4,528	$ 5,488

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

KENTUCKY-AMERICAN WATER COMPANY
Statement of Cash Flows
December 31, 2003 and 2002
(Dollars in thousands)

	December 31, 2003	December 31, 2002
Cash flows from operating activities		
Net income	$ 5,041	$ 6,022
Adjustments:		
Depreciation and amortization	5,223	5,117
Amortization, other	2,260	2,470
Provision for deferred income taxes	1,381	3,038
Amortization of deferred investment tax credits	(85)	(85)
Provision for losses on accounts receivable	184	258
Allowance for other funds used during construction	(445)	(441)
Deferred security costs	(952)	(1,423)
Deferred business services project expenses	(27)	(255)
Gain on disposition of property	(1)	-
Other, net	(59)	359
Changes in assets and liabilities (net of effects of acquisition):		
Accounts receivable	(232)	(480)
Unbilled revenues	(348)	18
Materials and supplies	22	(104)
Federal income tax refund due from affiliated company	(2,251)	-
Other current assets	(425)	(620)
Accounts payable	2,313	(577)
Accrued interest	-	604
Accrued taxes	1,903	(170)
Other current liabilities	367	532
Net cash provided by operating activities	13,869	14,263
Cash flows from investing activities		
Construction expenditures	(14,718)	(13,815)
Allowance for other funds used during construction	445	441
Acquisition, net of cash acquired	-	(89)
Removal costs from property, plant and equipment retirements, net of salvage	(330)	(400)
Proceeds from the disposition of property, plant and equipment	1	-
Net cash used in investing activities	(14,602)	(13,863)
Cash flows from financing activities		
Proceeds from issuance of long-term debt	-	24,000
Repayment of long-term debt	-	(13,000)
Debt issuance costs	-	(3)
Net borrowings (repayments) of short-term debt	1,346	(10,948)
Customer advances and contributions, net of refunds	4,452	4,088
Capital contribution by stockholder	9	-
Redemption of preferred stock	(857)	(40)
Dividends paid	(3,914)	(5,251)
Net cash provided by (used in) financing activities	1,036	(1,154)
Net increase (decrease) in cash	303	(754)
Cash at beginning of year	699	1,453
Cash at end of year	$ 1,002	$ 699
Cash paid during the year for:		
Interest, net of capitalized amount	$ 4,418	$ 4,142
Income taxes	$ 2,623	$ 1,217

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

KENTUCKY-AMERICAN WATER COMPANY
Statement of Capitalization
December 31, 2003 and 2002
(Dollars in thousands, except per share amounts)

	Call Price Per Share	December 31, 2003	December 31, 2002
Common Stockholder's Equity			
Common stock - no par value, authorized 2,000,000 shares 1,567,391 shares issued and outstanding in 2003 and 2002		$ 36,569	$ 36,569
Paid- in capital		30	21
Retained earnings		26,305	25,178
		62,904	61,768
Preferred Stock - $100 par value			
Without mandatory redemption requirements:			
Cumulative preferred stocks			
5.75% series, 4,642 shares issued and outstanding in 2003 and 4,700 shares issued and outstanding in 2002	$101.00	464	470
5.50% series, 4,947 shares issued and outstanding in 2003 and 5,000 shares issued and oustanding in 2002	$100.50	495	500
5.00% series, 5,939 shares issued and outstanding in 2003 and 6,000 shares issued and outstanding in 2002	$101.00	594	600
		1,553	1,570
With mandatory redemption requirements:			
Cumulative preferred stocks			
7.90% series, 8,400 shares issued and outstanding in 2002, all redeemed in 2003	$100.00	-	840
8.47% series, 45,000 shares issued and oustanding in 2003 and 2002	$100.00	4,500	4,500
		4,500	5,340
Long-Term Debt			
General mortgage bonds			
6.79% series due 2005		5,500	5,500
6.96% series due 2023		7,000	7,000
7.15% series due 2027		7,500	7,500
6.99% series due 2028		9,000	9,000
Notes payable to affiliate			
5.65% series due 2007		24,000	24,000
6.87% series due 2011		15,500	15,500
		68,500	68,500
Less: Current portion of long-term debt		-	-
Long-term debt, net of current maturities		68,500	68,500
Total Capitalization		$ 137,457	$ 137,178

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

KENTUCKY-AMERICAN WATER COMPANY
Statement of Retained Earnings and Stockholder's Equity
December 31, 2003 and 2002
(Dollars in thousands, except per share amounts)

	Common Stock		Paid-in	Retained	
	Shares	Par Value	Capital	Earnings	Total
Balance at December 31, 2001	1,567,391	$ 36,569	$ 21	$ 24,407	$ 60,997
Net income	-	-	-	6,022	6,022
Dividends paid					
Preferred stock	-	-	-	(534)	(534)
Common stock, $3.01 per share	-	-	-	(4,717)	(4,717)
Balance at December 31, 2002	1,567,391	36,569	21	25,178	61,768
Net income	-	-	-	5,041	5,041
Dividends paid					
Preferred stock	-	-	-	(513)	(513)
Common stock, $2.17 per share	-	-	-	(3,401)	(3,401)
Capital contribution by stockholder	-	-	9	-	9
Balance at December 31, 2003	1,567,391	$ 36,569	$ 30	$ 26,305	$ 62,904

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

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2003 and 2002
(Dollars in thousands)

Note 1: Organization and Operation

Kentucky-American Water Company (the Company) provides water service to approximately 108,000 customers and wastewater service to approximately 89 customers. These services are provided in 18 communities located in 10 counties in the state of Kentucky. As a public utility operating in Kentucky, the Company functions under rules and regulations prescribed by the Kentucky Public Service Commission (the Commission). The Company is a wholly-owned subsidiary of American Water Works Company, Inc. (American). Effective January 10, 2003, American was acquired by Thames Water Aqua US Holdings, Inc, which is a wholly-owned subsidiary of RWE Aktiengesellschaft (RWE).

Note 2: Significant Accounting Policies

Use of Estimates

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

Regulation

The Company has incurred various costs and received various credits, which have been reflected as regulatory assets and liabilities on its balance sheet. Accounting for such costs and credits as regulatory assets and liabilities is in accordance with Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation." This statement sets forth the application of accounting principles generally accepted in the United States of America for those companies whose rates are established by or are subject to approval by an independent third-party regulator.

Under SFAS No. 71, regulated companies defer costs and credits on the balance sheet as regulatory assets and liabilities when it is probable that those costs and credits will be recognized in the rate-making process in a period different from the period in which they would have been reflected in income by an unregulated company. These deferred regulatory assets and liabilities are then reflected in the income statement in the period in which the same amounts are reflected in the rates charged for service.

Property, Plant and Equipment

Additions to utility plant and replacements of retirement units of property are capitalized. Costs include material, direct labor and such indirect items as engineering and supervision, payroll taxes and benefits, transportation and an allowance for funds used during construction. Repairs and maintenance are charged to current operations.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
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(Dollars in thousands)

Note 2 (continued):

When a unit of property is retired or replaced, the recorded value of such unit is credited to the asset account and that value, including the cost of removal, is charged to accumulated depreciation. Effective January 1, 2003, the Company adopted the provisions of SFAS No. 143, "Accounting for Asset Retirement Obligations." In accordance with SFAS No. 143, removal cost (net of salvage) of $1,301 and $1,256 has been recorded as operation and maintenance expense for the years ended December 31, 2003 and 2002, respectively, to remove retirement costs from depreciation expense, where they were previously reported.

The cost of property, plant and equipment is depreciated using the straight-line average remaining life method. The composite depreciation rate, which includes recovery of removal cost (net of salvage), amounted to 2.81% in 2003 and 2.63% in 2002. In 2003, the Company changed its definition of a unit of property to be capitalized to conform to the accounting policy consistently applied by American's subsidiaries. As a result of this change, an additional $78 of property was capitalized during 2003.

Computer software is either purchased or developed in-house. The purchase price or development costs are capitalized as a unit of property.

In accordance with the Commission's regulations, depreciation on contributed facilities is charged to contributions in aid of construction. Such depreciation amounted to $876 in 2003 and $784 in 2002.

Utility plant acquisition adjustments represent the difference between the fair value of plant at the date of purchase and its original cost when first devoted to public service (less accumulated depreciation) and is amortized to expense over 10-year or 40-year periods.

Cash and Cash Equivalents

Substantially all of the Company's cash is invested in interest bearing accounts. The Company considers all highly liquid investments with maturities of three months or less when purchased to be cash equivalents. There were no cash equivalents held at December 31, 2003 or 2002.

Materials and Supplies

Materials and supplies are stated at average cost.

Regulatory and Long-Term Assets and Liabilities

Programmed maintenance costs are deferred and amortized to current operations on a straight-line basis over a period ranging between five and fifteen years, as authorized by the Commission in their determination of rates charged for service.

The Company has recorded a regulatory asset for the additional revenues expected to be realized as the tax effects of temporary differences previously flowed through to customers reverse. These temporary differences are primarily related to the difference between book and

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2003 and 2002
(Dollars in thousands)

Note 2 (continued):

tax depreciation on property placed in service before the adoption by the Commission of full normalization for rate-making purposes.

The regulatory asset for income taxes recoverable through rates is net of the reduction expected in future revenues as deferred taxes previously provided, attributable to the difference between the state and federal income tax rates under prior law and the current statutory rates, reverse over the average remaining service lives of the related assets.

Debt expense is amortized over the lives of the respective issues. Call premiums on the redemption of long-term debt, as well as unamortized debt expense, are deferred and amortized to the extent they will be recovered through future service rates. Expenses of preferred stock issues without sinking fund provisions are amortized over 30 years from the date of issue; expenses of issues with sinking fund provisions are charged to operations as shares are retired.

Deferred business services project expenses consist of reengineering and start-up activities for consolidated customer and shared administrative service centers that are being established by American. The costs for the customer service center are being deferred and are expected to be recovered in rates charged for utility service in the future. The shared administrative service center costs are being written off at the level of savings until the unamortized portion is recovered in rates.

The Company has deferred the cost of increased security measures that were implemented to secure facilities after the terrorist attacks on September 11, 2001. These costs are being deferred as it is expected that these costs will be recovered in the rates charged for utility service in the future.

Other Current Liabilities

Other current liabilities at December 31, 2002 includes payables of $600 which represents checks issued but not presented to the bank for payment.

Advances and Contributions in Aid of Construction

The Company may receive advances and contributions to fund construction necessary to extend service to new areas. As determined by the Commission, advances for construction are refundable for limited periods of time as new customers begin to receive service. Amounts that are no longer refundable are reclassified to contributions in aid of construction.

Utility plant funded by advances and contributions is excluded from rate base and is not depreciated for rate-making purposes. Generally, advances and contributions received during the period of January 1, 1987 through June 12, 1996 have been included in taxable income and the related property is depreciable for tax purposes. As a result of a tax law change, advances and contributions received subsequent to June 12, 1996 are excluded from taxable income and the related property is not depreciable for tax purposes.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2003 and 2002
(Dollars in thousands)

Note 2 (continued):

Recognition of Revenues

Water and wastewater service revenues for financial reporting purposes include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the date of the latest meter reading to the end of the accounting period.

Income Taxes

The Company, its parent and affiliates participate in a consolidated federal income tax return. Federal income tax expense for financial reporting purposes is provided on a separate return basis, except that the federal income tax rate applicable to the consolidated group is applied to separate company taxable income and the benefit of net operating losses, if any, is recognized currently.

Certain income and expense items are accounted for in different time periods for financial reporting than for income tax reporting purposes. Deferred income taxes have been provided on the difference between the tax bases of assets and liabilities and the amounts at which they are carried in the financial statements. These deferred income taxes are based on the enacted tax rates anticipated to be in effect when such temporary differences are expected to reverse. Regulatory assets and liabilities are recognized for the effect on revenues expected to be realized as the tax effects of temporary differences previously flowed through to customers reverse.

Investment tax credits have been deferred and are being amortized to income over the average estimated service lives of the related assets.

Allowance for Funds Used During Construction (AFUDC)

AFUDC is a non-cash adjustment to income with a corresponding charge to utility plant, which represents the cost of borrowed funds and a return on equity funds devoted to plant under construction. AFUDC is recorded to the extent permitted by the Commission.

Environmental Costs

Environmental expenditures that relate to current operations or provide a future benefit are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated. There were no remediation costs accrued at December 31, 2003 and 2002.

Asset Impairment

Long-lived assets and certain identifiable intangible assets held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets, on a separate entity basis, may not be recoverable. If the sum of the future cash flows expected to result from the use of the assets and their eventual disposition is less than the carrying amount of the assets, an impairment loss is recognized. Measurement of

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
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(Dollars in thousands)

Note 2 (continued):

an impairment loss would be based on the fair value of the assets. A regulatory asset is charged to earnings if and when future recovery in rates of that asset is no longer probable.

Reclassifications

Certain reclassifications have been made to conform to previously reported data to the current presentation.

Note 3: Utility Plant

The components of utility plant at December 31 are as follows:

	2003	2002
Sources of supply	$ 7,711	$ 7,344
Treatment and pumping	47,129	45,561
Transmission and distribution	140,433	133,231
Services, meters and fire hydrants	54,791	50,763
General structures and equipment	19,636	16,605
Construction work in progress	4,417	7,223
	274,117	260,727
Less: accumulated depreciation	(59,283)	(54,242)
	$ 214,834	$ 206,485

Depreciation expense amounted to $4,522 in 2003 and $4,364 in 2002.

Note 4: Preferred Stocks

There are no sinking fund payments through 2008.

The preferred stock agreement contains provisions for redemption at various prices, at any time, upon not less than 30 days' notice at the Company's discretion at the redemption price then applicable to the shares to be redeemed, together with accrued dividends to the redemption date. The redemption prices to which there shall be added in each case accrued dividends to the redemption date, for shares of the 7.9% Series, preferred stock shall be at $100.00 per share if redeemed on or after July 1, 1988.

Note 5: Long-Term Debt

Maturities of long-term debt will amount to $5,500 in 2005 and $24,000 in 2007. There are no maturities in 2004, 2006, or 2008.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2003 and 2002
(Dollars in thousands)

Note 5 (continued):

The general mortgage bond indentures, as supplemented, contain clauses restricting the declaration of common stock dividends and other distributions on capital stock if common stockholder's equity falls below a specified amount. There were no restrictions at December 31, 2003.

The general mortgage bonds are issuable in series. No bonds senior to the general mortgage bonds may be issued so long as the general mortgage bonds are outstanding. The amount of bonds authorized is unlimited as long as long-term debt does not exceed 65% of capitalization. Long-term debt is secured by utility plant.

The senior notes are unsecured and were issued to American Water Capital Corporation (AWCC), an affiliate, for the principal amount. AWCC provided the funding for this note by itself issuing senior notes to institutional investors at a price equal to the principal amount.

Note 6: Affiliate Borrowings

The Company maintains a line of credit through AWCC for $22,500. The Company may borrow from, or invest in, the line of credit. Effective November 1, 2003, AWCC has a 364-day, $550 million revolving credit agreement with RWE. Prior to November 1, 2003, AWCC had a 364-day, $500 million revolving credit agreement with a group of 11 domestic and international banks and issued commercial paper, which was supported by the revolving credit agreement. No compensating balances are required under the agreements.

At December 31, 2003 and 2002, there were $14,880 and $14,649 of short-term borrowings outstanding, respectively. The weighted average annual interest rate on these borrowings was 1.270% and 2.272%, respectively. The unused line of credit at December 31, 2003 was $7,620.

In addition, at December 31, 2003, notes payable-associated companies includes payables of $1,115 which represents checks issued but not presented to the bank for payment.

Note 7: General Taxes

Components of general tax expense for the years presented in the statement of income are as follows:

	2003	2002
Gross receipts and franchise	$ 86	$ 75
Property and capital stock	2,081	1,685
Payroll	429	441
	$ 2,596	$ 2,201

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2003 and 2002
(Dollars in thousands)

Note 8: Income Taxes

Components of income tax expense for the years presented in the statement of income are as follows:

	2003	2002
State income taxes:		
Current	$ 467	$ 407
Deferred		
Current	-	-
Non-current	269	452
	736	859
Federal income taxes:		
Current	1,711	685
Deferred		
Current	-	-
Non-current	1,112	2,586
Amortization of deferred investment tax credits	(85)	(85)
	2,738	3,186
Total income taxes	$ 3,474	$ 4,045

A reconciliation of income tax expense at the statutory federal income tax rate to the actual income tax expense is as follows:

	2003	2002
Federal income tax at statutory rate of 35%	$ 2,980	$ 3,523
Increases (decreases) resulting from -		
State taxes, net of federal income taxes	483	558
Flow through difference	56	10
Amortization of investment tax credits	(85)	(85)
Other, net	40	39
	$ 3,474	$ 4,045

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2003 and 2002
(Dollars in thousands)

Note 8 (continued):

The following table provides the components of the net deferred tax liability at December 31:

	2003	2002
Deferred tax assets:		
Advances and contributions	$ 4,115	$ 4,038
Deferred investment tax credits	628	662
Other	1,866	1,908
	6,609	6,608
Deferred tax liabilities:		
Utility plant, principally due to depreciation differences	33,130	31,571
Income taxes recoverable through rates	1,004	1,031
Deferred security costs	1,072	687
Other	3,950	4,552
	39,156	37,841
Net deferred tax liabilities	$ 32,547	$ 31,233

No valuation allowances were required on deferred tax assets at December 31, 2003 and 2002 as management believes it is more likely than not that these assets will be realized.

Note 9: Rate Matters

As necessary, the Company applies to the Commission for changes in the rates charged for service. The rate increase request is based on the level of operating expenses and capital costs that are expected to be in effect when the rates become effective. The revenues requested are based on forecasted sales, operating expenses and investments for the test year selected by the Company.

In connection with the merger of American with RWE, the Company is subject to an order from the Commission that requires that no rate filings will be submitted until March 2004.

Note 10: Employee Benefit Plans

Employees' Investment Plan

The Company previously participated in an Employees' Stock Ownership Plan that was merged into and replaced by the Employees' Investment Plan.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
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(Dollars in thousands)

Note 10 (continued):

The Employees' Investment Plan is sponsored by American, and generally all employees who are not included in a bargaining unit may participate by electing to contribute an amount that does not exceed 2% of their wages. In addition to the employees' participation, the Company made contributions equivalent to 1/2% of each participant's qualified compensation, and matches 100% of the contribution by each participant. The Company expensed contributions of $52 for 2003 that it made to the Employees' Investment Plan and $59 for 2002 that it made to the Employees' Stock Ownership Plan.

Savings Plan for Employees
The Company participates in a 401(k) Savings Plan for Employees sponsored by American. All employees can make contributions that are invested at their direction in one or more funds. The Company matches 50% of the first 5% of each associate's wages contributed to the plan. The Company expensed matching contributions to the plan totaling $82 for 2003 and $93 for 2002. All of the Company's matching contributions are invested in one or more funds at the direction of the employee.

Note 11: Postretirement Benefits

Pension Benefits
The Company participates in a noncontributory defined benefit pension plan sponsored by American covering substantially all associates. Benefits under the plan are based on the associate's years of service and average annual compensation for those 60 consecutive months of employment that yield the highest average. Pension cost of the Company is based on an allocation from American of the total cost related to the plan. Information regarding accumulated and projected benefit obligations is not prepared at the subsidiary level.

The Company's funding policy is to contribute at least the minimum amount required under the Employee Retirement Income Security Act of 1974. The Company made contributions to the American plan of $410 in 2003 and $216 in 2002.

Postretirement Benefits Other Than Pensions
The Company participates in an American plan that provides certain life insurance benefits for retired associates and certain health care benefits for retired associates and their dependents. Substantially all associates may become eligible for these benefits if they reach retirement age while still working for the Company. Retirees and their dependents under age 65 are covered by a point-of-service managed care plan that requires co-payments or an HMO. Associates who elect to retire prior to attaining age 65 are generally required to make contributions towards their medical coverage until attaining age 65. Retirees and their dependents age 65 and over are covered by a Medicare supplement plan. Costs of the Company are based on an allocation from American of the total cost related to the plan.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
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(Dollars in thousands)

Note 11 (continued):

Information regarding accumulated and projected benefit obligations is not prepared at the subsidiary level. The Company made contributions to trust funds established for these postretirement benefits of $794 in 2003 and $560 in 2002. The Company's policy is to fund postretirement benefits costs accrued.

Note 12: Related Party Transactions

American Water Works Service Company, Inc. (AWWS), an affiliate, provides certain management services to the Company (administration, accounting, data processing, engineering, etc.) and other operating water companies in the American system on an at-cost, not-for-profit basis in accordance with a management and service agreement.

Purchases of such services by the Company were accounted for as follows:

	2003	2002
Included in operation and maintenance expense as a charge against income	$ 3,046	$ 2,532
Capitalized in various balance sheet accounts	240	654
	$ 3,286	$ 3,186

The Company provided workspace, information system support, human resources and loss control services for associates of the Southeast Region of AWWS. Charges for direct costs and indirect overhead costs associated with these associates are billed to AWWS on an at-cost, not for profit basis, which amounted to $24 in 2003 and $15 in 2002. At December 31, 2003, net amounts receivable from this affiliate for these services were $0.

Some of the Company's associates have performed services at cost to AWWS relating to the establishment by American of consolidated customer and shared administrative service centers. The total amount of these services was $0 in 2003 and $148 in 2002. At December 31, 2003, net amounts receivable from this affiliate for these services were $0.

Costs associated with blueprinting of business processes involved with the Business Change Program amounted to $30. This was billed to AWS in 2003.

The Company has three operating agreements with American Water Services, Inc. (AWS), an affiliate, for the lease of granular activated carbon at one of the Company's water treatment plants. The agreements provide for AWS to regenerate the spent material and return it to the water treatment plant where it originated. Under the terms of the agreements, AWS will provide carbon for a period of thirty-six months beginning in each of March 1999, 2000, and 2001. The carbon is scheduled for replacement at thirty-six month intervals and is warranted to

(Dollars in thousands)

Note 12 (continued):

perform to specific standards during that period. The Company paid $95 in 2003 and $87 in 2002 to AWS under these agreements.

The Company maintains a line of credit through AWCC. The company paid AWCC fees of $41 in 2003 and $62 in 2002, preliminary costs of long-term financings of $0 in 2003 and $17 in 2002 and interest on borrowings of $181 in 2003 and $252 in 2002.

Note 13: Fair Values of Financial Instruments

The Company used the following methods and assumptions in estimating its fair value disclosures for financial instruments:

Current assets and current liabilities: The carrying amount reported in the balance sheet for current assets and current liabilities approximates their fair value.

Preferred stocks with mandatory redemption requirements and long-term debt: The fair values of the Company's preferred stocks with mandatory redemption requirements and long-term debt are estimated using discounted cash flow analyses based on the Company's current incremental financing rates for similar types of securities.

The carrying amounts and fair values of the Company's financial instruments at December 31 are as follows:

	2003		2002	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Preferred stock with mandatory redemption requirements	$ 4,500	$ 4,282	$ 5,340	$ 5,287
Long-term debt, including current maturities and excluding capital leases	$ 68,500	$ 70,057	$ 68,500	$ 69,256

Note 14: Operating Leases

The Company has entered into operating leases involving certain facilities and equipment. Rental expenses under operating leases were $125 in 2003 and $176 in 2002. The operating leases for their equipment expire over the next six years.

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Note 14 (continued):

At December 31, 2003, the minimum annual future rental commitments under operating leases that have initial or remaining non-cancelable lease terms in excess of one year are $116 in 2004, $114 in 2005, $75 in 2006, $44 in 2007 and $6 in 2008.

Note 15: Commitments and Contingencies

The Company's construction program for 2004 is estimated to cost approximately $18,549. Commitments have been made in connection with certain projects included in this program.

The Company is routinely involved in legal actions. In the opinion of management, none of these matters will have a material adverse effect, if any, on the financial position or results of operations of the Company.