ARTESIAN RESOURCES CORP
Form 10-Q
August 09, 2011

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

FORM 10-Q

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

For the quarterly period ended June 30, 2011

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 000-18516

ARTESIAN RESOURCES CORPORATION
(Exact name of registrant as specified in its charter)

| Delaware | 51-0002090 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |

664 Churchmans Road, Newark, Delaware 19702
Address of principal executive offices

(302) 453 – 6900
Registrant's telephone number, including area code

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

þYes oNo

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

þYes oNo

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

| Large Accelerated Filer | Accelerated Filer | Non-Accelerated Filer | Smaller Reporting |
|---|---|---|---|
| o | þ | o | Company o |

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

oYes þNo

As of August X, 2011, 7,599,405 shares of Class A Non-Voting Common Stock and 881,452 shares of Class B Common Stock were outstanding.

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FORM 10-Q

PART I – FINANCIAL INFORMATION
ITEM 1 – FINANCIAL STATEMENTS

ARTESIAN RESOURCES CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
Unaudited
(In thousands)

| ASSETS | June 30, 2011 | December 31, 2010 |
|---|---|---|
| Utility plant, at original cost less accumulated depreciation | $348,251 | $345,383 |
| Current assets | | |
| Cash and cash equivalents | 188 | 179 |
| Accounts receivable (less allowance for doubtful accounts 2011 - $228; 2010-$230) | 4,409 | 5,094 |
| Unbilled operating revenues | 4,374 | 3,614 |
| Materials and supplies | 1,360 | 1,246 |
| Prepaid property taxes | 3 | 1,260 |
| Prepaid expenses and other | 1,005 | 2,640 |
| Total current assets | 11,339 | 14,033 |
| Other assets | | |
| Non-utility property (less accumulated depreciation 2011-$357; 2010-$377) | 4,268 | 4,480 |
| Other deferred assets | 5,310 | 5,023 |
| Total other assets | 9,578 | 9,503 |
| Regulatory assets, net | 2,645 | 2,610 |
| | $371,813 | $371,529 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Stockholders' equity | | |
| Common stock | $7,675 | $7,637 |
| Preferred stock | --- | --- |
| Additional paid-in capital | 70,651 | 69,989 |
| Retained earnings | 17,379 | 17,520 |
| Total stockholders' equity | 95,705 | 95,146 |
| Long-term debt, net of current portion | 106,729 | 105,061 |
| | 202,434 | 200,207 |
| Current liabilities | | |
| Lines of credit | 25,632 | 29,071 |
| Overdraft payable | 425 | 740 |
| Current portion of long-term debt | 1,653 | 1,545 |
| Accounts payable | 2,636 | 3,401 |
| Accrued expenses | 2,847 | 2,126 |
| Deferred income taxes | --- | 459 |
| Accrued interest | 1,215 | 1,189 |
| Customer deposits | 907 | 805 |
| Other | 2,938 | 2,549 |
| Total current liabilities | 38,253 | 41,885 |
| | | |
| Commitments and contingencies | --- | --- |
| | | |
| Deferred credits and other liabilities | | |

| | | |
|---|---|---|
| Net advances for construction | 15,832 | 16,159 |
| Postretirement benefit obligation | 418 | 525 |
| Deferred investment tax credits | 653 | 664 |
| Deferred income taxes | 39,261 | 37,558 |
| Total deferred credits and other liabilities | 56,164 | 54,906 |
| | | |
| Net contributions in aid of construction | 74,962 | 74,531 |
| | $371,813 | $371,529 |

See notes to the condensed consolidated financial statements.

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ARTESIAN RESOURCES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND
CONDENSED CONSOLIDATED STATEMENTS OF RETAINED EARNINGS
Unaudited
(In thousands, except per share amounts)

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Operating revenues | | | | |
| Water sales | $14,683 | $13,909 | $27,598 | $26,804 |
| Other utility operating revenue | 711 | 714 | 1,458 | 1,333 |
| Non-utility revenue | 1,116 | 1,380 | 2,211 | 2,850 |
| | 16,510 | 16,003 | 31,267 | 30,987 |
| Operating expenses | | | | |
| Utility operating expenses | 8,136 | 7,466 | 16,214 | 14,834 |
| Non-utility operating expenses | 775 | 958 | 1,715 | 1,976 |
| Depreciation and amortization | 1,823 | 1,723 | 3,633 | 3,454 |
| State and federal income taxes | 1,260 | 1,209 | 1,954 | 2,326 |
| Property and other taxes | 928 | 1,027 | 1,944 | 1,990 |
| | 12,922 | 12,383 | 25,460 | 24,580 |
| Operating income | 3,588 | 3,620 | 5,807 | 6,407 |
| Other income (expense), net | | | | |
| Allowance for funds used during construction | 38 | 24 | 73 | 67 |
| Miscellaneous | (25) | (44) | 572 | 567 |
| Income before interest charges | 3,601 | 3,600 | 6,452 | 7,041 |
| Interest charges | 1,848 | 1,802 | 3,690 | 3,597 |
| Net income | $1,753 | $1,798 | $2,762 | $3,444 |
| Retained earnings, beginning of period | $17,084 | $15,817 | $17,520 | $15,577 |
| Less dividends | (1,458) | (1,415) | (2,903) | (2,821) |
| Retained earnings, end of period | $17,379 | $16,200 | $17,379 | $16,200 |
| Income per common share: | | | | |
| Basic | $0.23 | $0.24 | $0.36 | $0.46 |
| Diluted | $0.23 | $0.24 | $0.36 | $0.45 |
| Weighted average common shares outstanding | | | | |

| | | | | |
|---|---|---|---|---|
| Basic | 7,672 | 7,539 | 7,662 | 7,526 |
| Diluted | 7,714 | 7,607 | 7,706 | 7,595 |
| | | | | |
| Cash dividend per common share | $0.1902 | $0.1882 | $0.3794 | $0.3755 |

See notes to the condensed consolidated financial statements.

ARTESIAN RESOURCES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
Unaudited
(In thousands)

| | For the Six Months Ended June 30 | |
|---|---|---|
| | 2011 | 2010 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $2,762 | $3,444 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 3,633 | 3,454 |
| Deferred income taxes, net | 1,233 | 1,014 |
| Stock compensation | 62 | 48 |
| AFUDC | (73) | (67) |
| | | |
| Changes in assets and liabilities: | | |
| Accounts receivable, net of allowance for doubtful accounts | 685 | 926 |
| Unbilled operating revenues | (760) | (533) |
| Materials and supplies | (114) | (75) |
| Prepaid property taxes | 1,257 | 1,219 |
| Prepaid expenses and other | 1,635 | 448 |
| Other deferred assets | (239) | (213) |
| Regulatory assets | (35) | 90 |
| Accounts payable | (765) | (1,267) |
| Accrued expenses | 721 | 405 |
| Accrued interest | 26 | (154) |
| Customer deposits and other, net | 491 | 1,306 |
| Postretirement benefit obligation | (107) | (34) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 10,412 | 10,011 |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Capital expenditures (net of AFUDC) | (6,560) | (6,266) |
| Proceeds from sale of assets | 30 | 35 |
| NET CASH USED IN INVESTING ACTIVITIES | (6,530) | (6,231) |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Net repayments under lines of credit agreements | (3,439) | (2,404) |
| (Decrease) increase in overdraft payable | (315) | 189 |
| Net advances and contributions in aid of construction | 447 | 1,128 |
| Change in deferred debt issuance costs | 58 | (2) |
| Net proceeds from issuance of common stock | 638 | 673 |
| Equity issuance costs | (135) | --- |
| Dividends paid | (2,903) | (2,821) |
| Issuance of long-term debt | 2,837 | --- |
| Principal repayments of long-term debt | (1,061) | (473) |
| NET CASH USED IN FINANCING ACTIVITIES | (3,873) | (3,710) |

| | | |
|---|---|---|
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 9 | 70 |
| | | |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | 179 | 474 |
| | | |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $188 | $544 |
| | | |
| Supplemental Disclosures of Cash Flow Information: | | |
| Utility plant received as construction advances and contributions | $382 | $281 |
| Interest paid | $3,664 | $3,751 |
| Income taxes paid | $--- | $--- |

See notes to the condensed consolidated financial statements.

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – GENERAL

Artesian Resources Corporation, or Artesian Resources, includes income from the earnings of our eight wholly owned subsidiaries and the income derived from our Service Line Protection Plans described below. The terms "we", "our", "Artesian" and the "Company" as used herein refer to Artesian Resources and its subsidiaries. The variable interest entity previously required to be consolidated under guidance from the Financial Accounting Standards Board, or FASB, is no longer consolidated as of August 6, 2010, as further discussed in Note 2 below.

DELAWARE REGULATED SUBSIDIARIES

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

Artesian Wastewater Management, Inc., or Artesian Wastewater, is a regulated entity that owns wastewater collection and treatment infrastructure and provides wastewater services to customers in Delaware as a regulated public wastewater service company. Artesian Wastewater currently owns and operates five wastewater treatment facilities, which are capable of treating approximately 750,000 gallons per day and can be expanded to treat approximately 1.6 million gallons per day, or mgd.

The preliminary engineering and design work was completed on a regional wastewater treatment and disposal facility located in the northern Sussex County area that has the potential to treat up to approximately 8 mgd. This facility is strategically situated to provide service to the growing population in the Georgetown, Ellendale and Milton areas, as well as to neighboring municipal systems. This facility was granted conditional use approval by Sussex County Council to serve the Elizabethtown subdivision of approximately 4,000 homes and 439,000 square feet of proposed commercial space, as well as seven additional projects comprising approximately 3,000 residential units. The facility will also be capable of offering wastewater services to local municipalities. The agreement signed on June 30, 2008 (and as amended on April 29, 2009) between Artesian Utility Development, Inc., or Artesian Utility, and Northern Sussex Regional Water Recycling Complex, LLC, or NSRWRC, for the design, construction and operation of this facility was cancelled on August 6, 2010. Artesian Wastewater will manage the design and construction of the facility going forward and, once completed, the operation of the facility.

In July 2008, Artesian Wastewater and the Town of Georgetown, or Georgetown, finalized a wastewater service agreement establishing a long term arrangement that will meet the future wastewater treatment and disposal needs in Georgetown's growth and annexation areas. Artesian Wastewater will provide up to 1 mgd of wastewater capacity for the town.

MARYLAND REGULATED SUBSIDIARIES

Artesian Water Maryland, Inc., or Artesian Water Maryland, began operations in August 2007 with the acquisition of the Carpenters Point Water Company, which includes a 141 home community in Cecil County near the Interstate 95 growth corridor between Philadelphia and Baltimore and which has sufficient groundwater supply and elevated water storage to serve additional customers in the undeveloped portions of its franchise and surrounding area. The Mountain Hill Water Company was acquired in August 2008, which includes service rights to 8,000 acres of undeveloped land in Cecil County's growth area. Included in this Mountain Hill Service Area is the Principio Business Park, as well as the proposed 660 home residential development of Charlestown Crossing. We currently serve three commercial accounts in the Principio Business Park. On June 4, 2009, the Maryland Public Service Commission, or MDPSC, approved installation of a water main to serve residents of Whitaker Woods, an existing 172 home development located adjacent to the Mountain Hill Service Area. As of June 30, 2011, 38 homes in Whitaker Woods were receiving water service. On September 9, 2009, the MDPSC approved Artesian Water Maryland's request to construct a water system to serve the first phase, consisting of 71 homes, in the Charlestown Crossing housing development.

In November 2010, Artesian Water Maryland purchased water assets from the Town of Port Deposit, or Port Deposit, which includes access to the Susquehanna River as a source of water supply and water service rights for the service area that encompasses Port Deposit's existing 280 customers and several adjacent tracts of land including the Bainbridge property, a 1,200-acre former U.S. Navy facility, which has the potential to be developed for 2,800 residential homes as well as office, commercial, and educational uses. Artesian Water Maryland purchased all of the assets used in providing potable water, water distribution and water meter services, or the Facilities, from Port Deposit. Port Deposit transferred to Artesian Water Maryland all of Port Deposit's right, title and interest in and to all of the plant and equipment, associated real property, contracts and permits possessed by Port Deposit related to the operation of the Facilities as well as the water distribution, treatment and water meter systems possessed by Port Deposit or used in the operation of the Facilities. Port Deposit also transferred to Artesian Water Maryland all rights to serve the customers within Port Deposit (which shall include Port Deposit as it currently exists as well as certain additional growth areas that may be added to Port Deposit in the future) and all rights to be served by all vendors and suppliers of Port Deposit. Port Deposit shall collect and remit to Artesian Water Maryland its tariff connection charges as approved by the MDPSC for new connections to the water system within Port Deposit. The MDPSC approved this transaction on July 28, 2010, including the exercise of franchise agreements granted by Port Deposit and Cecil County, Maryland. The existing water system consists of a water treatment facility, an existing 700,000 gallon per day Susquehanna River Water Appropriation Permit, a 500,000-gallon ground storage tank and water mains.

In addition, Artesian Water Maryland has entered into the following agreement to further expand our service capabilities: In October 2008, Artesian Water Maryland signed an agreement, or the Cecil County Purchase Agreement, to purchase from Cecil County all of Cecil County's rights, title and interest in and to the Meadowview, Pine Hills, Harbourview and Route 7 water facilities and the associated parcels of real property, easement rights and water transmission and distribution systems at a price equal to the net asset value of the purchased assets, which was approximately $2.2 million as of June 30, 2008, and assume certain liabilities at closing. This sum may be paid in cash at closing or, upon mutual agreement, by a note payable to Cecil County. In response to the Cecil County Purchase Agreement, the Appleton Regional Community Alliance, or Appleton Alliance, filed a petition with The Circuit Court of Cecil County, Maryland, or Circuit Court, in opposition to the transactions on the grounds that Cecil County has no right to sell the assets involved in the transaction, which has delayed the closing. The Circuit Court decided in favor of Cecil County on July 24, 2009. On August 19, 2009, the Appleton Alliance filed an appeal of the Circuit Court's decision with the Maryland Court of Special Appeals. Upon the request of Cecil County, which was not opposed by the Appleton Alliance, the matter was moved to the state's highest Court of Appeals, where it was heard on June 2, 2010. The Court of Appeals issued a decision on June 21, 2011, holding that Maryland law does not prohibit Cecil County from entering into the Cecil County Purchase Agreement with Artesian Water Maryland. The decision enables Artesian Water Maryland to proceed with consummating the transaction contemplated by the Cecil County Purchase Agreement. The closing remains subject to receipt of approval of the transaction by the MDPSC. The Cecil County Purchase Agreement may be terminated by either party, subject to certain exceptions, in the event of uncured breach by the other party. Upon the mutual agreement of the parties, the closing date has been extended to the final day of the sixth month following the final judicial determination by the Maryland Court of Appeals on the Appleton Alliance petition. The closing is expected to occur on or before December 31, 2011.

Artesian Wastewater Maryland, Inc., or Artesian Wastewater Maryland, was incorporated on June 3, 2008 specifically for the purpose of executing the purchase agreements described below in order to provide regulated wastewater services in the State of Maryland.

In October 2008, Artesian Wastewater Maryland signed an agreement, or the Meadowview Agreement, to purchase the Meadowview Wastewater Facility and the Highlands Wastewater Facility and the associated parcels of real property, easement rights and wastewater collection systems with respect to each facility from Cecil County at a price equal to the net asset value of the purchased assets, which was approximately $7.8 million as of June 30, 2008, and assume certain liabilities at closing. The majority of the purchase price shall be paid by Artesian Wastewater Maryland's assumption of $7.2 million due by Cecil County under a tax-exempt Cecil County Sanitary District Bond, Series 2004B, or the Bond. In the event that the net asset value of the purchased assets as of the closing exceeds the amount due under the Bond, then the positive difference (if any) shall be paid by Artesian Wastewater Maryland to Cecil County in cash at closing or, upon mutual agreement, by a note payable to Cecil County.

In October 2008, Artesian Wastewater Maryland signed an agreement, or the Cherry Hill Agreement, to purchase the Cherry Hill Wastewater Facility and the Harbourview Wastewater Facility and the associated parcels of real property, easement rights and wastewater collection systems with respect to each facility from Cecil County at a price equal to the net asset value of the purchased assets, which was approximately $3.8 million as of June 30, 2008, and assume certain liabilities at closing. Cecil County shall immediately upon receipt of such payment, pay to its creditors an amount sufficient to pay all indebtedness of Cecil County in respect of the Cherry Hill and Harbourview Wastewater facilities, or the Indebtedness. If the amount of the purchase price under the Cherry Hill Agreement is less than the Indebtedness, Cecil County will pay out of its own funds any amount sufficient to discharge in full the Indebtedness in excess of the purchase price. If the purchase price exceeds the amount of Indebtedness, the positive difference will be paid by Artesian Wastewater Maryland and may be financed through a note payable to Cecil County.

The Meadowview Agreement and the Cherry Hill Agreement are also subject to the petition filed by the Appleton Alliance described in the Artesian Water Maryland section above. As a result, closing had been delayed until the final judicial determination on the Appleton Alliance petition. The Court of Appeals issued a decision on June 21, 2011, holding that Maryland law does not prohibit Cecil County from entering into the Meadowview Agreement and Cherry Hill Agreement with Artesian Wastewater Maryland. The decision enables Artesian Wastewater Maryland to proceed with consummating the transactions contemplated by the Meadowview Agreement and Cherry Hill Agreement. Closing on these transactions remains subject to receipt of approval of the transactions by the MDPSC. Under each of the agreements, either party may terminate such agreement, subject to certain exceptions, in the event of uncured breach by the other party. Upon the mutual agreement of the parties, the closing date has been extended to the final day of the sixth month following the final judicial determination by the Maryland Court of Appeals on the Appleton Alliance petition. The closing is expected to occur on or before December 31, 2011.

PENNSYLVANIA REGULATED SUBSIDIARY

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

OTHER SUBSIDIARIES

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

Artesian Utility was formed in 1996. It designs and builds water and wastewater infrastructure and provides contract water and wastewater services on the Delmarva Peninsula. Artesian Utility also evaluates land parcels, provides recommendations to developers on the size of water or wastewater facilities and the type of technology that should be used for treatment at such facilities, and operates water and wastewater facilities in Delaware and Maryland for municipal and governmental organizations. Artesian Utility also has several contracts with developers for design and construction of wastewater facilities within the Delmarva Peninsula, using a number of different technologies for treatment of wastewater at each facility.

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

One of the wastewater treatment facilities in Middletown now provides reclaimed wastewater for use in spray irrigation on public and agricultural lands in the area. Our relationship with the Town of Middletown has given us the opportunity to create the Artesian Water Resource Management Partnership, or AWRMP, to encourage and support the use of reclaimed water for agricultural irrigation and other needs. Using reclaimed water to irrigate farm fields can save the Delmarva region millions of gallons of groundwater each day. The AWRMP's first project in Middletown will save up to 3 million gallons of water per day during the peak growing season. Through the AWRMP initiative, Artesian will provide planning, engineering and technical expertise and help bring together the various state, local and private partners needed for water recycling project approvals.

The agreement signed on June 30, 2008 (and as amended April 29, 2009) between Artesian Utility and NSRWRC for the design, construction and operation of the Northern Sussex Regional Water Recycling Complex, a wastewater treatment facility to be located in Sussex County, Delaware, was cancelled on August 6, 2010. Artesian Wastewater will manage the design and construction of the facility going forward and, once constructed, the operation of the facility.

In connection with the Meadowview Agreement and the Cherry Hill Agreement described above under Artesian Wastewater Maryland, in March 2009, Artesian Utility signed an agreement with the Cecil County Department of Public Works in Cecil County, Maryland to operate the Meadowview Wastewater and Highlands Wastewater treatment and disposal facilities until Artesian Wastewater Maryland's purchase of the facilities is final. This agreement also employs Artesian Utility to operate two water supply and treatment stations and two booster stations in Cecil County. In June 2011, Artesian Utility received a notice of termination of the operation agreement for these facilities from Cecil County effective October 31, 2011. Artesian Wastewater Maryland's purchase of the facilities is expected to be final on or before December 31, 2011.

Artesian Development owns an approximately six-acre parcel of land zoned for office buildings located immediately adjacent to our corporate headquarters and two nine-acre parcels of land located in Sussex County.

In October 2010, Artesian Development purchased an office facility located in Sussex County, Delaware. The facility consists of approximately 10,000 square feet of office space along with nearly 10,000 square feet of warehouse space. This facility has allowed all of our Sussex County, Delaware operations to be housed in one central location.

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

OTHER

Artesian Resources initiated a Water Service Line Protection Plan, or WSLP Plan, in March 2005. The WSLP Plan covers all parts, material and labor required to repair or replace participating customers' leaking water service lines up to an annual limit. As of June 30, 2011, approximately 16,300, or 23.6%, of our eligible water customers had signed up for the WSLP Plan. The WSLP Plan was expanded in the second quarter of 2008 to include maintenance or repair to customers' sewer lines. This plan, the Sewer Service Line Protection Plan, or SSLP Plan, covers all parts, material and labor required to repair or replace participating customers' leaking or clogged sewer lines up to an annual limit. As of June 30, 2011, approximately 8,800, or 12.8%, of our eligible customers had signed up for the SSLP Plan. Also, in the second quarter of 2010, the WSLP Plan and SSLP Plan were extended to include non-customers of Artesian Resources. As of June 30, 2011, approximately 740 non-customer participants have signed up for either the WSLP Plan or SSLP Plan.

NOTE 2 – BASIS OF PRESENTATION

The unaudited condensed consolidated financial statements are presented in accordance with the requirements of Form 10-Q and consequently do not include all the disclosures required in the financial statements included in the Company's annual report on Form 10-K. Accordingly, these financial statements and related notes should be read in conjunction with the financial statements and related notes in the Company's annual report on Form 10-K for fiscal year 2010 as filed with the Securities and Exchange Commission on March 15, 2011.

The condensed consolidated financial statements include the accounts of Artesian Resources Corporation and its wholly-owned subsidiaries, including its principal operating company, Artesian Water. In the opinion of the Company, the accompanying unaudited condensed consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the Company's balance sheet position as of June 30, 2011, the results of operations for the quarterly and six month periods ended June 30, 2011 and 2010 and cash flows for the six month periods ended June 30, 2011 and 2010.

As more fully discussed in Note 9 - Northern Sussex Regional Water Recycling Complex, LLC, Artesian Resources and Darin A. Lockwood, the owner of NSRWRC, signed a Conclusion and Termination Agreement on August 6, 2010. Consequently, effective August 6, 2010, NSRWRC was deconsolidated from the Company's consolidated financial statements. The Company is no longer the primary beneficiary of NSRWRC and NSRWRC no longer constitutes a variable interest entity, or VIE, as defined by FASB Accounting Standards Codification, or ASC, Topic 810.

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

NOTE 3 – STOCK COMPENSATION PLANS

On May 25, 2005, the Company's stockholders approved a new Equity Compensation Plan, which authorizes up to 500,000 shares of Class A Non-Voting Common Stock, or Class A Stock, for issuance, referred to as the 2005 Equity Compensation Plan, or the Plan. Since May 25, 2005, no additional grants have been made under the Company's other stock-based compensation plans that were previously available. The Company accounts for stock options issued after January 1, 2006 under FASB ASC Topic 718. For the three and six months ended June 30, 2011, compensation expense of approximately $31,000 and $62,000 was recorded for stock options granted in May 2011 and May 2010. Approximately $27,000 and $48,000 in compensation expense was recorded during the three and six months ended June 30, 2010 for stock options issued in May 2010 and May 2009. Costs were determined based on the fair value at the grant dates and those costs are being charged to income over the service period associated with the grants.

The fair value of each option grant is estimated using the Black-Scholes-Merton option pricing model with the following weighted-average assumptions used for grants issued in 2011 and 2010. All options were granted at market value with a 10-year option term with a vesting period of one year from the date of grant.

| | 2011 | | 2010 | |
|---|---|---|---|---|
| Expected Dividend Yield | 3.99 | % | 4.24 | % |
| Expected Stock Price Volatility | 0.25 | | 0.27 | |
| Weighted Average Risk-Free Interest Rate | 3.12 | % | 3.38 | % |
| Weighted Average Expected Life of Options (in years) | 8.36 | | 8.97 | |

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

The following summary reflects changes in the shares of Class A Non-Voting Common Stock under option:

| | Option Shares | | Weighted Average Exercise Price | Weighted Average Remaining Life (Yrs.) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|---|
| Plan options | | | | | |
| Outstanding at January 1, 2011 | 440,800 | | $17.18 | | |
| Granted | 33,750 | | 19.06 | | |
| Exercised | (15,050 | ) | 11.54 | | |

| | | | | |
|---|---|---|---|---|
| Expired | --- | | | |
| Outstanding at June 30, 2011 | 459,500 | $17.50 | 4.93 | $622 |
| | | | | |
| Options exercisable at June 30, 2011 | 425,750 | $17.38 | 4.54 | $622 |

The total intrinsic value of options exercised during the six months ended June 30, 2011 was approximately $111,000.

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

| Non-vested Shares | Option Shares | Weighted Average Grant – Date Fair Value Per Option |
|---|---|---|
| Non-vested at January 1, 2011 | 33,750 | $3.73 |
| Granted | 33,750 | 3.50 |
| Vested | (33,750) | 3.73 |
| Canceled | --- | --- |
| Non-vested at June 30, 2011 | 33,750 | $3.50 |

As of June 30, 2011, there was $103,000 of total unrecognized expense related to non-vested option shares granted under the Plan. The cost will be recognized over the remaining 0.88 year vesting period of the unvested options.

NOTE 4 - REGULATORY ASSETS

FASB ASC Topic 980 stipulates generally accepted accounting principles for companies whose rates are established or subject to approvals by a third-party regulatory agency. Certain expenses are recoverable through rates charged to our customers, without a return on investment, and are deferred and amortized during future periods using various methods as permitted by the Delaware Public Service Commission, or DEPSC, the MDPSC and the PAPUC. Depreciation and salary study expenses are amortized on a straight-line basis over a period of five years, while all other expenses related to rate proceedings and applications to increase rates are amortized on a straight-line basis over a period of two years. The postretirement benefit obligation, which is being amortized over twenty years, is adjusted for the difference between the net periodic postretirement benefit costs and the cash payments. The amount recognized in the consolidated financial statements is determined on an actuarial basis, which uses assumptions about inflation, mortality, medical trend rates and discount rates. The deferred income taxes will be amortized over future years as the tax effects of temporary differences previously flowed through to the customers reverse. Goodwill is entirely associated with the acquisition of Mountain Hill in August 2008 and is currently being amortized on a straight-line basis over a period of fifty years. The purchase price of Mountain Hill included reimbursement of all carrying costs through the date of acquisition, which resulted in the recognition of goodwill. Deferred acquisition costs are the result of due diligence costs related to the proposed purchase agreements for water and wastewater facilities in Cecil County, Maryland and the November 2010 purchase of the Port Deposit, Maryland water assets. Amortization of these deferred acquisition costs begin once the acquired assets are placed into service.

Regulatory assets, net of amortization, comprise:

| | Unaudited (in thousands) | |
|---|---|---|
| | June 30, 2011 | December 31, 2010 |
| Postretirement benefit obligation | $530 | $637 |
| Deferred income taxes recoverable in future rates | 514 | 521 |
| Goodwill | 352 | 355 |
| Deferred acquisition costs | 1,018 | 1,009 |
| Expense of rate and regulatory proceedings | 231 | 88 |
| | $2,645 | $2,610 |

Expenses related to the Net Periodic Pension Cost for the postretirement benefit obligation are as follows:

| For the Six Months Ended June 30, | Unaudited (in thousands) | |
|---|---|---|
| | 2011 | 2010 |
| Net Periodic Pension Cost | | |
| Interest cost | $17 | $22 |
| Amortization of net loss (gain) | 7 | (2) |
| Amortization of transition obligation | 4 | 4 |
| Total Net Periodic Benefit Cost | $28 | $24 |

Contributions

Artesian Water contributed $54,000 to its postretirement benefit plan in the first six months of 2011. These contributions consist of insurance premium payments for medical, dental and life insurance benefits made on behalf of the Company's eligible retired employees.

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

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

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| | (in thousands) | | (in thousands) | |
| Average common shares outstanding during the period for Basic computation | 7,672 | 7,539 | 7,662 | 7,526 |
| Dilutive effect of employee stock options | 43 | 68 | 44 | 69 |
| Average common shares outstanding during the period for Diluted computation | 7,714 | 7,607 | 7,706 | 7,595 |

For the three and six months ended June 30, 2011, employee stock options to purchase 200,250 and 234,000 shares of common stock were excluded from the calculations of diluted net income per share as the calculated proceeds from the options' exercise were greater than the average market price of the Company's common stock during this period.

The Company has 15,000,000 authorized shares of Class A Non-Voting Common Stock, or Class A Stock, and 1,040,000 authorized shares of Class B Common Stock, or Class B Stock. As of June 30, 2011, 6,793,856 shares of Class A Stock and 881,452 shares of Class B Stock were issued and outstanding. As of June 30, 2010, 6,671,040 shares of Class A Stock and 881,452 shares of Class B Stock were issued and outstanding. The par value for both classes is $1.00 per share. For the three months ended June 30, 2011 and June 30, 2010 the Company issued 10,045 and 35,377 shares of Class A Stock, respectively. For the six months ended June 30, 2011 and June 30, 2010, the Company issued 38,202 and 45,262 shares of Class A Stock, respectively.

Equity per common share was $12.50 and $12.59 at June 30, 2011 and December 31, 2010, respectively. These amounts were computed by dividing common stockholders' equity by the number of shares of common stock outstanding on June 30, 2011 and December 31, 2010, respectively.

NOTE 6 - REGULATORY PROCEEDINGS

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

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

Rate Proceedings

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

On April 11, 2011, Artesian Water filed a request with the DEPSC to implement new rates to meet a requested increase in revenue of 19.45%, or approximately $10.9 million, on an annualized basis. The new rates are designed to support Artesian Water’s ongoing capital improvement program and to cover increased costs of operations, including chemicals and fuel, electricity, taxes, labor and benefits. Artesian Water’s last request to implement new rates was filed in April 2008. As permitted by law, on June 10, 2011, we placed temporary rates into effect designed to generate an increase in annual operating revenue of approximately 4.45%, or $2.5 million on an annualized basis, until new rates are approved by the DEPSC.

On December 29, 2010, Artesian Water Maryland filed an application with the MDPSC to revise its rates and charges concerning the former Mountain Hill Water system. Artesian Water Maryland requested authorization to implement proposed rates for water and wastewater services to meet a requested increase in revenue of approximately $65,000 on an annualized basis. In addition to the increase in rates, Artesian Water Maryland is requesting a change to its rate structure, reducing the per thousand gallon charge while adding a monthly customer and fire protection charge. If approved, these changes will result in a 34% increase for the average residential customer.

Service Territory Expansion Proceedings

On September 7, 2010, the DEPSC entered Order No. 7833, which approved the Revised Water Certificates of Public Convenience and Necessity Regulations as final. After extensive proceedings regarding Regulation Docket No. 51, the DEPSC repealed and replaced its existing Regulations Governing Certificates of Public Convenience and Necessity for Water Utilities with a new revised set of regulations (the “Revised Water CPCN Regulations”). The Revised Water CPCN Regulations changed the definition of a “Proposed Service Area” to encompass either a single parcel or two or more contiguous parcels that will be provided water by the same system or main extension.

In Maryland, the Company must obtain approval from the appropriate local government authority for the ability to serve a particular area and also ensure that acquired area is in the county’s master water and sewer plan. The authority to exercise a franchise must then be obtained from the MDPSC. Utilities that seek to develop a franchise by constructing new facilities must obtain appropriate approvals from the Maryland Department of the Environment, the local government and the MDPSC. The utility must also obtain approval for soil and erosion plans and easement agreements from appropriate parties.

On June 4, 2009, the MDPSC approved Artesian Water Maryland's request to construct a water system to serve the 172 residents of the Whitaker Woods housing development located adjacent to the Mountain Hill Service Area. This expanded franchise area is subject to the Mountain Hill tariff rates. We began serving customers in this development in November 2009. On September 9, 2009, the MDPSC approved Artesian Water Maryland's request to construct a water system to serve 71 residents in the Charlestown Crossing housing development. Construction was completed in July 2010.

In December 2009, Artesian Water Maryland applied for approval from the MDPSC to exercise a franchise to provide water service to the Town of Port Deposit. This application also requested authority to finance the purchase of water system facilities, and to establish water service rates. On July 28, 2010, the MDPSC approved our application. On November 1, 2010, Artesian Water Maryland closed on this transaction and began serving customers.

On September 30, 2008, Artesian Water Maryland and Artesian Wastewater Maryland filed joint applications with the MDPSC to exercise franchises granted to the Company by Cecil County. On March 31, 2009, we presented an updated application that included an extended service area and the acquisition of certain facilities. A petition by the Appleton Alliance delayed the exercise of franchises granted. On June 21, 2011, the Maryland Court of Appeals held that Maryland law does not prohibit the transfer and sale of assets contemplated by these transactions. See Note 1 – General – Maryland Regulated Subsidiaries for further discussion. We have re-applied to the MDPSC for authority to exercise the previously awarded franchises and expect to receive a decision by the end of August 2011.

Other Proceedings

Delaware law permits water utilities to put into effect, on a semi-annual basis, increases related to specific types of distribution system improvements through a Distribution System Improvement Charge, or DSIC. This charge may be implemented by water utilities between general rate increase applications that normally recognize changes in a water utility’s overall financial position. The DSIC approval process is less costly when compared to the approval process for general rate increase requests. The DSIC rate applied between base rate filings is capped at 7.5% of the amount billed to customers under otherwise applicable rates and charges, and the DSIC rate increase applied cannot exceed 5% within any 12-month period. During 2010, Artesian Water filed two applications with the DEPSC for approval to collect a 0.34% increase and 0.68% increase during the first and second half of the year, respectively. These increases recover the costs of eligible revenue producing improvements made since the last rate increase in 2008, and were calculated to generate approximately $286,000 in revenue annually. In November 2010, we filed an application with the DEPSC for approval to increase the DSIC rate to 1.47% effective January 1, 2011, which will generate approximately $390,000 in revenue on an annual basis. The DEPSC approved the DSIC effective January 1, 2010, July 1, 2010 and January 1, 2011, subject to audit at a later date. For the six months ended June 30, 2010 and June 30, 2011, we earned approximately $88,000 and $347,000, respectively, in DSIC revenue.

On April 10, 2006, the DEPSC made effective new rules under Regulation Docket 15 that govern the terms and conditions under which water utilities require advances or contributions from customers or developers. These regulations require that developers pay for all water facilities within a new development, with such funding recorded as contributions in aid of construction by the water utility. In addition, the utility is required to receive a contribution in aid of construction of $1,500 for each new residential connection to its system towards the cost of water supply, treatment and storage facilities. These regulations further require developers to fully pay for facilities to serve satellite systems. These required contributions are intended to place a greater burden upon new customers to pay for the cost of facilities required to serve them. On February 12, 2010 and February 11, 2011, respectively, we filed the first and second of three required annual reports with the DEPSC, in order to demonstrate our compliance with Regulation Docket 15.

In 2003, legislation was enacted in Delaware requiring all water utilities serving within northern New Castle County, Delaware to certify by July 2006, and each three years thereafter, that they have sufficient sources of self-supply to serve their respective systems. The DEPSC accepted our certification of sufficient water supply through 2009. Artesian Water filed a new certification of self-sufficiency with the DEPSC on June 30, 2009, for the period through 2012. On June 1, 2010, the DEPSC accepted our self-sufficiency certification through 2012.

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NOTE 7 – INCOME TAXES

Under FASB ASC Topic 740, an uncertain tax position represents our expected treatment of a tax position taken, or planned to be taken in the future, that has not been reflected in measuring income tax expense for financial reporting purposes. As a result of our review of our tax positions, we determined that we had no material uncertain tax positions. The Company would recognize, if applicable, interest accrued and penalties related to unrecognized tax benefits in interest expense and in accordance with the regulations of the jurisdictions involved. There were no such interest and penalty charges for the six months ended June 30, 2011 or June 30, 2010. The Company remains subject to examination by state authorities for tax years 2007 through 2010 and by federal authorities for the tax year 2009 through 2010. During the second quarter of 2010, the Internal Revenue Service, or IRS, conducted an examination of the Company's Federal income tax returns for 2007 and 2008. The IRS has proposed no changes to the 2007 consolidated corporate income tax return. The IRS made changes to the tax depreciation expense, which is related to the bonus depreciation calculation, on the 2008 consolidated corporate income tax return in the amount of approximately $1.9 million. This change does not constitute a disallowance of a deduction, but only a deferral of such deduction. The depreciation expense will be taken in subsequent years over the remaining tax lives of the applicable assets. This adjustment reduces the Net Operating Loss generated in 2008 by the same amount. The Company agrees with this change.

NOTE 8 – FAIR VALUE OF FINANCIAL INSTRUMENTS

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

Current Assets and Liabilities

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

Long-term Financial Liabilities

The fair value of Artesian Resources' long-term debt as of June 30, 2011 and December 31, 2010, determined by discounting their future cash flows using current market interest rates on similar instruments with comparable maturities as guided under FASB ASC 825 are shown as below:

In thousands

| | June 30, 2011 | December 31, 2010 |
|---|---|---|
| Carrying amount | $108,382 | $106,606 |
| Estimated fair value | 118,338 | 113,481 |

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

NOTE 9 – NORTHERN SUSSEX REGIONAL WATER RECYCLING COMPLEX, LLC

On August 6, 2010, Artesian Resources, on behalf of itself and all applicable subsidiaries, signed a Conclusion and Termination Agreement, or Termination Agreement, with Darin A. Lockwood, on behalf of himself and all applicable business entities in which he has an interest, or Lockwood, including without limitation the NSRWRC, a business entity owned by Lockwood, pursuant to which all contracts and agreements with Lockwood and NSRWRC were cancelled except as set forth below.

The Termination Agreement supersedes and terminates all contracts and agreements previously existing between the parties, including the cancellation of the Wastewater Services Agreement between Artesian Utility and NSRWRC for the design, construction and operation of the Northern Sussex Regional Water Recycling Complex, a wastewater treatment facility to be located in Sussex County, Delaware. Artesian Wastewater will manage the design and construction of the facility going forward and, once constructed, the operation of the facility. Other contracts cancelled by the Termination Agreement include a sublease agreement for office space, an asset purchase agreement and a consulting agreement. Any other contracts or business relationships between Artesian Resources and Lockwood not specifically noted were also cancelled with no additional compensation paid to either party. Pursuant to the Termination Agreement, Lockwood received a final net settlement payment of $800,000 including deposit. In addition, on August 6, 2010, Artesian Resources and Lockwood entered into a confidentiality agreement and covenant not to compete.

Pursuant to the Termination Agreement, Artesian Wastewater purchased the 75-acre parcel of land, purchased by Lockwood on July 1, 2008, for the operation of the wastewater facility known as the Northern Sussex Regional Water Recharge Complex and entered into a Water and Wastewater Easement Agreement that provides Artesian Wastewater right of way to a portion of land adjacent to the 75-acre parcel of land. The Company purchased the land (with a carrying value of $5.2 million) and all engineering and design work (with a carrying value of $2.7 million) by paying off the $7.9 million remaining balance of the NSRWRC's construction loan with a financial institution secured by the 75-acre parcel that was previously guaranteed by the Company. There is no other security pledged for the 75-acre parcel of land. No gain was recognized as a result of the Termination Agreement since the assets were purchased at their carrying cost on NSRWRC's balance sheet and the loan concurrently repaid equaled the carrying value of the assets at the date of the Termination Agreement.

As a result of the Termination Agreement, effective August 6, 2010, NSRWRC was deconsolidated from the Company's consolidated financial statements. The Company is no longer the primary beneficiary of NSRWRC and NSRWRC no longer constitutes a VIE, as defined by FASB ASC Topic 810. See Note 2 – Basis of Presentation. The deconsolidation of NSRWRC resulted in the reclassification of the facility from non-utility property to utility plant on our Condensed Consolidated Balance Sheet. Also, as a result of the Termination Agreement, the Company recognized interest expense for the first six months of 2011 related to higher short term borrowings in Artesian Wastewater that previously had been capitalized in the first six months of 2010.

NOTE 10 – RELATED PARTY TRANSACTIONS

Prior to the signing of the Termination Agreement on August 6, 2010 discussed in Note 9 - Northern Sussex Regional Water Recycling Complex, LLC, the Company entered into transactions in the normal course of business with related parties. The owner of NSRWRC is the sole owner of Meridian Architects and Engineers, LLC, or Meridian Architects, Meridian Enterprises, LLC, or Meridian Enterprises, and Meridian Consulting, LLC, or Meridian Consulting. Approximately $22,500 was paid to Meridian Enterprises for the six months ended June 30, 2010 for office space rental. Also, as of June 30, 2010, the Company had accounts receivable balances for engineering services due from the following entities, all of which are owned by the owner of NSRWRC: Meridian Architects of approximately $58,000,