KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
FORECASTED TEST PERIOD FILING REQUIREMENTS
EXHIBIT NO. 28

Description of Filing Requirement:

Annual Reports to Stockholders, 2003 – 2007

Response:

Please see attached.

For electronic version, see KAW_APP_EX28_103108.pdf

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 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.

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.

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.

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

(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.

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.

(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.

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.

Kentucky-American Water Company

Financial Statements

December 31, 2004 and 2003

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
Two Commerce Square, Suite 1700
2001 Market Street
Philadelphia PA 19103-7042
Telephone (267) 330 3000
Facsimile (267) 330 3300

Report of Independent Auditors

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

In our opinion, the accompanying balance sheets and the related statements of income, of capitalization, of changes in stockholder's 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, 2004 and 2003, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 3 to the financial statements, the 2003 financial statements have been restated.

PricewaterhouseCoopers LLP

March 25, 2005

KENTUCKY-AMERICAN WATER COMPANY
Balance Sheets
December 31, 2004 and 2003
(Dollars in thousands)

Assets

	2004	(Restated) 2003
Property, plant and equipment		
Utility plant - at original cost less accumulated depreciation	$ 229,107	$ 220,343
Utility plant acquisition adjustments, net	408	428
Non-utility property	250	250
	229,765	221,021
Current assets		
Cash and cash equivalents	584	1,002
Customer accounts receivable	1,067	1,851
Allowance for uncollectible accounts	(170)	(71)
Unbilled revenues	1,913	2,466
Accounts receivable - associated companies	30	118
Other accounts receivable	623	1,052
Notes receivable-associated companies	1,819	-
Federal income tax refund due from affiliated company	1,439	2,251
Materials and supplies	536	443
Deferred vacation pay	103	471
Other	2,078	1,549
	10,022	11,132
Regulatory and other long-term assets		
Deferred programmed maintenance expense	2,140	2,396
Regulatory asset-income taxes recoverable through rates	4,686	4,785
Debt and preferred stock expense	613	692
Deferred business service project expense	-	1,334
Deferred security costs	-	2,655
Deferred rate proceedings	951	6
Preliminary survey & investigation	135	147
Other	3,152	4,814
	11,677	16,829
	$ 251,464	$ 248,982

The accompanying notes are an integral part of these financial statements

KENTUCKY-AMERICAN WATER COMPANY
Balance Sheets
December 31, 2004 and 2003
(Dollars in thousands)

Capital and Liabilities

	2004	(Restated) 2003
Capitalization		
Common stock	$ 36.569	$ 36,569
Paid-in capital	30	30
Retained earnings	23,672	26,475
Total common stockholder's equity	60,271	63,074
Preferred stock without mandatory redemption requirements	1,549	1.553
Preferred stock with mandatory redemption requirements	4,500	4,500
Long-term debt	77,000	68,500
Total capitalization	143,320	137,627
Current liabilities		
Notes payable - associated companies	-	15.995
Current portion of long-term debt	5,500	-
Accounts payable	4.260	2,734
Accounts payable - associated companies	1,107	1,238
Accrued interest	1,459	1.457
Accrued taxes	1,627	1,967
Tax/sewer collections payable	866	439
Accrued vacation pay	103	471
Other	723	352
	15,645	24,653
Regulatory and other long-term liabilities		
Deferred income taxes	33.119	32,596
Customer advances for construction	15.777	12,507
Deferred investment tax credits	1,461	1.556
Regulatory liability - cost of removal	6.212	5.509
Accrued pension expense	3,192	2,368
Accrued postretirement benefit expense	300	498
Other	215	415
	60,276	55,449
Contributions in aid of construction	32,223	31,253
Commitments and contingencies	-	-
	$ 251,464	$ 248,982

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Income
For the Years Ended December 31, 2004 and 2003
(Dollars in thousands)

	2004	2003
Operating revenues	$ 42,455	$ 42,800
Operating expenses		
Operation and maintenance	28,820	21,771
Depreciation and amortization	6,305	5,541
General taxes	2,812	2,596
	37,937	29,908
Utility operating income	4,518	12,892
Other income (deductions)		
Allowance for other funds used during construction	116	445
Gain on disposition of property	200	1
Other deductions, net	(399)	(327)
	(83)	119
Income before interest charges and income taxes	4,435	13,011
Interest charges		
Interest on long-term debt	5,001	4,447
Interest on short-term debt	65	181
Amortization of debt expense	79	78
Allowance for borrowed funds used during construction	(58)	(210)
	5,087	4,496
(Loss) income before income taxes	(652)	8,515
Provision for income taxes	(207)	3,474
Net (loss) income	(445)	5,041
Dividends on preferred stock	448	513
(Loss) income to common stock	$ (893)	$ 4,528

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Cash Flows
For the Years Ended December 31, 2004 and 2003
(Dollars in thousands)

	2004	2003
Cash flows from operating activities		
Net (loss) income	$ (445)	$ 5,041
Adjustments:		
Depreciation and amortization	6,305	5,541
Removal costs net of salvage	1,059	983
Amortization, other	706	959
Provision for deferred income taxes	634	1,381
Amortization of deferred investment tax credits	(96)	(85)
Provision for losses on accounts receivable	450	184
Allowance for other funds used during construction	(116)	(445)
Deferred security costs	2,655	(952)
Deferred business services project expenses	1,078	(27)
Gain on disposition of property	(200)	(1)
Other, net	338	1,344
Changes in assets and liabilities:		
Accounts receivable	433	(232)
Unbilled revenues	553	(348)
Materials and supplies	(93)	22
Federal income tax refund due from affiliated company	812	(2,251)
Other current assets	356	(1,828)
Accounts payable	1,526	2,313
Accrued interest	2	-
Accrued taxes	(340)	1,903
Other current liabilities	299	367
Net cash provided by operating activities	15,916	13,869
Cash flows from investing activities		
Construction expenditures	(15,284)	(14,718)
Allowance for other funds used during construction	116	445
Removal costs from property, plant and equipment retirements, net of salvage	(356)	(330)
Proceeds from the disposition of property, plant and equipment	200	1
Net investment in notes receivable-associated companies	(1,819)	-
Net cash used in investing activities	(17,143)	(14,602)
Cash flows from financing activities		
Proceeds from issuance of long-term debt	14,000	-
Net (repayments) borrowings of notes payable-associated companies	(15,995)	1,346
Customer advances and contributions, net of refunds	5,166	4,452
Capital contribution by stockholder	-	9
Redemption of preferred stock	(2)	(857)
Dividends paid	(2,360)	(3,914)
Net cash provided by financing activities	809	1,036
Net (decrease) increase in cash and cash equivalents	(418)	303
Cash and cash equivalents at beginning of year	1,002	699
Cash and cash equivalents at end of year	$ 584	$ 1,002
Cash paid during the year for:		
Interest, net of capitalized amount	$ 5,006	$ 4,418
Income taxes	$ 300	$ 2,623

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Capitalization
December 31, 2004 and 2003
(Dollars in thousands, except per share amounts)

	Call Price Per Share	2004	2003
Common stockholder's equity			
Common stock - no par value, authorized 2,000,000 shares 1,567,391 shares issued and outstanding in 2004 and 2003		$ 36,569	$ 36,569
Paid-in capital		30	30
Retained earnings		23,672	26,475
		60,271	63,074
Preferred stocks - $100 par value			
Without mandatory redemption requirements:			
Cumulative preferred stocks			
5 75% series, 4,642 shares outstanding in 2004 and 2003	$ 101 00	464	464
5 50% series, 4,947 shares outstanding in 2004 and 2003	$ 100 50	495	495
5 00% series, 5,896 shares outstanding in 2004 and 5,939 shares outstanding in 2003	$ 101 00	590	594
		1,549	1,553
With mandatory redemption requirements:			
Cumulative preferred stocks			
8 47% series, 45,000 shares outstanding in 2004 and 2003 due for redemption 2036 or anytime before that date	$ 102 00	4,500	4,500
		4,500	4,500
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
4 75% series due 2014		14,000	-
		82,500	68,500
Less: Current portion of long-term debt		(5,500)	-
Long-term debt, net of current maturities		77,000	68,500
Total capitalization		$ 143,320	$ 137,627

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Changes in Stockholder's Equity
For the Years Ended December 31, 2004 and 2003
(Dollars in thousands, except per share amounts)

	Common Stock		Paid-in	Retained	
	Shares	Par Value	Capital	Earnings	Total
Balance at December 31, 2002, as previously reported	1,567,391	$ 36,569	$ 21	$ 25,178	$ 61.768
Restatement adjustment, see Note 3				170	170
Balance at December 31, 2002, as restated	1.567,391	36.569	21	25,348	61.938
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	26,475	63.074
Net income	-	-	-	(445)	(445)
Preferred stock redemption discount	-	-	-	2	2
Dividends paid					
Preferred stock	-	-	-	(448)	(448)
Common stock, $1 22 per share	-	-	-	(1,912)	(1,912)
Balance at December 31, 2004	1,567,391	$ 36,569	$ 30	$ 23,672	$ 60,271

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

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2004 and 2003
(Dollars in thousands)

Note 1: Organization and Operation

Kentucky-American Water Company (the Company) provides water service to approximately 111,000 customers and wastewater service to approximately 83 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.

Note 2 (continued):

When a unit of property is retired, the recorded value of such unit is credited to the asset account and charged to accumulated depreciation.

The cost of property, plant and equipment is depreciated using the straight-line average remaining life method. The composite depreciation rate amounted to 2.75% in 2004 and 2.81% in 2003. 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.

Computer software is either purchased or developed in-house. The purchase price or development costs are capitalized as a unit of property. Software costs totaling $221 and $3,257, were capitalized during 2004 and 2003, respectively.

In accordance with the Commission's regulations, depreciation on contributed facilities is charged to contributions in aid of construction. Such depreciation amounted to $926 in 2004 and $876 in 2003.

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 are 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, 2004 or 2003.

Customer Accounts Receivable

Customer accounts receivable represent amounts billed to the Company's water and wastewater customers on a cycle basis.

Allowance for Uncollectible Accounts

The allowance for uncollectible accounts reflects the Company's best estimate of probable losses in the customer accounts receivable balances. The allowance is based on known troubled accounts, historical experience and other available evidence. Customer accounts are written off based upon approved regulatory or legislative requirements.

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

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2004 and 2003
(Dollars in thousands)

Note 2 (continued):

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 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.

The Company has recorded a regulatory liability for costs associated with the removal of property, plant and equipment in accordance with SFAS 143, "Accounting for Asset Retirement Obligations." Retirement costs are recovered through customer rates during the life of the associated asset Removal costs, net of salvage, of $1,059 and $983 are recorded in operation and maintenance expense as of December 31, 2004 and 2003, respectively

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.

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.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2004 and 2003
(Dollars in thousands)

Note 2 (continued):

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, 2004 and 2003.

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 undiscounted 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 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.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2004 and 2003
(Dollars in thousands)

Note 2 (continued):

Reclassifications

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

Note 3: Restatement of Prior Period Financial Statements

In 2004, the Company discovered an error in its current and deferred state tax payable accounts. As a result, accrued taxes and deferred income taxes were improperly reported in periods prior to 2004. The Company recorded adjustments to properly state the retained earnings balance at December 31, 2003 and 2002 and accrued taxes and deferred income taxes at December 31, 2003. The impact of these adjustments is as follows:

	2003 (As Originally Reported)	2003 (Restated)
Balance Sheet:		
Accrued taxes	2.186	1.967
Deferred income taxes	32,547	32,596
Retained earnings	26.305	26.475

	2002 (As Originally Reported)	2002 (Restated)
Balance Sheet:		
Retained earnings	25.178	25.348

Note 4: Utility Plant

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

	2004	2003
Sources of supply	$ 8,018	$ 7,711
Treatment and pumping	47,714	47.129
Transmission and distribution	146,911	140,433
Services, meters and fire hydrants	59.255	54.791
General structures and equipment	20.678	19,636
Construction work in progress	6,346	4,417
	288,922	274,117
Less: accumulated depreciation	(59,815)	(53,774)
	$ 229,107	$ 220,343

Depreciation expense amounted to $6,523 in 2004 and $5,717 in 2003.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2004 and 2003
(Dollars in thousands)

Note 5: Preferred Stocks

There are no sinking fund payments through 2009.

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 6: 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 2006, 2008, or 2009.

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, 2004.

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 collateralized 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 7: Affiliate Borrowings

The Company maintains a line of credit through AWCC for $15,000. 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. Effective November 1, 2004 this line of credit has been extended to October 31, 2005. 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, 2004, there were $1,046 of investments, and at December 31, 2003 there were $14,880 of short-term borrowings outstanding. The weighted average annual interest

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2004 and 2003
(Dollars in thousands)

Note 7 (continued):

rate on these balances was 1.139% and 1.270%, respectively. The unused line of credit at December 31, 2004 was $15,000

In addition, notes receivable-associated companies includes is offset by payables of $1,046 at December 31, 2004 and notes payable-associated companies includes payables of $1,114 at December 31, 2003. These payables represent checks issued but not presented to the bank for payment.

Note 8: General Taxes

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

	2004	2003
Gross receipts and franchise	$ 95	$ 86
Property and capital stock	2,328	2,081
Payroll	389	429
	$ 2,812	$ 2,596

Note 9: Income Taxes

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

	2004	2003
State income taxes:		
Current	$ 399	$ 467
Deferred		
Non-current	(406)	269
	(7)	736
Federal income taxes:		
Current	(1,144)	1,711
Deferred		
Non-current	1.040	1,112
Amortization of deferred investment tax credits	(96)	(85)
	(200)	2,738
Total income taxes	$ (207)	$ 3,474

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2004 and 2003
(Dollars in thousands)

Note 9 (continued):

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

	2004	2003
Federal income tax at statutory rate of 35%	$ (228)	$ 2,980
Increases (decreases) resulting from -		
State taxes, net of federal income taxes	(5)	483
Flow through difference	81	56
Amortization of investment tax credits	(96)	(85)
Non-deductible items	46	11
Other, net	(5)	29
	$ (207)	$ 3,474

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

	2004	2003
Deferred tax assets:		
Advances and contributions	$ 4,181	$ 4,115
Deferred investment tax credits	627	628
Other	1,045	1,866
	5,853	6,609
Deferred tax liabilities:		
Utility plant, principally due to depreciation differences	35,728	33,130
Income taxes recoverable through rates	997	1,004
Deferred security costs	(4)	1,072
Other	2,251	3,999
	38,972	39,205
Net deferred tax liability	$ 33,119	$ 32,596

No valuation allowances were required on deferred tax assets at December 31, 2004 and 2003 as management believes it is more likely than not that these assets will be realized.

Note 10: Rate Matters

On April 30, 2004, the Company filed a petition and tariffs with the Kentucky Public Service Commission to increase its authorized revenues by $7,297. The rate petition was predicated on a forecasted test-year ending November 30, 2005. The rate increase was driven by several cost of service element increases above those approved in the 2000 rate petition as approved by the Commission in its Order of November 27, 2000: 1) increased rate base of $17,078 ($3,724 revenue requirement) and 2) $4,242 of increased O&M expenses primarily related to increased management fees, labor benefit costs, recovery of on-going and deferred security expenses, increased general taxes offset by lower interest costs.

The Commission held hearings on the petition during the week of December 10, 2004, and briefs and reply briefs were filed during January 2005. On February 28, 2005 the Commission issued its Order authorizing an overall increase in revenue of $4,283. The order permits an increase in billed tariffs of $3,611 and the creation of an activation fee which is expected to produce $672 annually. The Commission's order rejected rate recovery for deferred security costs and business service transitions costs. The Company filed a petition for rehearing requesting that the Commission reconsider its position on allocating consolidated federal income tax losses unrelated to the Company's operations, and recognition of the deferred expenses related to security costs and business service costs. On March 30, 2005 the Commission denied the Company's petition for rehearing. On April 27, 2005 the Company made a filing with the Franklin County Circuit Court appealing the Commission's decision regarding federal income taxes, deferred security cost, and deferred business service costs The Company has assessed the status of eventual rate recovery of its deferred business service project expense and additional security costs and determined that rate recovery is not likely. Based on this assessment the Company has expensed $3,904 in 2004 related to deferred business services and additional security costs previously deferred.

Note 11: 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

The Employees' Investment Plan is sponsored by American, and generally all non-bargaining unit employees who were active in the Employees' Stock Ownership Plan on or before January 10, 2003 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 $36 for 2004 that it made to the Employees' Investment Plan.

This plan is being discontinued as of May 22, 2005.

Kentucky-American Water Company

(a subsidiary of American Water Works Company, Inc.)

Financial Statements

As of and for the years ended December 31, 2005 and 2004

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
Two Commerce Square, Suite 1700
2001 Market Street
Philadelphia PA 19103-7042
Telephone (267) 330 3000
Facsimile (267) 330 3300

Report of Independent Auditors

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

In our opinion, the accompanying balance sheets and the related statements of operations, of capitalization, of changes in common stockholder's 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, 2005 and 2004, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, in 2005.

PricewaterhouseCoopers LLP

March 24, 2006

KENTUCKY-AMERICAN WATER COMPANY
Balance Sheets
December 31, 2005 and 2004
(Dollars in thousands)

Assets

	2005	2004
Property, plant and equipment		
Utility plant - at original cost less accumulated depreciation	$ 246,335	$ 229,107
Utility plant acquisition adjustments, net	338	408
Non-utility property	250	250
	246,923	229,765
Current assets		
Cash and cash equivalents	130	584
Customer accounts receivable	1,282	1,067
Allowance for uncollectible accounts	(259)	(170)
Unbilled revenues	2,478	1,913
Other accounts receivable	591	623
Notes receivable-associated companies	-	1,819
Federal income tax refund due from affiliated company	-	1,439
Materials and supplies	426	536
Other	461	145
	5,109	7,956
Long-term assets		
Regulatory assets	10,674	13,108
Preliminary survey & investigation	135	135
Other	85	500
	10,894	13,743
	$ 262,926	$ 251,464

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

KENTUCKY-AMERICAN WATER COMPANY
Balance Sheets
December 31, 2005 and 2004
(Dollars in thousands)

Capital and Liabilities

	2005	2004
Capitalization		
Common stockholder's equity	$ 63,706	$ 60,271
Preferred stock without mandatory redemption requirements	1,469	1,549
Preferred stock with mandatory redemption requirements	-	4,500
Long-term debt (excluding current portion):		
Preferred stock with mandatory redemption requirements	4,500	-
Long-term debt	77,000	77,000
Total capitalization	146,675	143,320
Current liabilities		
Notes payable - associated companies	9,308	-
Current portion of long-term debt	-	5,500
Accounts payable	2,086	4,260
Accounts payable - associated companies	554	1,107
Accrued interest	1,366	1,459
Accrued taxes	1,880	1,627
Other	2,975	1,846
	18,169	15,799
Long-term liabilities		
Deferred income taxes	33,993	33,119
Customer advances for construction	16,448	15,777
Deferred investment tax credits	1,388	1,461
Regulatory liability - cost of removal	6,561	6,212
Accrued pension expense	3,680	3,192
Accrued postretirement benefit expense	300	300
Other	30	61
	62,400	60,122
Contributions in aid of construction	35,682	32,223
Commitments and contingencies	-	-
	$ 262,926	$ 251,464

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Operations
For the Years Ended December 31, 2005 and 2004
(Dollars in thousands)

	2005	2004
Operating revenues	$ 50,120	$ 42,455
Operating expenses		
Operation and maintenance	27,524	29,509
Depreciation and amortization	5,835	5,616
General taxes	2,737	2,812
Gain on disposition of property	-	(200)
	36,096	37,737
Operating income	14,024	4,718
Other income (deductions)		
Allowance for other funds used during construction	347	116
Other deductions, net	(318)	(399)
	29	(283)
Income before interest charges and income taxes	14,053	4,435
Interest charges		
Interest on long-term debt	5,369	5,001
Interest on short-term debt	184	65
Amortization of debt expense	77	79
Other interest	4	-
Allowance for borrowed funds used during construction	(148)	(58)
	5,486	5,087
Income (loss) before income taxes	8,567	(652)
Income taxes provision (benefit)	3,354	(207)
Net income (loss)	5,213	(445)
Dividends on preferred stock	80	448
Income (loss) to common stock	$ 5,133	$ (893)

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Cash Flows
For the Years Ended December 31, 2005 and 2004
(Dollars in thousands)

	2005	2004
Cash flows from operating activities		
Net income (loss)	$ 5,213	$ (445)
Adjustments:		
Depreciation and amortization	5,835	5.616
Removal costs net of salvage	1.128	1.059
Amortization, other	2,311	2,217
Provision for deferred income taxes	1,982	634
Amortization of deferred investment tax credits	(73)	(96)
Provision for losses on accounts receivable	477	450
Allowance for other funds used during construction	(347)	(116)
Deferred security costs	-	2,655
Deferred business services project expenses	-	1.078
Gain on disposition of property	-	(200)
Other, net	(120)	(1.198)
Changes in assets and liabilities:		
Accounts receivable	(603)	433
Unbilled revenues	(565)	553
Materials and supplies	110	(93)
Federal income tax refund due from affiliated company	1,439	812
Other current assets	(284)	916
Accounts payable	(2,174)	1.526
Accrued taxes	253	(340)
Other current liabilities	483	455
Net cash provided by operating activities	15,065	15,916
Cash flows from investing activities		
Construction expenditures	(19,182)	(15.284)
Allowance for other funds used during construction	347	116
Acquisition	(2,635)	-
Removal costs from property, plant and equipment retirements, net of salvage	(774)	(356)
Proceeds from the disposition of property, plant and equipment	-	200
Net investment in notes receivable-associated companies	1,819	(1,819)
Net cash used in investing activities	(20,425)	(17,143)
Cash flows from financing activities		
Proceeds from issuance of long-term debt	-	14.000
Repayment of long-term debt	(5.500)	-
Net borrowings (repayments) of notes payable-associated companies	9,308	(15.995)
Customer advances and contributions, net of refunds	2,956	5,166
Redemption of preferred stock	(54)	(2)
Dividends paid	(1,804)	(2,360)
Net cash provided by financing activities	4,906	809
Net decrease in cash and cash equivalents	(454)	(418)
Cash and cash equivalents at beginning of year	584	1,002
Cash and cash equivalents at end of year	$ 130	$ 584
Cash paid during the year for:		
Interest, net of capitalized amount	$ 5,502	$ 5,006
Income taxes, net of refunds	$ 450	$ 300

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Capitalization
December 31, 2005 and 2004
(Dollars in thousands, except per share amounts)

	Call Price Per Share	2005	2004
Stockholder's equity			
Common stock - no par value, authorized 2,000,000 shares 1,567,391 shares issued and outstanding in 2005 and 2004		$ 36.569	$ 36,569
Paid-in capital		56	30
Retained earnings		27,081	23,672
Preferred stocks - $100 par value			
Cumulative preferred stocks without mandatory redemption requirements:			
5.75% series, 3,918 shares outstanding in 2005 and 4,642 shares outstanding in 2004	$ 101.00	392	464
5.50% series, 4,889 shares outstanding in 2005 and 4,947 shares outstanding in 2004	$ 100.50	489	495
5.00% series, 5,866 shares outstanding in 2005 and 5,896 shares outstanding in 2004	$ 100.00	588	590
Cumulative preferred stocks with mandatory redemption requirements			
8.47% series, 45,000 shares outstanding in 2004	$ 100.00	-	4,500
Total stockholder's equity		65,175	66,320
Long-term debt			
Preferred stocks - $100 par value			
Cumulative preferred stocks with mandatory redemption requirements:			
8.47% series, 45,000 shares outstanding in 2005, due for redemption 2036	$ 100.00	4,500	-
		4,500	-
General mortgage bonds			
6.79% series redeemed in 2005		-	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
4.75% series due 2014		14,000	14,000
		77,000	82,500
Less: Current portion of long-term debt		-	(5,500)
Long-term debt, net of current maturities		77,000	77,000
Total capitalization		$ 146,675	$ 143,320

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Changes in Common Stockholder's Equity
For the Years Ended December 31, 2005 and 2004
(Dollars in thousands, except per share amounts)

	Common Stock		Paid-in	Retained	
	Shares	Par Value	Capital	Earnings	Total
Balance at December 31, 2003	1,567,391	$ 36,569	$ 30	$ 26,475	$ 63,074
Net loss	-	-	-	(445)	(445)
Preferred stock redemption discount	-	-	-	2	2
Dividends paid					
Preferred stock	-	-	-	(448)	(448)
Common stock, $1.22 per share	-	-	-	(1,912)	(1,912)
Balance at December 31, 2004	1,567,391	36,569	30	23,672	60,271
Net income	-	-	-	5,213	5,213
Gain on redemption of preferred stock	-	-	26	-	26
Dividends paid					
Preferred stock	-	-	-	(80)	(80)
Common stock, $1.10 per share	-	-	-	(1,724)	(1,724)
Balance at December 31, 2005	1,567,391	$ 36,569	$ 56	$ 27,081	$ 63,706

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

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2005 and 2004
(Dollars in thousands)

Note 1: Organization and Operation

Kentucky-American Water Company (the Company) provides water service to approximately 113,000 (unaudited) customers and wastewater service to approximately 711 (unaudited) customers. These services are provided in 12 (unaudited) communities located in 10 (unaudited) 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). American is a wholly-owned subsidiary of Thames Water Aqua US Holdings, Inc., 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
December 31, 2005 and 2004
(Dollars in thousands)

Note 2 (continued):

When units of property are replaced, retired or abandoned, the recorded value thereof is credited to the asset account and such value, together with the net cost of removal, is charged to accumulated depreciation. To the extent the Company recovers cost of removal or other retirement costs through rates after the retirement of costs are incurred, a regulatory asset is recorded. In some cases, the Company recovers retirement costs through rates during the life of the associated asset and before the costs are incurred. There amounts result in a regulatory liability being reported based on the amounts previously recovered through customer rates. Removal costs, net of salvage, of $1,128 and $1,059 are recorded in operation and maintenance expense as of December 31, 2005 and 2004, respectively.

The cost of property, plant and equipment is depreciated using the straight-line average remaining life method. The composite depreciation rate amounted to 2.85% in 2005 and 2.75% in 2004.

Computer software is either purchased or developed in-house. The purchase price or development costs are capitalized as a unit of property. Software costs totaling $560 and $221, were capitalized during 2005 and 2004, respectively.

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 are amortized to expense over the remaining useful lives of the corresponding purchased plant assets.

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, 2005 or 2004.

Accounts Receivable

The majority of the Company's accounts receivable are due from trade customers. Customer accounts receivable represent amounts billed to the Company's water and wastewater customers on a cycle basis. When customers request extended payment terms, credit is extended based upon Commission guidelines and generally, collateral is not required.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2005 and 2004
(Dollars in thousands)

Note 2 (continued):

Allowance for Uncollectible Accounts

The Company maintains allowance for uncollectible accounts for estimated probable losses resulting from the inability of the Company's customers to make required payments. The Company continues to assess the adequacy of the reserves for doubtful accounts based on financial condition of the Company's customers and other external factors that may impact collectibility. Accounts outstanding longer than the payment terms are considered past due. The Company considers a number of factors in determining the allowance for uncollectible accounts, including the length of time trade accounts receivable are past due, the customer's current ability to pay their obligations to the Company, the Company's previous loss history, approved regulatory or legislative requirements. The Company writes off accounts receivable when they become uncollectible.

Materials and Supplies

Materials and supplies are stated at average cost.

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.

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. Other operating revenues are recognized when services are performed.

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.

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 basis 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.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2005 and 2004
(Dollars in thousands)

Note 2 (continued):

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, 2005 and 2004.

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 undiscounted 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 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.

Mandatorily Redeemable Preferred Stock
On May 15, 2003, the Financial Accounting Standards Board (FASB) approved Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" (SFAS 150). SFAS 150 establishes standards for classifying and measuring certain financial instruments with characteristics of both liabilities and equity. SFAS 150 requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). The Company adopted SFAS 150 as of January 1, 2005.

Effective January 1, 2005, the Company's mandatorily redeemable preferred stock was classified as a liability and recorded at the present value of redemption amounts, using the rates implicit in the stock agreements at inception. Additionally, beginning January 1, 2005, any change in the redemption value of the Company's mandatorily redeemable preferred stock or dividend payments to their holders, which previously reduced retained earnings, have been recorded as increases or decreases to interest expense. In accordance with SFAS 150, which specifically prohibits the restatement of financial statements prior to its adoption, prior period amounts have not been reclassified.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2005 and 2004
(Dollars in thousands)

Note 2 (continued):

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:

	Range of Remaining Useful Lives	2005	2004
Land and other non-depreciable assets	-	$ 4,637	$ 4,468
Sources of supply	30 to 90 Years	7,580	7,683
Treatment and pumping	25 to 56 Years	50,992	47,563
Transmission and distribution	18 to 85 Years	150,222	143,024
Services, meters and fire hydrants	20 to 98 Years	63,769	59,255
General structures and equipment	5 to 61 Years	23,151	20,583
Wastewater	20 Years	3,382	-
Construction work in progress	-	11,481	6,346
		315,214	288,922
Less: accumulated depreciation		(68,879)	(59,815)
		$ 246,335	$ 229,107

Depreciation expense amounted to $6,828 in 2005 and $6,523 in 2004.

Note 4: Regulatory Assets and Liabilities

The regulatory assets represent costs that are expected to be fully recovered from customers in future rates while regulatory liabilities represent amounts that are expected to be refunded to customers in future rates or amounts recovered from customers in advance of incurring the costs. Except for income taxes, regulatory assets and regulatory liabilities are excluded from the Company's rate base and do not earn a return. The components of regulatory assets are as follows:

	2005	2004
Income taxes recoverable through rates	$ 3,693	$ 4,686
Bluegrass water project, source of supply	1,998	2,055
Programmed maintenance expense	1,761	2,140
Bluegrass water project, pipeline	1,746	2,101
Rate proceedings	782	951
Debt and preferred stock expense	536	613
Other	158	562
	$ 10,674	$ 13,108

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2005 and 2004
(Dollars in thousands)

Note 4 (continued):

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

The Company has recorded a regulatory liability to defer the income impact of the state of Kentucky's income tax rate change from 8.25% to 7.00% effective for 2005. The income impact results from the application of the 7.00% tax rate against the Company's previously recorded deferred tax liabilities, which were established at 8.25%. The Company has recorded a deferred tax rate change liability of $926 which it is amortizing straight-line over thirty-five years.

The Company has recorded a regulatory asset for the Bluegrass water project source of supply costs in the amount of $2,283 to be amortized over a forty year period. Approval was granted per the Commission order dated December 12, 2000.

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 Bluegrass water project pipeline costs in the amount of $3,551 with a ten year amortization period which was approved by the Commission per order dated November 27, 2000.

Expense of rate proceedings is deferred and amortized on a straight-line basis over three years as authorized by the Commission in their determination of rates charged for service.

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.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2005 and 2004
(Dollars in thousands)

Note 5: Preferred Stocks

There are no sinking fund payments through 2010.

Preferred stock agreements contain provisions for redemption at various prices on thirty days notice at the Company's discretion. In the event of voluntary liquidation, the 5.75% series is redeemable at $101.00 per share. The 5.50% series is redeemable at $100.50 per share and the 5.00% series redeemable at $100.00 per share. The 8.47% series is redeemable at $100.00, plus make whole premium. In the event of involuntary liquidation or governmental acquisition, all classes are redeemable at $100 per share. Upon redemption the price must be increased by accrued dividends to the date of redemption.

In 2005, certain shareholders offered shares of preferred stock for sale back to the Company. Thirty shares of the 5.00% series were purchased for $2. Fifty-eight shares of the 5.50% series were purchased for $4 and 724 of the 5.75% series were purchased for $51.

Note 6: Long-Term Debt

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. General mortgage bonds are collateralized by utility plant.

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, 2005.

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

Maturities of long-term debt will amount to $24,000 in 2007. There are no maturities in 2006, 2008, 2009 or 2010.

Note 7: Short-term Borrowings

The Company maintains a line of credit through AWCC for $12,000. The Company may borrow from, or invest in, the line of credit. The line was decreased by $3,000 during 2005, per an amendment to the agreement with AWCC. No compensating balances are required under the agreements.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2005 and 2004
(Dollars in thousands)

Note 7 (continued):

At December 31, 2005 there were $9,308 of short-term borrowings outstanding. At December 31, 2004, the Company had invested $1,819 with AWCC. The weighted average annual interest rates on these balances were 3.36% and 1.14% in 2005 and 2004, respectively. The unused short-term line of credit at December 31, 2005 was $2,692.

Note 8: General Taxes

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

	2005	2004
Gross receipts and franchise	$ 32	$ 95
Property and capital stock	2,322	2,328
Payroll	380	389
Miscellaneous	3	-
	$ 2,737	$ 2,812

Note 9: Income Taxes

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

	2005	2004
State income taxes:		
Current	$ 81	$ 399
Deferred		
Current	(15)	-
Non-current	523	(406)
	589	(7)
Federal income taxes:		
Current	1.364	(1,144)
Deferred		
Current	(212)	-
Non-current	1,686	1,040
Amortization of deferred investment tax credits	(73)	(96)
	2,765	(200)
Total income taxes	$ 3,354	$ (207)

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2005 and 2004
(Dollars in thousands)

Note 9 (continued):

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

	2005	2004
Federal income tax at statutory rate of 35%	$ 2,999	$ (228)
Increases (decreases) resulting from -		
State taxes, net of federal income taxes	382	(5)
Flow through difference	135	81
Amortization of investment tax credits	(73)	(96)
Non-deductible items	-	46
Other, net	(89)	(5)
	$ 3,354	$ (207)

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

	2005	2004
Deferred tax assets:		
Advances and contributions	$ 4,229	$ 4,181
Deferred investment tax credits	549	627
Other	1,386	1,045
	6,164	5,853
Deferred tax liabilities:		
Utility plant, principally due to depreciation differences	36,174	35,728
Income taxes recoverable through rates	503	997
Deferred security costs	1,111	(4)
Other	2,369	2,251
	40,157	38,972
Net deferred tax liability	$ 33,993	$ 33,119

No valuation allowances were required on deferred tax assets at December 31, 2005 and 2004 as management believes it is more likely than not that these assets will be realized.

Note 10: Rate Matters

On April 30, 2004, the Company filed a petition and tariffs with the Kentucky Public Service Commission to increase its authorized revenues by $7,297. The rate petition was predicated on a forecasted test-year ending November 30, 2005.

Note 10 (continued):

The rate increase was driven by several cost of service element increases above those approved in the 2000 rate petition as approved by the Commission in its Order of November 27, 2000: 1) increased rate base of $17,078 ($3,724 revenue requirement) and 2) $4,242 of increased O&M expenses primarily related to increased management fees, labor benefit costs, recovery of on-going and deferred security expenses, increased general taxes offset by lower interest costs.

The Commission held hearings on the petition during the week of December 10, 2004, and briefs and reply briefs were filed during January 2005. On February 28, 2005 the Commission issued its Order authorizing an overall increase in revenue of $4,283. The order permits an increase in billed tariffs of $3,611 and the creation of an activation fee which is expected to produce $672 annually. The Commission's order rejected rate recovery for deferred security costs and business service transitions costs. The Company filed a petition for rehearing requesting that the Commission reconsider its position on allocating consolidated federal income tax losses unrelated to the Company's operations, and recognition of the deferred expenses related to security costs and business service costs. On March 30, 2005 the Commission denied the Company's petition for rehearing. On April 27, 2005 the Company made a filing with the Franklin County Circuit Court appealing the Commission's decision regarding federal income taxes, deferred security cost and deferred business service costs. The Company assessed the status of eventual rate recovery of its deferred business service project expense and additional security costs and determined that rate recovery is not likely. Based on this assessment the Company expensed $3,904 in 2004 related to deferred business services and additional security costs previously deferred.

Note 11: 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.

The Employees' Investment Plan is sponsored by American, and generally all non-bargaining unit employees who were active in the Employees' Stock Ownership Plan on or before January 10, 2003 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 $29 for 2005 and $36 for 2004 that it made to the Employees' Investment Plan.

This plan was discontinued as of May 22, 2005.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2005 and 2004
(Dollars in thousands)

Note 11 (continued):

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 employee's wages contributed to the plan. The Company expensed matching contributions to the plan totaling $78 for 2005 and $72 for 2004. All of the Company's matching contributions are invested in one or more funds at the direction of the employee.

Note 12: Postretirement Benefits

Pension Benefits

The Company participates in a noncontributory defined benefit pension plan sponsored by American covering substantially all employees. Benefits under the plan are based on the employee'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 $506 in 2005 and $359 in 2004.

Postretirement Benefits Other Than Pensions

The Company participates in an American plan that provides certain life insurance benefits for retired employees and certain health care benefits for retired employees and their dependents. Substantially all employees, except non-bargaining unit employees hired on or after January 1, 2002, 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. Employees 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.

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 $894 in 2005 and $824 in 2004. The Company's policy is to fund postretirement benefits costs accrued.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2005 and 2004
(Dollars in thousands)

Note 13: Related Party Transactions

American Water Works Service Company, Inc. (AWWS), a subsidiary of American, 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:

	2005	2004
Included in operation and maintenance expense as a charge against income	$ 5,892	$ 5,773
Capitalized primarily in utility plant	1,217	818
	$ 7,109	$ 6,591

The Company provided workspace, information system support, human resources and loss control services for associates 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 $43 in 2005 and $157 in 2004.

The Company has three operating agreements with American Water Services, Inc. (AWS), a subsidiary of American, 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. The carbon is scheduled for replacement at thirty-six month intervals and is warranted to perform to specific standards during that period. The Company paid $97 in 2005 and $96 in 2004 to AWS under these agreements.

The Company maintains a line of credit through AWCC. The Company paid AWCC fees of $24 in 2005 and $25 in 2004 and interest on borrowings of $184 in 2005 and $64 in 2004.

Note 14: 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 amounts reported in the balance sheet for current assets and current liabilities approximate their fair value.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2005 and 2004
(Dollars in thousands)

Note 14 (continued):

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:

	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Preferred stock with mandatory redemption requirements	$ 4,500	$ 4,692	$ 4,500	$ 4,210
Long-term debt, including current maturities	$ 77,000	$ 79,567	$ 82,500	$ 86,231

Note 15: Operating Lease

The Company has entered into operating leases involving certain facilities and equipment. Rental expenses under operating leases were $35 in 2005 and $35 in 2004. The operating leases for equipment expire over the next three years.

At December 31, 2005, the minimum annual future rental commitments under operating leases that have initial or remaining non-cancelable lease terms in excess of one year are $23 in 2006, $19 in 2007, $12 in 2008, and none thereafter.

Note 16: Commitments and Contingencies

Commitments have been made in connection with certain construction programs.

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

Note 17: Acquisitions

On September 15, 2005, the Company completed its acquisition of the Owenton Borough Water Authority for $2,635. The acquired operations provided water and sewer service to approximately 1,744 (unaudited) customers at the time of acquisition. In 2005, during the period owned, the Company recorded $252 in operating revenue.

Kentucky-American Water Company

(a subsidiary of American Water Works Company, Inc.)

Financial Statements

As of and for the years ended December 31, 2006 and 2005

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
Two Commerce Square, Suite 1700
2001 Market Street
Philadelphia, PA 19103-7042
Telephone (267) 330 3000
Facsimile (267) 330 3300

Report of Independent Auditors

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

In our opinion, the accompanying balance sheets and the related statements of income, of capitalization, of changes in common stockholder's 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, 2006 and 2005, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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.

PricewaterhouseCoopers LLP

March 16, 2007

KENTUCKY-AMERICAN WATER COMPANY
Balance Sheets
December 31, 2006 and 2005
(Dollars in thousands)

Assets

	2006	2005
Property, plant and equipment		
Utility plant - at original cost less accumulated depreciation	$ 263,467	$ 246,335
Utility plant acquisition adjustments, net	348	338
Non-utility property	250	250
	264,065	246,923
Current assets		
Cash and cash equivalents	79	130
Customer accounts receivable	2,453	1,282
Allowance for uncollectible accounts	(261)	(259)
Unbilled revenues	2,510	2,478
Other accounts receivable	603	591
Materials and supplies	516	426
Other	68	461
	5,968	5,109
Long-term assets		
Regulatory assets	9,603	10,680
Other	151	214
	9,754	10,894
	$ 279,787	$ 262,926

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

KENTUCKY-AMERICAN WATER COMPANY
Balance Sheets
December 31, 2006 and 2005
(Dollars in thousands)

Capital and Liabilities

	2006	2005
Capitalization		
Common stockholder's equity	$ 72,972	$ 63,706
Preferred stock without mandatory redemption requirements	1,466	1,469
Long-term debt (excluding current portion):		
Preferred stock with mandatory redemption requirements	4,500	4,500
Long-term debt	49,900	77,000
Total capitalization	128,838	146,675
Current liabilities		
Notes payable - associated companies	6,674	9,308
Current portion of long-term debt	27,100	-
Accounts payable	5,511	2,086
Accrued taxes	4,317	1,880
Other	4,166	4,895
	47,768	18,169
Long-term liabilities		
Deferred income taxes	35,168	33,993
Customer advances for construction	16,493	16.448
Deferred investment tax credits	1,303	1,388
Regulatory liability - cost of removal	7,597	6,561
Accrued pension expense	2,382	3.680
Accrued postretirement benefit expense	343	300
Other	60	30
	63,346	62,400
Contributions in aid of construction	39,835	35,682
Commitments and contingencies	-	-
	$ 279,787	$ 262,926

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Income
For the Years Ended December 31, 2006 and 2005
(Dollars in thousands)

	2006	2005
Operating revenues	$ 49,010	$ 50,120
Operating expenses		
Operation and maintenance	27,957	27,524
Depreciation	7,891	6,828
Amortization	(1,151)	(993)
General taxes	2,860	2,737
	37,557	36,096
Operating income	11,453	14,024
Other income (deductions)		
Allowance for other funds used during construction	274	347
Other deductions, net	(406)	(318)
	(132)	29
Income before interest deductions and income taxes	11,321	14,053
Interest deductions (income)		
Interest on long-term debt	5,111	5,369
Interest on short-term debt	409	184
Amortization of debt expense	73	77
Other interest	65	4
Allowance for borrowed funds used during construction	(117)	(148)
	5,541	5,486
Income before income taxes	5,780	8,567
Provision for income taxes	2,430	3,354
Net income	3,350	5,213
Dividends on preferred stock	79	80
Income to common stock	$ 3,271	$ 5,133

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Cash Flows
For the Years Ended December 31, 2006 and 2005
(Dollars in thousands)

	2006	2005
Cash flows from operating activities		
Net income	$ 3,350	$ 5,213
Adjustments:		
Depreciation and amortization	6,740	5,835
Removal costs net of salvage	1,227	1,128
Amortization, other	1,701	2,311
Provision for deferred income taxes	1,334	1,982
Amortization of deferred investment tax credits	(85)	(73)
Provision for losses on accounts receivable	405	477
Allowance for other funds used during construction	(274)	(347)
Other, net	(1,915)	(120)
Changes in assets and liabilities:		
Accounts receivable	(1,574)	(603)
Unbilled revenues	(32)	(565)
Federal income tax refund due from affiliated company	-	1,439
Other current assets	291	(174)
Accounts payable	3,425	(2,174)
Accrued taxes	2,437	253
Other current liabilities	(729)	483
Net cash provided by operating activities	16,301	15,065
Cash flows from investing activities		
Construction expenditures	(25,103)	(19,182)
Allowance for other funds used during construction	274	347
Acquisition	-	(2,635)
Removal costs from property, plant and equipment retirements, net of salvage	(174)	(774)
Net investment in notes receivable-associated companies	-	1,819
Net cash used in investing activities	(25,003)	(20,425)
Cash flows from financing activities		
Repayment of long-term debt	-	(5,500)
Net borrowings (repayments) of notes payable-associated companies	(2,634)	9,308
Customer advances and contributions, net of refunds	5,372	2,956
Capital contribution by stockholder	8,000	
Redemption of preferred stock	(3)	(54)
Dividends paid	(2,084)	(1,804)
Net cash provided by financing activities	8,651	4,906
Net decrease in cash and cash equivalents	(51)	(454)
Cash and cash equivalents at beginning of year	130	584
Cash and cash equivalents at end of year	$ 79	$ 130
Cash paid during the year for:		
Interest, net of capitalized amount	$ 6,190	$ 5,502
Income taxes, net of refunds	$ 128	$ 450

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Capitalization
December 31, 2006 and 2005
(Dollars in thousands, except per share amounts)

	Call Price Per Share	2006	2005
Stockholder's equity			
Common stock - no par value, authorized 2,000,000 shares 1,567,391 shares issued and outstanding in 2006 and 2005		$ 36,569	$ 36,569
Paid-in capital		8,056	56
Retained earnings		28,347	27,081
Total common stockholder's equity		72,972	63,706
Preferred stocks - $100 par value			
Cumulative preferred stocks without mandatory redemption requirements:			
5.75% series, 3,918 shares outstanding in 2006 and 2005	$ 101.00	392	392
5.50% series, 4,883 shares outstanding in 2006 and 4,889 shares outstanding in 2005	$ 100.50	488	489
5.00% series, 5,866 shares outstanding in 2006 and 5,866 shares outstanding in 2005	$ 100.00	586	588
		1,466	1,469
Long-term debt			
Preferred stocks - $100 par value			
Cumulative preferred stocks with mandatory redemption requirements:			
8.47% series, 45,000 shares outstanding in 2006, due for redemption 2036	$ 100.00	4,500	4,500
		4,500	4,500
General mortgage bonds			
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
4.75% series due 2014		14,000	14,000
		77,000	77,000
Less: Current portion of long-term debt		(27,100)	-
Long-term debt, net of current maturities		49,900	77,000
Total capitalization		$ 128,838	$ 146,675

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Changes in Common Stockholder's Equity
For the Years Ended December 31, 2006 and 2005
(Dollars in thousands, except per share amounts)

	Common Stock		Paid-in	Retained	
	Shares	**Par Value**	**Capital**	**Earnings**	**Total**
Balance at December 31, 2004	1,567,391	$ 36,569	$ 30	$ 23,672	$ 60,271
Net loss	-	-	-	5,213	5,213
Gain on redemption of preferred stock	-	-	26	-	26
Dividends paid					
Preferred stock	-	-	-	(80)	(80)
Common stock, $1.10 per share	-	-	-	(1,724)	(1,724)
Balance at December 31, 2005	1,567,391	36,569	56	27,081	63,706
Net income	-	-	-	3,350	3,350
Dividends paid					
Preferred stock	-	-	-	(79)	(79)
Common stock, $1 28 per share	-	-	-	(2,005)	(2,005)
Capital contribution by stockholder	-	-	8,000	-	8,000
Balance at December 31, 2006	1,567,391	$ 36,569	$ 8,056	$ 28,347	$ 72,972

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

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2006 and 2005
(Dollars in thousands)

Note 1: Organization and Operation

Kentucky-American Water Company (the Company) provides water service to approximately 115,820 (unaudited) customers and wastewater service to approximately 703 (unaudited) customers. These services are provided in 12 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). American is a wholly-owned subsidiary of Thames Water Aqua US Holdings, Inc., 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
December 31, 2006 and 2005
(Dollars in thousands)

Note 2 (continued):

When units of property are replaced, retired or abandoned, the recorded value thereof is credited to the asset account and such value, together with the net cost of removal, is charged to accumulated depreciation. To the extent the Company recovers cost of removal or other retirement costs through rates after the retirement of costs are incurred, a regulatory asset is recorded. In some cases, the Company recovers retirement costs through rates during the life of the associated asset and before the costs are incurred. These amounts result in a regulatory liability being reported based on the amounts previously recovered through customer rates. Removal costs, net of salvage, of $1,227 and $1,128 are recorded in operation and maintenance expense as of December 31, 2006 and 2005, respectively.

The cost of property, plant and equipment is depreciated using the straight-line average remaining life method.

Computer software is either purchased or developed in-house. The purchase price or development costs are capitalized as a unit of property. Software costs totaling $133 and $560, were capitalized during 2006 and 2005, respectively.

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 are amortized to expense over the remaining useful lives of the corresponding purchased plant assets. The range of remaining lives is from 4 to 39 years.

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, 2006 or 2005.

Accounts Receivable
The majority of the Company's accounts receivable are due from trade customers. Customer accounts receivable represent amounts billed to the Company's water and wastewater customers on a cycle basis. When customers request extended payment terms, credit is extended based upon Commission guidelines and generally, collateral is not required.

Allowance for Uncollectible Accounts
The Company maintains allowance for uncollectible accounts for estimated probable losses resulting from the inability of the Company's customers to make required payments. Accounts outstanding longer than the payment terms are considered past due. The Company considers a number of factors in determining the allowance for uncollectible accounts, including the length of time trade accounts receivable are past due and the Company's previous loss history. The Company writes-off accounts receivable when they become uncollectible

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2006 and 2005
(Dollars in thousands)

Note 2 (continued):

The change in the Company's allowance for 2006 and 2005 are as follows:

	2006	2005
Balance as of January 1	$ 259	$ 170
Provision charged to expense	405	477
Accounts written-off	(465)	(437)
Recoveries of accounts previously written-off	62	49
Balance as of December 31	$ 261	$ 259

Materials and Supplies

Materials and supplies are stated at cost. Cost is determined using the average cost method.

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. The Company depreciates contributed property and amortizes contributions in aid of construction at the composite rate of the related property. For the years ended December 31, 2006 and 2005, cash advances and contributions were $8,429 and $6,777, and non-cash advances and contributions were $0 and $3,219, respectively.

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. Other operating revenues are recognized when services are performed.

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.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2006 and 2005
(Dollars in thousands)

Note 2 (continued):

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 basis 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, 2006 and 2005.

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 undiscounted 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 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 previously reported data to the current presentation.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2006 and 2005
(Dollars in thousands)

Note 3: Utility Plant

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

	Range of Remaining Useful Lives	2006	2005
Land and other non-depreciable assets	-	$ 4,758	$ 4,637
Sources of supply	30 to 90 Years	9,238	7,580
Treatment and pumping	25 to 56 Years	51,224	50,992
Transmission and distribution	18 to 85 Years	164,275	150,222
Services, meters and fire hydrants	20 to 98 Years	69,230	63,769
General structures and equipment	3 to 61 Years	25,294	23,151
Wastewater	5 to 50 Years	3,504	3,382
Construction work in progress	-	11,772	11,481
		339,295	315,214
Less: accumulated depreciation		(75,828)	(68,879)
		$ 263,467	$ 246,335

Note 4: Regulatory Assets and Liabilities

The regulatory assets represent costs that are expected to be fully recovered from customers in future rates while regulatory liabilities represent amounts that are expected to be refunded to customers in future rates or amounts recovered from customers in advance of incurring the costs. Except for income taxes, regulatory assets and regulatory liabilities are excluded from the Company's rate base and do not earn a return. The components of regulatory assets are as follows:

	2006	2005
Income taxes recoverable through rates	$ 3,611	$ 3,693
Bluegrass water project, source of supply	1,970	1,998
Programmed maintenance expense	1,468	1,761
Bluegrass water project, pipeline	1,391	1,746
Rate proceedings	421	782
Debt and preferred stock expense	463	536
Other	279	164
	$ 9,603	$ 10,680

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.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2006 and 2005
(Dollars in thousands)

Note 4 (continued):

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

The Company has recorded a regulatory asset for the Bluegrass water project source of supply costs in the amount of $2,283 to be amortized over a forty year period. Approval was granted per the Commission order dated May 9, 2001.

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 Bluegrass water project pipeline costs in the amount of $3,551 with a ten year amortization period which was approved by the Commission per order dated November 27, 2000.

Expense of rate proceedings is deferred and amortized on a straight-line basis over three years as authorized by the Commission in their determination of rates charged for service.

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.

Note 5: Preferred Stocks

There are no sinking fund payments through 2011.

Preferred stock agreements contain provisions for redemption at various prices on thirty days notice at the Company's discretion. In the event of voluntary liquidation, the 5.75% series is redeemable at $101.00 per share. The 5.50% series is redeemable at $100.50 per share and the 5.00% series redeemable at $100.00 per share. The 8.47% series is redeemable at $100.00, plus make whole premium. In the event of involuntary liquidation or governmental acquisition, all classes are redeemable at $100 per share. Upon redemption the price must be increased by accrued dividends to the date of redemption.

In 2006, certain shareholders offered shares of preferred stock for sale back to the Company. Six shares of the 5.5% series were purchased.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2006 and 2005
(Dollars in thousands)

Note 5 (continued):

In 2005, certain shareholders offered shares of preferred stock for sale back to the Company. Thirty shares of the 5.00% series were purchased for $2. Fifty-eight shares of the 5.50% series were purchased for $4 and 724 of the 5.75% series were purchased for $51.

Note 6: Long-Term Debt

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 limited only to the extent that long-term debt cannot exceed 65% of total capitalization. General mortgage bonds are collateralized by utility plant.

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, 2006.

The senior notes payable to affiliate are unsecured and were issued to American Water Capital Corporation (AWCC), an affiliate, for the principal amount. The indenture for the 6.87% series note has a sinking fund provision that requires an annual retirement of $3,100 from 2007 through 2011.

Maturities of long-term debt, excluding sinking fund payments, will amount to $24,000 in 2007. There are no maturities in 2008, 2009, 2010 or 2011. The Company plans to issue general mortgage bonds through American Water Capital Corporation (AWCC), a subsidiary of American, to retire the $24,000 debt maturing in 2007.

Note 7: Short-term Borrowings

The Company maintains a line of credit through AWCC for $12,000. The Company may borrow from, or invest in, the line of credit. No compensating balances are required under the agreements.

At December 31, 2006 and 2005 there were $6,674 and $9,308 of short-term borrowings outstanding, respectively. The weighted average annual interest rates on these balances were 6.07% and 3.36% in 2006 and 2005, respectively. The unused short-term line of credit at December 31, 2006 was $5,326.

During 2006, the Company received a capital contribution of $8,000 from American, primarily used to pay down short term debt.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2006 and 2005
(Dollars in thousands)

Note 8: General Taxes

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

	2006	2005
Property	2,377	2,354
Payroll	480	380
Miscellaneous	3	3
	$ 2,860	$ 2,737

Note 9: Income Taxes

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

	2006	2005
State income taxes:		
Current	$ 120	$ 81
Deferred		
Current	22	(15)
Non-current	293	523
	435	589
Federal income taxes:		
Current	1,061	1,364
Deferred		
Current	106	(212)
Non-current	913	1,686
Amortization of deferred investment tax credits	(85)	(73)
	1,995	2,765
Total income taxes	$ 2,430	$ 3,354

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2006 and 2005
(Dollars in thousands)

Note 9 (continued):

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

	2006	2005
Federal income tax at statutory rate of 35%	$ 2,023	$ 2,999
Increases (decreases) resulting from -		
State taxes, net of federal income taxes	283	382
Flow through difference	121	135
Amortization of investment tax credits	(85)	(73)
Other, net	88	(89)
	$ 2,430	$ 3,354

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

	2006	2005
Deferred tax assets:		
Advances and contributions	$ 3,929	$ 4,229
Deferred investment tax credits	506	540
Other	995	1,599
	5,430	6,368
Deferred tax liabilities:		
Utility plant, principally due to depreciation differences	36,878	36,174
Income taxes recoverable through rates	432	494
Deferred security costs	1,106	1,111
Other	2,182	2,582
	40,598	40,361
Net deferred tax liability	$ 35,168	$ 33,993

No valuation allowances were required on deferred tax assets at December 31, 2006 and 2005 as management believes it is more likely than not that deferred tax assets will be realized.

Note 10: 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.

The Company received approval from the Commission to increase its annual rates by $4,283 for water service effective February 28, 2005.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2006 and 2005
(Dollars in thousands)

Note 11: 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.

The Employees' Investment Plan is sponsored by American, and generally all non-bargaining unit employees who were active in the Employees' Stock Ownership Plan on or before January 10, 2003 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 $29 for 2005 that it made to the Employees' Investment Plan.

This plan was discontinued as of May 22, 2005.

Savings Plan for Employees

The Company maintains 401(k) Savings Plans that allow employees to save for retirement on a tax-deferred basis. Employees can make contributions that are invested at their direction in one or more funds. The Company makes matching contributions based on a percentage of an employee's contribution, subject to certain limitation. Due to the elimination of participants in the defined benefit pension plan, on January 1, 2006 the Company began providing an additional 5.25% of base pay defined contribution benefit for union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006. The Company expensed contributions to the plan totaling $79 for 2006 and $78 for 2005. All of the Company's contributions are invested in one or more funds at the direction of the employee.

Note 12: Postretirement Benefits

Pension Benefits

The Company participates in a noncontributory defined benefit pension plan sponsored by American covering employees hired before January 1, 2006. Benefits under the plan are based on the employee'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 $1,358 in 2006 and $506 in 2005.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2006 and 2005
(Dollars in thousands)

Note 12 (continued):

Postretirement Benefits Other Than Pensions

The Company participates in an American plan that provides certain life insurance benefits for retired employees and certain health care benefits for retired employees and their dependents. Employees, except non-bargaining unit employees hired on or after January 1, 2002, 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. Employees 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.

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 $812 in 2006 and $894 in 2005. The Company's policy is to fund postretirement benefits costs accrued.

Note 13: Related Party Transactions

American Water Works Service Company, Inc. (AWWS), a subsidiary of American, 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:

	2006	2005
Included in operation and maintenance expense as a charge against income	$ 7,556	$ 5,892
Capitalized primarily in utility plant	545	1,217
	$ 8,101	$ 7,109

The Company provided workspace, information system support, human resources and loss control services for associates 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 $23 in 2006 and $43 in 2005.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2006 and 2005
(Dollars in thousands)

Note 13 (continued):

The Company has three operating agreements with American Water Services, Inc. (AWS), a subsidiary of American, for the lease of granular activated carbon at one of the Company's water treatment plants. Under the terms of the agreements, AWS will provide carbon for a period of thirty-six months. The Company paid $100 in 2006 and $97 in 2005 to AWS under these agreements.

The Company maintains a line of credit through AWCC (See Note 7). The Company paid AWCC fees of $24 in 2006 and $24 in 2005 and interest on borrowings of $406 in 2006 and $184 in 2005.

Note 14: 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 amounts reported in the balance sheet for current assets and current liabilities approximate 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:

	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Preferred stock with mandatory redemption requirements	$ 4,500	$ 5,795	$ 4,500	$ 4,692
Long-term debt, including current maturities	$ 77,000	$ 80,170	$ 77,000	$ 79,567

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2006 and 2005
(Dollars in thousands)

Note 15: Operating Lease

The Company has entered into operating leases involving certain facilities and equipment. Rental expenses under operating leases were $28 in 2006 and $35 in 2005. The operating leases for equipment expire over the next two years.

At December 31, 2006, the minimum annual future rental commitments under operating leases that have initial or remaining non-cancellable lease terms in excess of one year are $22 in 2007, $14 in 2008, and none thereafter.

Note 16: Commitments and Contingencies

Commitments have been made in connection with certain construction programs.

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

Note 17: Acquisitions

On September 15, 2005, the Company completed its acquisition of the Owenton Borough Water Authority for $2,635. The acquired operations provided water and sewer service to approximately 1,744 (unaudited) customers at the time of acquisition. The Company recorded operating revenue of $1,035 in 2006 and $252 in 2005 during the period owned.

Kentucky-American Water Company

(a wholly-owned subsidiary of American Water Works Company, Inc.)

Financial Statements

As of and for the years ended December 31, 2007 and 2006

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
Two Commerce Square, Suite 1700
2001 Market Street
Philadelphia, PA 19103-7042
Telephone (267) 330 3000
Facsimile (267) 330 3300

Report of Independent Auditors

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

In our opinion, the accompanying balance sheets and the related statements of operations, of capitalization, of changes in common stockholder's 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, 2007 and 2006, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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.

PricewaterhouseCoopers LLP

February 28, 2008

KENTUCKY-AMERICAN WATER COMPANY
Balance Sheets
December 31, 2007 and 2006
(Dollars in thousands)

Assets

	2007	2006
Property, plant and equipment		
Utility plant - at original cost less accumulated depreciation	$ 286,216	$ 263,467
Utility plant acquisition adjustments, net	327	348
Non-utility property	250	250
Total property, plant and equipment	286,793	264,065
Current assets		
Cash and cash equivalents	398	79
Customer accounts receivable	1,928	2,453
Allowance for uncollectible accounts	(223)	(261)
Unbilled revenues	2,562	2,510
Other accounts receivable	196	603
Materials and supplies	635	516
Other	82	68
Total current assets	5,578	5,968
Regulatory and other long-term assets		
Regulatory assets	9,276	9,603
Other	156	151
Total regulatory and other long-term assets	9,432	9,754
Total assets	$ 301,803	$ 279,787

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

KENTUCKY-AMERICAN WATER COMPANY
Balance Sheets
December 31, 2007 and 2006
(Dollars in thousands)

Capitalization and Liabilities

	2007	2006
Capitalization		
Common stockholder's equity	$ 74,484	$ 72,972
Preferred stock without mandatory redemption requirements	1,466	1,466
Long-term debt (excluding current portion):		
Preferred stock with mandatory redemption requirements	4,500	4,500
Long-term debt	79,800	49,900
Total capitalization	160,250	128,838
Current liabilities		
Notes payable - associated companies	19,356	6,674
Current portion of long-term debt	3,100	27,100
Accounts payable	6,490	5,511
Accrued taxes	2,310	4,317
Other	3,471	4,166
Total current liabilities	34,727	47,768
Regulatory and other long-term liabilities		
Deferred income taxes	35,537	35,168
Customer advances for construction	14,653	16,493
Deferred investment tax credits	1,218	1,303
Regulatory liability - cost of removal	8,440	7,597
Accrued pension expense	2,174	2,382
Accrued postretirement benefit expense	384	343
Other	835	60
Total regulatory and other long-term liabilities	63,241	63,346
Contributions in aid of construction	43,585	39,835
Commitments and contingencies	-	-
Total capitalization and liabilities	$ 301,803	$ 279,787

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Income
For the Years Ended December 31, 2007 and 2006
(Dollars in thousands)

	2007	2006
Operating revenues	$ 52,497	$ 49,010
Operating expenses		
Operation and maintenance	27,191	26,329
Depreciation	7,924	7,891
Amortization	(369)	477
General taxes	3,057	2,860
Total operating expenses, net	37,803	37,557
Operating income	14,694	11,453
Other income (deductions)		
Allowance for other funds used during construction	843	274
Other income (deductions), net	7	(406)
Total other income (deductions)	850	(132)
Income before interest deductions and income taxes	15,544	11,321
Interest deductions (income)		
Interest on long-term debt	4,652	5,111
Interest on short-term debt	1,416	409
Amortization of debt expense	75	73
Other interest	(38)	65
Allowance for borrowed funds used during construction	(384)	(117)
Total interest deductions (income)	5,721	5,541
Income before income taxes	9,823	5,780
Provision for income taxes	4,065	2,430
Net income	5,758	3,350
Dividends on preferred stock	79	79
Income to common stock	$ 5,679	$ 3,271

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Cash Flows
For the Years Ended December 31, 2007 and 2006
(Dollars in thousands)

	2007	2006
Cash flows from operating activities		
Net income	$ 5,758	$ 3,350
Adjustments:		
Depreciation and amortization	7,555	8,368
Removal costs net of salvage	1,221	1,227
Amortization of debt costs	75	73
Provision for deferred income taxes	760	1,334
Amortization of deferred investment tax credits	(85)	(85)
Provision for losses on accounts receivable	383	405
Allowance for other funds used during construction	(843)	(274)
Other, net	(327)	(1,915)
Changes in assets and liabilities:		
Accounts receivable	104	(1,574)
Unbilled revenues	(52)	(32)
Other current assets	274	291
Accounts payable	2,523	3,425
Accrued taxes	(2,007)	2,437
Other current liabilities	(695)	(729)
Net cash provided by operating activities	14,644	16,301
Cash flows from investing activities		
Construction expenditures	(32,230)	(25,103)
Allowance for other funds used during construction	843	274
Removal costs from property, plant and equipment retirements, net of salvage	(363)	(174)
Net cash used in investing activities	(31,750)	(25,003)
Cash flows from financing activities		
Proceeds from issuance of long-term debt	47,000	-
Repayment of long-term debt	(41,100)	-
Debt issuance costs	(458)	-
Net borrowings (repayments) of notes payable-associated companies	12,682	(2,634)
Customer advances and contributions, net of refunds	3,547	5,372
Capital contribution by stockholder	-	8,000
Redemption of preferred stock	-	(3)
Dividends paid	(4,246)	(2,084)
Net cash provided by financing activities	17,425	8,651
Net increase (decrease) in cash and cash equivalents	319	(51)
Cash and cash equivalents at beginning of year	79	130
Cash and cash equivalents at end of year	$ 398	$ 79
Cash paid during the year for:		
Interest, net of capitalized amount	$ 5,115	$ 6,190
Income taxes, net of refunds	$ 3,036	$ 128
Capital Expenditures acquired on account but unpaid as of year end	$ 3,088	$ 4,631

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Capitalization
December 31, 2007 and 2006
(Dollars in thousands, except per share amounts)

	Call Price Per Share	2007	2006
Stockholder's equity			
Common stock - no par value, authorized 2,000,000 shares 1,567,391 shares issued and outstanding in 2007 and 2006		$ 36,569	$ 36,569
Paid-in capital		8,056	8,056
Retained earnings		29,859	28,347
Total common stockholder's equity		74,484	72,972
Preferred stocks - $100 par value			
Cumulative preferred stocks without mandatory redemption requirements:			
5.75% series, 3,918 shares outstanding in 2007 and 2006	$ 101.00	392	392
5.50% series, 4,883 shares outstanding in 2007 and 2006	$ 100.50	488	488
5.00% series, 5,866 shares outstanding in 2007 and 2006	$ 100.00	586	586
		1,466	1,466
Long-term debt			
Preferred stocks - $100 par value			
Cumulative preferred stocks with mandatory redemption requirements:			
8.47% series, 45,000 shares outstanding in 2006, due for redemption 2036	$ 100.00	4,500	4,500
		4,500	4,500
General mortgage bonds			
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
6.87% series due 2011		12,400	15,500
4.75% series redeemed 2007		-	14,000
6.59% series due 2037		47,000	-
		87,400	81,500
Less: Current portion of long-term debt and preferred stock		(3,100)	(27,100)
Long-term debt, net of current maturities		84,300	54,400
Total capitalization		$ 160,250	$ 128,838

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

KENTUCKY-AMERICAN WATER COMPANY
Statements of Changes in Common Stockholder's Equity
For the Years Ended December 31, 2007 and 2006
(Dollars in thousands, except per share amounts)

	Common Stock		Paid-in	Retained	
	Shares	Par Value	Capital	Earnings	Total
Balance at December 31, 2005	1,567,391	$ 36,569	$ 56	$ 27,081	$ 63,706
Net loss	-	-	-	3,350	3,350
Dividends paid					
Preferred stock	-	-	-	(79)	(79)
Common stock, $1.28 per share	-	-	-	(2,005)	(2,005)
Capital contribution by stockholder	-	-	8,000	-	8,000
Balance at December 31, 2006	1,567,391	36,569	8,056	28,347	72,972
Net income	-	-	-	5,758	5,758
Dividends paid					
Preferred stock	-	-	-	(79)	(79)
Common stock, $2.66 per share	-	-	-	(4,167)	(4,167)
Balance at December 31, 2007	1,567,391	$ 36,569	$ 8,056	$ 29,859	$ 74,484

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

Note 1: Organization and Operation

Kentucky-American Water Company (the "Company") provides water service to approximately 117,119 (unaudited) customers and wastewater service to approximately 705 (unaudited) customers. These services are provided in 12 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. ("AWW"). AWW 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 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. The Company considers the carrying value of long-lived assets, including regulatory assets, revenue recognition and accounting for income taxes to be its critical accounting estimates.

Regulation

The Company is subject to regulation by the Commission and the local governments of the state of Kentucky (the "Regulators"). These Regulators have allowed recovery of costs and credits which the Company has recorded as regulatory assets and liabilities. Accounting for future recovery of costs and credits as regulatory assets and liabilities is in accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" ("SFAS 71"). This statement sets forth the application of generally accepted accounting principles for those companies whose rates are established by or are subject to approval by an independent third-party regulator. Under SFAS 71, regulated utilities 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 operations by a non-regulated company. These deferred regulatory assets and liabilities are then reflected in the statement of operations in the period in which the costs and credits are reflected in the rates charged for service.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2007 and 2006
(Dollars in thousands)

Note 2 (continued):

Property, Plant and Equipment

Property, plant and equipment consist primarily of utility plant. 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.

When units of property are replaced, retired or abandoned, the recorded value thereof is credited to the asset account and charged to accumulated depreciation. To the extent the Company recovers cost of removal or other retirement costs through rates, a regulatory asset or liability may occur where timing differences exist between when the Company incurs costs of removal and when the Company recovers such costs in rates. Removal costs, net of salvage, are recorded as reductions to the regulatory liability or an increase to the regulatory asset, as applicable.

The cost of property, plant and equipment is depreciated using the straight-line average remaining life method.

Computer software is either purchased or developed in-house. The purchase price or development costs are capitalized as a unit of property. Software costs totaling $105 and $133 were capitalized during 2007 and 2006, respectively.

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 are amortized to expense over the remaining useful lives of the corresponding purchased plant assets. Amortization of utility plant acquisition adjustments were $21 for 2007 and 2006. The remaining lives range from 4 to 39 years.

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, 2007 or 2006.

Accounts Receivable

The majority of the Company's accounts receivable are due from trade customers. Customer accounts receivable represent amounts billed to the Company's water and wastewater customers on a cycle basis. Credit is extended based on the guidelines of the applicable Regulators and generally, collateral is not required.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2007 and 2006
(Dollars in thousands)

Note 2 (continued):

Allowance for Uncollectible Accounts

Allowances for uncollectible accounts are maintained for estimated probable losses resulting from the Company's inability to collect receivables from customers. Accounts that are outstanding longer than the payment terms are considered past due. A number of factors are considered in determining the allowance for uncollectible accounts, including the length of time receivables are past due and previous loss history. The Company writes-off accounts when they become uncollectible

The following table summarizes the changes in the Company's allowance for uncollectible accounts:

	2007	2006
Balance as of January 1	$ 261	$ 259
Provision charged to expense	383	405
Accounts written-off	(485)	(465)
Recoveries of accounts previously written-off	64	62
Balance as of December 31	$ 223	$ 261

Materials and Supplies

Materials and supplies are stated at the lower of cost or net realizable value. Cost is determined using the average cost method.

Advances and Contributions in Aid of Construction

The Company may receive advances and contributions from customers, home builders, real estate developers, and others to fund construction necessary to extend service to new areas. Advances for construction are refundable for limited periods of time as new customers begin to receive service or other contractual obligations are fulfilled. Advances which are which are no longer refundable are reclassified to contributions in aid of construction. Contributions in aid of construction are permanent collections of plant assets or cash for a particular construction project. For ratemaking purposes, the amount of such advances and contributions generally serves as a rate base reduction, since they represent non-investor supplied funds.

The Company depreciates utility plant funded by contributions and amortizes these amounts as a reduction to amortization expense, producing a result which is functionally equivalent to reducing the original cost of the utility plant for the contributions. For the years ended December 31, 2007 and 2006, cash advances and contributions received were $6,117 and $8,429, and there were no non-cash advances and contributions.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2007 and 2006
(Dollars in thousands)

Note 2 (continued):

Recognition of Revenues

Water and wastewater service revenues are provided and included in 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

AWW and its subsidiaries participate in a consolidated federal income tax return for U.S. tax purposes. Members of the consolidated group are charged with the amount of federal income tax expense determined as if they filed separate returns.

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 projected to reverse. In addition, 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.

The Company accounts for sales tax collected from customers and remitted to taxing authorities on a net basis.

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 or a return on equity funds devoted to plant under construction. AFUDC is recorded to the extent permitted by the Regulators.

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, 2007 and 2006.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2007 and 2006
(Dollars in thousands)

Note 2 (continued):

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 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 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 previously reported data to the current presentation.

Note 3: Utility Plant

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

	Range of Remaining Useful Lives	2007	2006
Land and other non-depreciable assets	-	$ 4,776	$ 4,754
Sources of supply	32 to 67 Years	9,280	9,239
Treatment and pumping	47 to 63 Years	55,123	51,227
Transmission and distribution	23 to 72 Years	174,712	164,283
Services, meters and fire hydrants	38 to 72 Years	73,098	69,233
General structures and equipment	5 to 52 Years	24,813	25,295
Wastewater	5 to 50 Years	3,540	3,501
Construction work in progress	-	21,309	11,763
		366,651	339,295
Less: Accumulated depreciation		(80,435)	(75,828)
		$ 286,216	$ 263,467

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2007 and 2006
(Dollars in thousands)

Note 4: Regulatory Assets

The regulatory assets represent costs that are expected to be fully recovered from customers in future rates. Depending upon Commission approval certain assets are included in the Company's rate base and others are not.

The components of regulatory assets are as follows:

	2007	2006
Income taxes recoverable through rates	$ 2,904	$ 3,611
Bluegrass water project, source of supply	1,884	1,970
Programmed maintenance expense	1,859	1,468
Bluegrass water project, pipeline	1,065	1,391
Rate proceedings expense	486	421
Debt and preferred stock expense	846	463
Other	232	279
	$ 9,276	$ 9,603

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

The Company has recorded a regulatory asset for the Bluegrass water project source of supply costs in the amount of $2,283 to be amortized over a forty year period. Approval was granted per the Commission order dated May 9, 2001.

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 Bluegrass water project pipeline costs in the amount of $3,551 with a ten year amortization period which was approved by the Commission per order dated November 27, 2000.

Expense of rate proceedings is deferred and amortized on a straight-line basis over three years as authorized by the Commission in their determination of rates charged for service.

Note 4 (continued):

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.

Note 5: Preferred Stocks

There are no sinking fund payments through 2012.

Preferred stock agreements contain provisions for redemption at various prices on thirty days notice at the Company's discretion. In the event of voluntary liquidation, the 5.75% series is redeemable at $101.00 per share. The 5.50% series is redeemable at $100.50 per share and the 5.00% series redeemable at $100.00 per share. The 8.47% series is redeemable at $100.00, plus make whole premium. In the event of involuntary liquidation or governmental acquisition, all classes are redeemable at $100 per share. Upon redemption the price must be increased by accrued dividends to the date of redemption.

In 2006, certain shareholders offered shares of preferred stock for sale back to the Company. Six shares of the 5.5% series were purchased.

Note 6: Long-Term Debt

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 limited only to the extent that long-term debt cannot exceed 65% of total capitalization. General mortgage bonds are collateralized by utility plant.

The general mortgage bond indentures 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, 2007 or 2006.

The senior notes payable to affiliate are unsecured and were issued to American Water Capital Corporation ("AWCC"), a subsidiary of AWW, for the principal amount.

The Company issued a long-term notes payable to affiliate in the amount of $47,000 at a rate of 6.59% due in 2037. The proceeds were used to reduce notes payable to associated companies.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2007 and 2006
(Dollars in thousands)

Note 6 (continued):

A note payable issued to AWCC (4.75% due 2014) was redeemed in 2007 by the Company. As agreed with the Regulators, the difference between the book value of the note and the cash consideration required to extinguish it was deferred as a regulatory liability in accordance with FAS 71. The deferred credit recognized of $827 will be amortized as a component of net interest expense through 2014.

The indenture for the 6.87% series note has a sinking fund provision that requires an annual retirement of $3,100 from 2008 through 2010.

Maturities of long-term debt will amount to $3,100 in 2011. There are no maturities in 2008 through 2010 and 2012.

Note 7: Short-term Borrowings

The Company maintains a line of credit through AWCC for $74,000. The line was increased by $62,000 in 2007 per an amendment to the agreement with AWCC. The Company may borrow from, or invest in, the line of credit. No compensating balances are required under the agreements.

At December 31, 2007 and 2006, there were $19,356 and $6,674 of short-term borrowings outstanding, respectively. The weighted average annual interest rates on these balances were 5.64% and 6.07% in 2007 and 2006, respectively. The unused short-term line of credit at December 31, 2007 was $54,644.

During 2006, the Company received a capital contribution of $8,000 from AWW, primarily used to pay down short-term debt.

Note 8: General Taxes

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

	2007	2006
Property	$ 2,519	$ 2,377
Payroll	533	480
Other	5	3
	$ 3,057	$ 2,860

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2007 and 2006
(Dollars in thousands)

Note 9: Income Taxes

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

	2007	2006
State income taxes:		
Current	$ 703	$ 120
Deferred		
Current	3	22
Non-current	(83)	293
	623	435
Federal income taxes:		
Current	2,687	1,061
Deferred		
Current	14	106
Non-current	826	913
Amortization of deferred investment tax credits	(85)	(85)
	3,442	1,995
Total income taxes	$ 4,065	$ 2,430

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

	2007	2006
Federal income tax at statutory rate of 35%	$ 3,438	$ 2,023
Increases (decreases) resulting from -		
State taxes, net of federal income taxes	405	283
Flow through difference	139	121
Amortization of investment tax credits	(85)	(85)
Other, net	168	88
	$ 4,065	$ 2,430

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2007 and 2006
(Dollars in thousands)

Note 9 (continued):

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

	2007	2006
Deferred tax assets:		
Advances and contributions	$ 22,284	$ 21,923
Deferred investment tax credits	474	506
Other	2,280	915
	25,038	23,344
Deferred tax liabilities:		
Utility plant, principally due to depreciation differences	57,412	54,993
Income taxes recoverable through rates	56	432
Other	3,107	3,087
	60,575	58,512
Net deferred tax liability	$ 35,537	$ 35,168

No valuation allowances were required on deferred tax assets at December 31, 2007 and 2006 as management believes it is more likely than not that these assets will be realized.

Note 10: Rate Matters

As necessary, the Company applies to the Commission for changes in the rates charged for service. The revenues requested are based on forecasted sales, operating expenses, and investments for the first full year after the effective dates of the new rates.

The Company filed a general rate case on April 30, 2007 seeking an increase in rates of $13,188 or 26.02%. On September 14, 2007, a settlement agreement was executed by the Company and the other parties recommending an increase in rates of $8,000 or 15.64%. On November 29, 2007, the Commission issued its Order approving the settlement agreement with an effective date of December 1, 2007.

Note 11: Employee Benefit Plans

Savings Plan for Employees

The Company maintains a 401(k) savings plan that allows employees to save for retirement on a tax-deferred basis. Employees can make contributions that are invested at their direction in one or more funds. The Company makes matching contributions based on a percentage of an employee's contribution, subject to certain limitations. Due to the Company's discontinuing new entrants into the defined benefit pension plan, on January 1, 2006 the Company began providing an additional 5.25% of base pay defined contribution benefit for union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006. The Company expensed contributions to the plans totaling $154 for 2007, $79 for 2006 and $107 for 2005. All of the Company's contributions are invested in one or more funds at the direction of the employee.

Note 12: Postretirement Benefits

Pension Benefits

The Company participates in a Company funded defined benefit pension plan sponsored by AWW covering employees hired before January 1, 2006. Benefits under the plan are based on the employee's years of service and average annual compensation for those 60 consecutive months of employment which yield the highest average. The pension plan has been closed for any employee hired on or after January 1, 2006. Union employees hired on or after January 1, 2001 had their accrued benefit frozen and will be able to receive this benefit as a lump sum upon termination or retirement. Union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006 are provided with a 5.25% of base pay defined contribution plan. Pension cost of the Company is based on an allocation from AWW of the total cost related to the plan. Information regarding accumulated and projected benefit obligations is not prepared at the subsidiary level. The Company was allocated costs of $721 and $774 for 2007 and 2006, respectively.

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 AWW plan of $929 in 2007 and $1,358 in 2006.

(Dollars in thousands)

Note 12 (continued):

Postretirement Benefits Other Than Pensions

The Company participates in an AWW plan that provides certain life insurance benefits for retired employees and certain health care benefits for retired employees and their dependents. The retiree welfare plans are closed for union employees hired on or after January 1, 2006, and non-union employees hired on or after January 1, 1002. Retirees and their dependents under age 65 are covered by a point-of-service managed care plan that requires co-payments or an HMO. Employees 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 AWW of the total cost related to the plan. Information regarding accumulated and projected benefit obligations is not prepared at the subsidiary level. The Company was allocated costs of $758 and $855 for 2007 and 2006, respectively.

Costs of the Company are based on an allocation from AWW of the total cost related to the plan. 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 $716 in 2007 and $812 in 2006. The Company's policy is to fund postretirement benefits costs accrued.

Note 13: Related Party Transactions

American Water Works Service Company, Inc. ("AWWS"), a subsidiary of AWW, provides certain management services to the Company (administration, accounting, data processing, engineering, etc.) and other operating water companies in the AWW 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:

	2007	2006
Included in operation and maintenance expense as a charge against income	$ 7,528	$ 7,556
Capitalized primarily in utility plant	653	545
	$ 8,181	$ 8,101

The Company provided workspace for certain associates 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 $15 in 2007 and $23 in 2006.

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2007 and 2006
(Dollars in thousands)

Note 13 (continued):

The Company has operating arrangements with American Anglian Environmental Technologies, L.P. ("AAET"), a subsidiary of AWW, for the lease of granular activated carbon at one of the Company's water treatment plants. Under the arrangements, AAET will provide carbon for a period of 36 months. The Company paid $111 in 2007 and $100 in 2006 to AAET under these arrangements.

The Company maintains a line of credit through AWCC (See Note 7). The Company paid AWCC fees of $93 in 2007 and $24 in 2006 and interest on borrowings of $1,288 in 2007 and $406 in 2006. Interest expense on long-term debt due to AWCC was $2,639 in 2007 and $3,083 in 2006.

Note 14: 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 amounts reported in the balance sheet for current assets and current liabilities approximate 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:

	2007		2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Preferred stock with mandatory redemption requirements, including current maturities	$ 4,500	$ 4,566	$ 4,500	$ 5,795
Long-term debt, including current maturities	$ 82,900	$ 84,147	$ 77,000	$ 80,170

KENTUCKY-AMERICAN WATER COMPANY
Notes to Financial Statements
December 31, 2007 and 2006
(Dollars in thousands)

Note 15: Operating Lease

The Company has entered into operating leases involving certain facilities and equipment. Rental expenses under operating leases were $60 in 2007 and $28 in 2006. The operating leases for equipment expire in 2008, 2009 and 2010.

At December 31, 2007, the minimum annual future rental commitments under operating leases that have initial or remaining non-cancelable lease terms in excess of one year are $137 in 2008, $89 in 2009, $46 in 2010, $1 in 2011, $1 in 2012 and $1 annually, thereafter.

Note 16: Commitments and Contingencies

Commitments have been made in connection with certain construction programs.

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