YORK WATER CO
Form 10-Q
August 03, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
OR
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 001-34245

THE YORK WATER COMPANY
(Exact name of registrant as specified in its charter)

PENNSYLVANIA	23-1242500
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
130 EAST MARKET STREET, YORK, PENNSYLVANIA	17401
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (717) 845-3601

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.
YES NO

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES NO

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

Large accelerated filer	Accelerated filer ý	Non-accelerated filer
		(Do not check if a smaller reporting company)

Small Reporting company   Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES   NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock, No par value	12,847,840 Shares outstanding as of August 3, 2017

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THE YORK WATER COMPANY

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

THE YORK WATER COMPANY

Balance Sheets (Unaudited)
(In thousands of dollars, except per share amounts)

	Jun. 30, 2017	Dec. 31, 2016
ASSETS		
UTILITY PLANT, at original cost	$358,456	$343,412
Plant acquisition adjustments	(3,263)	(3,667)
Accumulated depreciation	(71,855)	(68,838)
Net utility plant	283,338	270,907
OTHER PHYSICAL PROPERTY, net of accumulated depreciation of $365 in 2017 and $353 in 2016	735	745
CURRENT ASSETS:		
Cash and cash equivalents	2	4,209
Accounts receivable, net of reserves of $325 in 2017 and $305 in 2016	4,234	4,296
Unbilled revenues	2,492	2,429
Recoverable income taxes	-	282
Materials and supplies inventories, at cost	775	746
Prepaid expenses	897	658
Total current assets	8,400	12,620
OTHER LONG-TERM ASSETS:		
Notes receivable	255	255
Deferred regulatory assets	33,440	33,027
Other assets	3,088	2,940
Total other long-term assets	36,783	36,222
Total Assets	$329,256	$320,494

The accompanying notes are an integral part of these statements.

THE YORK WATER COMPANY

Balance Sheets (Unaudited)
(In thousands of dollars, except per share amounts)

	Jun. 30, 2017	Dec. 31, 2016
STOCKHOLDERS' EQUITY AND LIABILITIES		
COMMON STOCKHOLDERS' EQUITY:		
Common stock, no par value, authorized 46,500,000 shares, shares issued 12,845,989 in 2017 and 12,852,295 in 2016, shares outstanding 12,845,989 in 2017 and 12,852,295 in 2016	$78,302	$78,513
Retained earnings	36,948	35,548
Total common stockholders' equity	115,250	114,061
PREFERRED STOCK, authorized 500,000 shares, no shares issued	-	-
LONG-TERM DEBT, excluding current portion	88,166	84,609
COMMITMENTS	-	-
CURRENT LIABILITIES:		
Current portion of long-term debt	44	44
Accounts payable	5,148	3,669
Dividends payable	1,802	1,803
Accrued compensation and benefits	1,197	1,233
Accrued income taxes	157	-
Accrued interest	984	921
Other accrued expenses	467	514
Total current liabilities	9,799	8,184
DEFERRED CREDITS:		
Customers' advances for construction	7,483	7,102
Deferred income taxes	56,750	54,169
Deferred employee benefits	8,297	8,990
Other deferred credits	6,678	6,725
Total deferred credits	79,208	76,986
Contributions in aid of construction	36,833	36,654
Total Stockholders' Equity and Liabilities	$329,256	$320,494

The accompanying notes are an integral part of these statements.

THE YORK WATER COMPANY

Statements of Income (Unaudited)
(In thousands of dollars, except per share amounts)

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
OPERATING REVENUES:				
Residential	$7,886	$7,491	$15,145	$14,722
Commercial and industrial	3,450	3,435	6,589	6,580
Other	918	894	1,810	1,796
	12,254	11,820	23,544	23,098
OPERATING EXPENSES:				
Operation and maintenance	2,262	2,028	4,288	3,921
Administrative and general	2,489	2,274	4,882	4,488
Depreciation and amortization	1,686	1,555	3,367	3,182
Taxes other than income taxes	288	268	621	598
	6,725	6,125	13,158	12,189
Operating income	5,529	5,695	10,386	10,909
OTHER INCOME (EXPENSES):				
Interest on debt	(1,326)	(1,316)	(2,642)	(2,621)
Allowance for funds used during construction	196	47	319	100
Other income (expenses), net	(94)	(99)	(220)	(262)
	(1,224)	(1,368)	(2,543)	(2,783)
Income before income taxes	4,305	4,327	7,843	8,126
Income taxes	1,370	1,480	2,327	2,793
Net Income	$2,935	$2,847	$5,516	$5,333
Basic Earnings Per Share	$0.23	$0.23	$0.43	$0.42
Diluted Earnings Per Share	$0.23	$0.23	$0.43	$0.42
Cash Dividends Declared Per Share	$0.1602	$0.1555	$0.3204	$0.3110

The accompanying notes are an integral part of these statements.

THE YORK WATER COMPANY

Statements of Common Stockholders' Equity (Unaudited)
(In thousands of dollars, except per share amounts)
For the Periods Ended June 30, 2017 and 2016

	Common Stock Shares	Common Stock Amount	Retained Earnings	Total
Balance, December 31, 2016	12,852,295	$ 78,513	$ 35,548	$ 114,061
Net income	-	-	5,516	5,516
Dividends	-	-	(4,116)	(4,116)
Retirement of common stock	(37,229)	(1,263)	-	(1,263)
Issuance of common stock under dividend reinvestment, direct stock and employee stock purchase plans	29,418	1,018	-	1,018
Stock-based compensation	1,505	34	-	34
Balance, June 30, 2017	12,845,989	$ 78,302	$ 36,948	$ 115,250

	Common Stock Shares	Common Stock Amount	Retained Earnings	Total
Balance, December 31, 2015	12,812,377	$ 77,317	$ 31,753	$ 109,070
Net income	-	-	5,333	5,333
Dividends	-	-	(3,994)	(3,994)
Issuance of common stock under dividend reinvestment, direct stock and employee stock purchase plans	55,359	1,568	-	1,568
Balance, June 30, 2016	12,867,736	$ 78,885	$ 33,092	$ 111,977

The accompanying notes are an integral part of these statements.

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THE YORK WATER COMPANY

Statements of Cash Flows (Unaudited)
(In thousands of dollars, except per share amounts)

	Six Months Ended June 30	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$5,516	$5,333
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,367	3,182
Stock-based compensation	34	-
Increase in deferred income taxes	1,381	607
Other	84	170
Changes in assets and liabilities:		
Increase in accounts receivable and unbilled revenues	(154)	(252)
Decrease in recoverable income taxes	282	1,039
Increase in materials and supplies, prepaid expenses, regulatory and other assets	(2,537)	(1,091)
Increase (decrease) in accounts payable, accrued compensation and benefits, accrued expenses, deferred employee benefits, and other deferred credits	1,173	(736)
Increase in accrued interest and taxes	220	4
Net cash provided by operating activities	9,366	8,256
CASH FLOWS FROM INVESTING ACTIVITIES:		
Utility plant additions, including debt portion of allowance for funds used during construction of $178 in 2017 and $56 in 2016	(13,867)	(5,009)
Acquisitions of water and wastewater systems	(472)	(29)
Cash received from surrender of life insurance policies	-	596
Net cash used in investing activities	(14,339)	(4,442)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Customers' advances for construction and contributions in aid of construction	773	892
Repayments of customer advances	(213)	(155)
Proceeds of long-term debt issues	7,911	-
Repayments of long-term debt	(4,426)	(22)
Change in cash overdraft position	1,083	-
Repurchase of common stock	(1,263)	-
Issuance of common stock	1,018	1,568
Dividends paid	(4,117)	(3,967)
Net cash provided by (used in) financing activities	766	(1,684)
Net change in cash and cash equivalents	(4,207)	2,130
Cash and cash equivalents at beginning of period	4,209	2,879
Cash and cash equivalents at end of period	$2	$5,009
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest, net of amounts capitalized	$2,329	$2,491
Income taxes	20	660

Supplemental disclosure of non-cash investing and financing activities:
Accounts payable includes $3,162 in 2017 and $645 in 2016 for the construction of utility plant.

The accompanying notes are an integral part of these statements.

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THE YORK WATER COMPANY

Notes to Interim Financial Statements
(In thousands of dollars, except per share amounts)

1. Basis of Presentation

The interim financial statements are unaudited but, in the opinion of management, reflect all adjustments, consisting of only normal recurring accruals, necessary for a fair presentation of results for such periods. Because the financial statements cover an interim period, they do not include all disclosures and notes normally provided in annual financial statements, and therefore, should be read in conjunction with the financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Operating results for the three and six month periods ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017.

2. Common Stock and Earnings Per Share

Net income of $2,935 and $2,847 for the three months ended June 30, 2017 and 2016, respectively, and $5,516 and $5,333 for the six months ended June 30, 2017 and 2016 respectively, is used to calculate both basic and diluted earnings per share. Basic earnings per share is based on the weighted average number of common shares outstanding. Diluted earnings per share is based on the weighted average number of common shares outstanding plus potentially dilutive shares. The dilutive effect of employee stock-based compensation is included in the computation of diluted earnings per share and is calculated using the treasury stock method and expected proceeds upon exercise or issuance of the stock-based compensation. The following table summarizes the shares used in computing basic and diluted earnings per share.

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Weighted average common shares, basic	12,839,968	12,849,884	12,844,500	12,835,495
Effect of dilutive securities:				
Employee stock-based compensation	80	-	81	-
Weighted average common shares, diluted	12,840,048	12,849,884	12,844,581	12,835,495

On March 11, 2013, the Board of Directors, or the Board, authorized a share repurchase program granting the Company authority to repurchase up to 1,200,000 shares of the Company's common stock from time to time. The stock repurchase program has no specific end date and the Company may repurchase shares in the open market or through privately negotiated transactions. The Company may suspend or discontinue the repurchase program at any time. During the three and six months ended June 30, 2017, the Company repurchased 12,900 and 37,229 shares respectively. No shares were repurchased during the three or six months ended June 30, 2016. As of June 30, 2017, 618,004 shares remain authorized for repurchase.

3. Commitments

The Company has committed to capital expenditures of approximately $11,598 for an additional raw water pumping station and force main, of which $3,490 remains to be incurred as of June 30, 2017. The Company may make additional commitments for this project in 2017.

During its triennial testing completed in 2016, the Company determined it exceeded the action level for lead at the customer's tap as established by the Lead and Copper Rule, or LCR, issued by the U.S. Environmental Protection Agency. The rule allows the Company to have five samples of the 50 high-risk homes tested exceed the action level of 15 parts per billion, or PPB. The testing found that six properties with lead service lines, all built before 1935, exceeded the action level, and the reported exceedance amount was 1 PPB. The Company has determined that only 3% of the company-owned service lines in the system are lead. The Company will be required, per the LCR, to engage in more frequent testing for lead, public education, and annually replace 7% of the remaining company-owned lead service lines in its distribution system. The Company has announced plans to perform in excess of the required actions. Specifically, the Company will provide the affected customers with a free water test and a 200 gallon per month credit to flush their line in order to reduce any lead content until their lead service line has been replaced. The cost of the water tests and flushing credits was $4 for the three months ended June 30, 2017 and $11 for the six months ended June 30, 2017. Additional amounts for water tests and flushing credits are not expected to have a material impact on the financial position of the Company over the remaining three and a half years.

In addition, the Company has entered into a consent order agreement with the Pennsylvania Department of Environmental Protection. Under the agreement, the Company has committed to exceed the LCR replacement schedule by replacing all of the remaining company-owned lead service lines within the next three and a half years. The cost for these service line replacements was approximately $1,030 through June 30, 2017 and is included in utility plant. Additional replacements are expected to be approximately $1,600 over the next three and a half years, and will be integrated into the Company's annual capital budgets.

Finally, the Company has been granted approval by the PPUC to modify its tariff to include the cost of the replacement of lead customer-owned service lines that are discovered when the Company replaces its lead service lines over the next three and a half years, and to include the cost of the annual replacement of up to 400 lead customer-owned service lines whenever they are discovered, regardless of the material used for the Company-owned service line over nine years. The tariff modification allows the Company to replace customer-owned service lines at its own initial cost. The Company will record the costs as a regulatory asset to be recovered in future base rates to customers, over a reasonable period of at least four but not more than six years. The cost for the customer-owned lead service line replacements under the four-year tariff modification was approximately $93 through June 30, 2017 and is included as a regulatory asset. Additional replacements are expected to be approximately $130 under the four-year tariff modification, assuming the average percentage of customer-owned lead service lines that were replaced when company-owned lead service lines were replaced through June 30, 2017 remains consistent over the entire replacement period. The Company is unable to predict how many lead customer-owned service lines are in use, and, therefore, its current estimate of $1,040 for replacements under the nine-year tariff modification is subject to adjustment as more facts become available.

4. Pensions

Components of Net Periodic Pension Cost

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Service cost	$270	$255	$540	$509
Interest cost	398	400	796	800
Expected return on plan assets	(598)	(559)	(1,197)	(1,117)
Amortization of actuarial loss	123	140	246	280
Amortization of prior service cost	(3)	(3)	(6)	(6)
Rate-regulated adjustment	385	342	771	684
Net periodic pension expense	$575	$575	$1,150	$1,150

Employer Contributions

The Company previously disclosed in its financial statements for the year ended December 31, 2016 that it expected to contribute $2,300 to its pension plans in 2017. For the six months ended June 30, 2017, contributions of $1,150 had been made. The Company expects to contribute the remaining $1,150 over the final two quarters of 2017.

5. Debt

	As of Jun. 30, 2017	As of Dec. 31, 2016
10.17% Senior Notes, Series A, due 2019	$6,000	$6,000
9.60% Senior Notes, Series B, due 2019	5,000	5,000
1.00% Pennvest Note, due 2019	96	118
10.05% Senior Notes, Series C, due 2020	6,500	6,500
8.43% Senior Notes, Series D, due 2022	7,500	7,500
Variable Rate Pennsylvania Economic Development Financing Authority Exempt Facilities Revenue Refunding Bonds, Series 2008A, due 2029	12,000	12,000
4.75% York County Industrial Development Authority Revenue Bonds, Series 2006, due 2036	10,500	10,500
4.50% Pennsylvania Economic Development Financing Authority Exempt Facilities Revenue Refunding Bonds, Series 2014, due 2038	14,870	14,870
5.00% Monthly Senior Notes, Series 2010A, due 2040	15,000	15,000
4.00% - 4.50% York County Industrial Development Authority Exempt Facilities Revenue Bonds, Series 2015, due 2029 - 2045	10,000	10,000
Committed Line of Credit, due 2019	3,507	-
Total long-term debt	90,973	87,488
Less discount on issuance of long-term debt	(220)	(226)
Less unamortized debt issuance costs	(2,543)	(2,609)
Less current maturities	(44)	(44)
Long-term portion	88,166	84,609

In the second quarter of 2017, the Company renewed its $13,000 and $11,000 committed lines of credit and extended the maturity date of each to May 2019. In addition, the Company renewed its $7,500 line of credit and extended the maturity date to June 2018.

6. Interest Rate Swap Agreement

The Company is exposed to certain risks relating to its ongoing business operations. The primary risk managed by using derivative instruments is interest rate risk. The Company utilizes an interest rate swap agreement to effectively convert the Company's $12,000 variable-rate debt issue to a fixed rate. Interest rate swaps are contracts in which a series of interest rate cash flows are exchanged over a prescribed period. The notional amount on which the interest payments are based ($12,000) is not exchanged. The interest rate swap provides that the Company pays the counterparty a fixed interest rate of 3.16% on the notional amount of $12,000. In exchange, the counterparty pays the Company a variable interest rate based on 59% of the U.S. Dollar one-month LIBOR rate on the notional amount. The intent is for the variable rate received from the swap counterparty to approximate the variable rate the Company pays to bondholders on its variable rate debt issue, resulting in a fixed rate being paid to the swap counterparty and reducing the Company's interest rate risk. The Company's net payment rate on the swap was 2.53% and 2.88% during the three months that ended June 30, 2017 and 2016, respectively, and 2.59% and 2.84% for the six months that ended June 30, 2017 and 2016, respectively.

The interest rate swap agreement is classified as a financial derivative used for non-trading activities. The accounting standards regarding accounting for derivatives and hedging activities require companies to recognize all derivative instruments as either assets or liabilities at fair value on the balance sheet. In accordance with the standards, the interest rate swap is recorded on the balance sheet in other deferred credits at fair value (see Note 7).

The Company uses regulatory accounting treatment rather than hedge accounting to defer the unrealized gains and losses on its interest rate swap. Instead of the effective portion being recorded as other comprehensive income or loss and the ineffective portion being recognized in earnings using the cash flow hedge accounting rules provided by the derivative accounting standards, the entire unrealized swap value is recorded as a regulatory asset. Based on current ratemaking treatment, the Company expects the unrealized gains and losses to be recognized in rates as a component of interest expense as the swap settlements occur. Swap settlements are recorded in the income statement with the hedged item as interest expense. Swap settlements resulted in the reclassification from regulatory assets to interest expense $76 and $86 during the three month period ended June 30, 2017 and 2016, respectively, and $155 and $173 for the six month period ended June 30, 2017 and 2016, respectively. The overall swap result was a loss of $120 and $334 for the three months ended June 30, 2017 and 2016, respectively, and a loss of $129 and $843 for the six months ended June 30, 2017 and 2016, respectively. The Company expects to reclassify $281 from regulatory assets to interest expense as a result of swap settlements over the next 12 months.

The interest rate swap agreement contains provisions that require the Company to maintain a credit rating of at least BBB- with Standard & Poor's. If the Company's rating were to fall below this rating, it would be in violation of these provisions, and the counterparty to the derivative could request immediate payment if the derivative was in a liability position. On April 21, 2017, Standard & Poor's affirmed the Company's credit rating at A-, with a stable outlook and adequate liquidity. The Company's interest rate swap was in a liability position as of June 30, 2017. If a violation due to credit rating, or some other default provision, were triggered on June 30, 2017, the Company would have been required to pay the counterparty approximately $2,401.

The interest rate swap will expire on October 1, 2029. Other than the interest rate swap, the Company has no other derivative instruments.

7. Fair Value Measurements

The accounting standards regarding fair value measurements establish a fair value hierarchy which indicates the extent to which inputs used in measuring fair value are observable in the market. Level 1 inputs include quoted prices for identical instruments and are the most observable. Level 2 inputs include quoted prices for similar assets and observable inputs such as interest rates, commodity rates and yield curves. Level 3 inputs are not observable in the market and include management's own judgments about the assumptions market participants would use in pricing the asset or liability.

The Company has recorded its interest rate swap liability at fair value in accordance with the standards. The liability is recorded under the caption "Other deferred credits" on the balance sheet. The table below illustrates the fair value of the interest rate swap as of the end of the reporting period.

Description	June 30, 2017	Fair Value Measurements at Reporting Date Using Significant Other Observable Inputs (Level 2)
Interest Rate Swap	$2,263	$2,263

Fair values are measured as the present value of all expected future cash flows based on the LIBOR-based swap yield curve as of the date of the valuation. These inputs to this calculation are deemed to be Level 2 inputs. The balance sheet carrying value reflects the Company's credit quality as of June 30, 2017. The rate used in discounting all prospective cash flows anticipated to be made under this swap reflects a representation of the yield to maturity for 30-year debt on utilities rated A- as of June 30, 2017. The use of the Company's credit rating resulted in a reduction in the fair value of the swap liability of $138 as of June 30, 2017. The fair value of the swap reflecting the Company's credit quality as of December 31, 2016 is shown in the table below.

Description	December 31, 2016	Fair Value Measurements at Reporting Date Using Significant Other Observable Inputs (Level 2)
Interest Rate Swap	$2,292	$2,292

The carrying amount of current assets and liabilities that are considered financial instruments approximates fair value as of the dates presented. The Company's total long-term debt, with a carrying value of $90,973 at June 30, 2017, and $87,488 at December 31, 2016, had an estimated fair value of approximately $103,000 and $99,000, respectively. The estimated fair value of debt was calculated using a discounted cash flow technique that incorporates a market interest yield curve with adjustments for duration and risk profile. These inputs to this calculation are deemed to be Level 2 inputs. The Company recognized its credit rating in determining the yield curve, and did not factor in third party credit enhancements including bond insurance on the 2006 York County Industrial Development Authority issue and the letter of credit on the 2008 Pennsylvania Economic Development Financing Authority Series A issue.

Customers' advances for construction and notes receivable had carrying values at June 30, 2017 of $7,483 and $255, respectively. At December 31, 2016, customers' advances for construction and notes receivable had carrying values of $7,102 and $255, respectively. The relative fair values of these amounts cannot be accurately estimated since the timing of future payment streams is dependent upon several factors, including new customer connections, customer consumption levels and future rate increases.

8. Income Taxes

The Company filed for a change in accounting method under the Internal Revenue Service tangible property regulations effective in 2014. Under the change in accounting method, the Company is permitted to deduct the costs of certain asset improvements that were previously being capitalized and depreciated for tax purposes as an expense on its income tax return. This ongoing deduction results in a reduction in the effective income tax rate, a net reduction in income tax expense, and a reduction in the amount of income taxes currently payable. It also results in increases to deferred tax liabilities and regulatory assets representing the appropriate book and tax basis difference on capital additions. As a result, the Company's effective tax rate was 31.8% and 34.2% for the three months ended June 30, 2017 and 2016, respectively, and 29.7% and 34.4% for the six months ended June 30, 2017 and 2016, respectively. The effective tax rate will vary depending on the level of eligible asset improvements that are placed in service each period, which level was higher during the first six months of 2017 as compared to the first six months of 2016.

9. Acquisitions

On January 6, 2017, the Company completed the acquisition of the water assets of Stockham's Village Mobile Home Park in Adams County, Pennsylvania. The Company began operating the existing system through an interconnection with its current distribution system on January 9, 2017. The acquisition resulted in the addition of approximately 80 new water customers with purchase price and acquisition costs of approximately $24. The purchase price and acquisition costs were more than the depreciated original cost of the assets. The Company recorded an acquisition adjustment of approximately $17 and will seek approval from the Pennsylvania Public Utility Commission, or PPUC, to amortize the acquisition adjustment over the remaining life of the acquired assets.

On February 23, 2017, the Company completed the acquisition of the wastewater collection assets of West York Borough in York County, Pennsylvania. The Company began operating the existing collection facilities on February 27, 2017. The acquisition resulted in the addition of approximately 1,700 wastewater customers, representing more than 2,200 units, with purchase price and acquisition costs of approximately $448. The purchase price and acquisition costs were more than the depreciated original cost of the assets. The Company recorded an acquisition adjustment of approximately $358 and will seek approval from the PPUC to amortize the acquisition adjustment over the remaining life of the acquired assets.

The result of these acquisitions has been immaterial to total Company results.

10. Stock-Based Compensation

On May 2, 2016, the Company's stockholders approved The York Water Company Long-Term Incentive Plan, or LTIP. The LTIP was adopted to provide the incentive of long-term stock-based awards to officers, directors and key employees. The LTIP provides for the granting of nonqualified stock options, incentive stock options, stock appreciation rights, performance restricted stock grants and units, restricted stock grants and units, and unrestricted stock grants. A maximum of 100,000 shares of common stock may be issued under the LTIP over the ten-year life of the plan. The maximum number of shares of common stock subject to awards that may be granted to any participant in any one calendar year is 2,000. Shares of common stock issued under the LTIP may be treasury shares or authorized but unissued shares. The LTIP will be administered by the Compensation Committee of the Board, or the full Board, provided that the full Board will administer the LTIP as it relates to awards to non-employee directors of the Company. The Company filed a registration statement with the Securities and Exchange Commission on May 11, 2016 covering the offering of stock under the LTIP. The LTIP was effective on July 1, 2016.

On April 26, 2017, the Board awarded stock to non-employee directors effective May 1, 2017. This stock award vested immediately. On April 26, 2017, the Compensation Committee awarded restricted stock to officers and key employees effective May 1, 2017. This restricted stock award vests ratably over three years beginning May 1, 2017. In addition, the Board of Directors accelerated the vesting period for restricted stock granted in 2016 to two retiring officers from three years to their 2017 retirement dates. The Company will recognize the acceleration on the books from the approval date to the retirement dates.

The restricted stock awards provide the grantee with the rights of a shareholder, including the right to receive dividends and to vote such shares, but not the right to sell or otherwise transfer the shares during the restriction period. As a result, the awards are included in common shares outstanding on the balance sheet. Restricted stock awards result in compensation expense valued at the fair market value of the stock on the date of the grant and are amortized ratably over the restriction period.

The following tables summarize the stock grant amounts and activity for the six months ended June 30, 2017.

	Number of Shares	Grant Date Weighted Average Fair Value
Nonvested at beginning of the period	660	$37.20
Granted	1,505	$38.00
Vested	(711)	$38.00
Forfeited	-	-
Nonvested at end of the period	1,454	$37.64

For the three months ended June 30, 2017, the statement of income includes $32 of stock-based compensation and related recognized tax benefits of $13. For the six months ended June 30, 2017, the statement of income includes $34 of stock-based compensation and related recognized tax benefits of $14. The total fair value of the shares vested in the six months ended June 30, 2017 was $27. Total stock-based compensation related to nonvested awards not yet recognized is $47 which will be recognized over the next three years.

11. Rate Matters

From time to time, the Company files applications for rate increases with the PPUC and is granted rate relief as a result of such requests. Most recently, the PPUC authorized an increase in rates effective February 28, 2014.

The PPUC permits water utilities to collect a distribution system improvement charge, or DSIC. The DSIC allows the Company to add a charge to customers' bills for qualified replacement costs of certain infrastructure without submitting a rate filing. This surcharge mechanism typically adjusts periodically based on additional qualified capital expenditures completed or anticipated in a future period. The DSIC is capped at 5% of base rates, and is reset to zero when new base rates that reflect the costs of those additions become effective or when a utility's earnings exceed a regulatory benchmark. During its most recent quarterly reporting period, the Company's earnings were below the regulatory benchmark and the Company began recognizing DSIC in June 2017 for bills rendered after July 1, 2017 that included June consumption. The DSIC provided revenues of $62 for the three and six months ended June 30, 2017 and $0 for the three and six months ended June 30, 2016.

12. Impact of Recent Accounting Pronouncements

In May 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2017-09, Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting. This ASU clarifies when a change to the terms or conditions of a share-based payment award must be accounted for as a modification. The guidance requires modification accounting if the fair value, vesting condition or the classification of the award is not the same immediately before and after a change to the terms and conditions of the award. The ASU is effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption available. The Company does not expect the adoption of this standard to have a material impact on its financial position, results of operations and cash flows.

In March 2017, the FASB issued ASU No. 2017-07, Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Post-Retirement Benefit Cost. This ASU requires employers to report the service cost component in the same line item as other compensation costs arising from services rendered by employees during the reporting period. The other components of net benefit costs will be presented in the income statement separately from the service cost and outside of a subtotal of income from operations. In addition, only the service cost component may be eligible for capitalization where applicable. The ASU is effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption available. The Company is currently assessing the impact of the adoption of the standard.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. This ASU supersedes the revenue recognition requirements in Accounting Standards Codification 605—Revenue Recognition and most industry-specific guidance throughout the Codification. The standard requires that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, deferring the effective date of this amendment for public companies by one year to fiscal years beginning after December 15, 2017. Early adoption is permitted for fiscal years beginning after December 15, 2016, the original effective date. The standard permits the use of either a retrospective or cumulative effect transition method. The Company has not yet selected a transition method and is in the process of assessing the impact of the adoption of the standard on its financial position, results of operations and cash flows. Based on its evaluation of ASU 2014-09 to date, which is still ongoing, the Company does not expect it to have a material impact on its results of operations or cash flows in the periods after adoption. This evaluation will be updated if contributions in aid of construction currently not in revenues are determined to be in the scope of the ASU. Under ASU 2014-09, revenue is recognized as control transfers to the customer. As such, revenue for the Company's contracts is generally from a single performance obligation that will be recognized at a point in time. This is consistent with the revenue recognition model the Company currently uses for its contracts. The Company will comply with the new disclosure requirements included in ASU 2014-09 which will have a significant impact on disclosures upon adoption. The Company will complete its assessment of the expected impact of adoption, including selecting a transition method for adoption, in 2017, and continue to evaluate ASU 2014-09 through the date of adoption including the impact of adoption if contributions in aid of construction are determined to be in scope.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (In thousands of dollars, except per share amounts)

Forward-looking Statements

Certain statements contained in this report on Form 10-Q constitute "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933. Words such as "may," "should," "believe," "anticipate," "estimate," "expect," "intend," "plan" and similar expressions are intended to identify forward-looking statements. These forward-looking statements include certain information relating to the Company's business strategy; statements including, but not limited to:

- the amount and timing of rate increases and other regulatory matters including the recovery of costs recorded as regulatory assets;
- expected profitability and results of operations;
- trends;
- goals, priorities and plans for, and cost of, growth and expansion;
- strategic initiatives;
- availability of water supply;
- water usage by customers; and
- the ability to pay dividends on common stock and the rate of those dividends.

The forward-looking statements in this report reflect what the Company currently anticipates will happen. What actually happens could differ materially from what it currently anticipates will happen. The Company does not intend to make a public announcement when forward-looking statements in this report are no longer accurate, whether as a result of new information, what actually happens in the future or for any other reason. Important matters that may affect what will actually happen include, but are not limited to:

- changes in weather, including drought conditions or extended periods of heavy rainfall;
- levels of rate relief granted;
- the level of commercial and industrial business activity within the Company's service territory;
- construction of new housing within the Company's service territory and increases in population;
- changes in government policies or regulations, including the tax code;
- the ability to obtain permits for expansion projects;
- material changes in demand from customers, including the impact of conservation efforts which may impact the demand of customers for water;
- changes in economic and business conditions, including interest rates, which are less favorable than expected;
- loss of customers;
- changes in, or unanticipated, capital requirements;
- the impact of acquisitions;
- changes in accounting pronouncements;
- changes in the Company's credit rating or the market price of its common stock;
- the ability to obtain financing; and
- other matters set forth in Item 1A, "Risk Factors" of the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

General Information

The primary business of the Company is to impound, purify to meet or exceed safe drinking water standards and distribute water. The Company also owns and operates three wastewater collection systems and two treatment systems. The Company operates within its franchised water territory, which covers 39 municipalities within York County, Pennsylvania and nine municipalities within Adams County, Pennsylvania. The Company's wastewater operations include portions of four municipalities in York County, Pennsylvania. The Company is regulated by the Pennsylvania Public Utility Commission, or PPUC, for both water and wastewater in the areas of billing, payment procedures, dispute processing, terminations, service territory, debt and equity financing and rate setting. The Company must obtain PPUC approval before changing any practices associated with the aforementioned areas.

Water service is supplied through the Company's own distribution system. The Company obtains the bulk of its water supply from both the South Branch and East Branch of the Codorus Creek, which together have an average daily flow of 73.0 million gallons. This combined watershed area is approximately 117 square miles. The Company has two reservoirs, Lake Williams and Lake Redman, which together hold up to approximately 2.2 billion gallons of water. The Company supplements its reservoirs with a 15-mile pipeline from the Susquehanna River to Lake Redman which provides access to an additional supply of 12.0 million gallons of untreated water per day. The Company also owns seven wells which are capable of providing a safe yield of approximately 366,000 gallons per day to supply water to its customers in Carroll Valley Borough and Cumberland Township, Adams County. As of June 30, 2017, the Company's average daily availability was 35.4 million gallons, and average daily consumption was approximately 18.2 million gallons. The Company's service territory had an estimated population of 196,000 as of December 31, 2016. Industry within the Company's service territory is diversified, manufacturing such items as fixtures and furniture, electrical machinery, food products, paper, ordnance units, textile products, air conditioning systems, laundry detergent, barbells and motorcycles.

The Company's water business is somewhat dependent on weather conditions, particularly the amount and timing of rainfall. Revenues are particularly vulnerable to weather conditions in the summer months. Prolonged periods of hot and dry weather generally cause increased water usage for watering lawns, washing cars, and keeping golf courses and sports fields irrigated. Conversely, prolonged periods of dry weather could lead to drought restrictions from governmental authorities. Despite the Company's adequate water supply, customers may be required to cut back water usage under such drought restrictions which would negatively impact revenues. The Company has addressed some of this vulnerability by instituting minimum customer charges which are intended to cover fixed costs of operations under all likely weather conditions.

The Company's business does not require large amounts of working capital and is not dependent on any single customer or a very few customers for a material portion of its business. Increases in revenues are generally dependent on the Company's ability to obtain rate increases from the PPUC in a timely manner and in adequate amounts and to increase volumes of water sold through increased consumption and increases in the number of customers served. The Company continuously looks for water and wastewater acquisition and expansion opportunities both within and outside its current service territory as well as additional opportunities to enter into bulk water contracts with municipalities and other entities to supply water.

The Company has agreements with several municipalities to provide sewer billing and collection services. The Company also has a service line protection program on a targeted basis in order to further diversify its business. Under this optional program, customers pay a fixed monthly fee, and the Company will repair or replace damaged customer service lines, as needed, subject to an annual maximum dollar amount. Opportunities to expand both initiatives are being pursued.

Results of Operations

Three Months Ended June 30, 2017 Compared
With Three Months Ended June 30, 2016

Net income for the second quarter of 2017 was $2,935, an increase of $88, or 3.1%, from net income of $2,847 for the same period of 2016. The primary contributing factors to the increase were higher revenues, an increased allowance for funds used during construction, and lower income taxes, which were partially offset by higher operating expenses.

Operating revenues for the three months ended June 30, 2017, increased $434, or 3.7%, from $11,820 for the three months ended June 30, 2016 to $12,254 for the corresponding 2017 period. The primary reasons for the increase were revenues from the recent West York Borough wastewater acquisition of $188 and the distribution system improvement charge, or DSIC, allowed by the PPUC of $62. The DSIC allows the Company to add a charge to customers' water bills for qualified replacement costs of certain infrastructure without submitting a rate filing. Growth in the water customer base also added to revenues. The average number of water customers served in the 2017 period increased as compared to the 2016 period by 1,038 customers, from 65,938 to 66,976 customers. The average number of wastewater customers served in the 2017 period increased as compared to the 2016 period by 1,644 customers, from 641 to 2,285 customers, due to the acquisition. The increase in revenue was partially offset by lower per capita consumption. Total per capita consumption for the second quarter of 2017 was 3.1% lower than the same period last year.

Operating expenses for the second quarter of 2017 increased $600, or 9.8%, from $6,125 for the second quarter of 2016 to $6,725 for the corresponding 2017 period. The increase was primarily due to higher expenses of approximately $164 for West York wastewater operating expenses, $131 for depreciation and $118 for health insurance. Also adding to the increase were $34 for wages, $40 for directors fees, $25 for water treatment materials and supplies, $25 for other taxes and $23 for decreased wages and benefits that were able to be capitalized. Other expenses increased by a net of $89. The increase was partially offset by approximately $26 for lower costs for the annual shareholder reports and $23 for the absence of rate case expenses.

Interest on debt for the second quarter of 2017 increased $10, or 0.8%, from $1,316 for the second quarter of 2016 to $1,326 for the corresponding 2017 period. The increase was primarily due to interest on line of credit borrowings. The average debt outstanding under the lines of credit was $1,374 for the second quarter of 2017 and $0 for the second quarter of 2016. The average interest rate on the lines of credit was 2.06% for the quarter ended June 30, 2017.

Allowance for funds used during construction increased $149, from $47 in the second quarter of 2016 to $196 in the corresponding 2017 period, due to a higher volume of eligible construction mainly related to the pumping station and force main project.

Other income (expenses), net for the second quarter of 2017 reflects decreased expenses of $5 as compared to the same period of 2016. Lower charitable contributions of $12 were the primary reason for the decrease. Other expenses increased by a net of $7.

Income taxes for the second quarter of 2017 decreased $110, or 7.4%, compared to the same period of 2016 due to a higher volume of asset improvements eligible for the tax benefit under the Internal Revenue Service, or IRS, tangible property regulations, or TPR. The Company's effective tax rate was 31.8% for the second quarter of 2017 and 34.2% for the second quarter of 2016.

Six Months Ended June 30, 2017 Compared
With Six Months Ended June 30, 2016

Net income for the first six months of 2017 was $5,516, an increase of $183, or 3.4%, from net income of $5,333 for the same period of 2016. The primary contributing factors to the increase were lower income taxes, higher revenues and an increased allowance for funds used during construction, which were partially offset by higher operating expenses.

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Operating revenues for the six months ended June 30, 2017 increased $446, or 1.9%, from $23,098 for the six months ended June 30, 2016 to $23,544 for the corresponding 2017 period. The primary reasons for the increase were $250 of revenues from the recent West York Borough wastewater acquisition and $62 from the DSIC. Growth in the water customer base also added to revenues. The average number of water customers served in the 2017 period increased as compared to the 2016 period by 1,046 customers, from 65,776 to 66,822 customers. The average number of wastewater customers served in the 2017 period increased as compared to the 2016 period by 1,096 customers, from 639 to 1,735 customers, due to the acquisition. The increase in revenue was partially offset by lower per capita consumption. Total per capita consumption for the first six months of 2017 was 2.1% lower than the same period last year. For the remainder of the year, the Company expects revenues to increase due to the DSIC, higher summer demand, and an expected increase in the number of water and wastewater customers from acquisitions and growth within the Company's service territory. Other regulatory actions and weather patterns could impact results.

Operating expenses for the first six months of 2017 increased $969, or 7.9%, from $12,189 for the first six months of 2016 to $13,158 for the corresponding 2017 period. The increase was primarily due to higher expenses of approximately $232 for West York wastewater operating expenses, $223 for health insurance and $185 for depreciation. Also adding to the increase were $77 for legal expenses for a tariff modification and lead disclosure, $56 for wages, $52 for water treatment expenses, $41 for decreased wages and benefits that were able to be capitalized and $33 for power costs. Other expenses increased by a net of $127. The increase was partially offset by approximately $57 for the absence of rate case expenses. For the remainder of the year, the Company expects depreciation expense to continue to rise due to additional investment in utility plant, and other expenses to increase at a moderate rate as costs to treat water and to maintain and extend the distribution system continue to rise and the full cost to operate the West York Borough wastewater collection system are incurred.

Interest on debt for the first six months of 2017 increased $21, or 0.8%, from $2,621 for the first six months of 2016 to $2,642 for the corresponding 2017 period. The increase was due to higher short-term interest rates on the variable rate debt and interest on line of credit borrowings. The average debt outstanding under the lines of credit was $691 for the first six months of 2017 and $0 for first six months of 2016. The average interest rate on the lines of credit was 1.03% for the six months ended June 30, 2017. Interest expense for the remainder of the year is expected to remain higher due to continued borrowings under lines of credit.

Allowance for funds used during construction increased $219, from $100 in the first six months of 2016 to $319 in the corresponding 2017 period, due to a higher volume of eligible construction mainly related to the pumping station and force main project. Allowance for funds used during construction for the remainder of the year is expected to increase until the completion of the project, at which time the amount will decrease, likely in the fourth quarter of 2017.

Other income (expenses), net for the first six months of 2017 reflects decreased expenses of $42 as compared to the same period of 2016. Higher earnings on life insurance policies of approximately $36, outside services in 2016 not repeated in 2017 of $23, and lower retirement expense of $7 were the primary reasons for the decrease. Other expenses increased by a net of $24. For the remainder of the year, other income (expenses) will be largely determined by the change in market returns and discount rates for retirement programs and related assets.

Income taxes for the first six months of 2017 decreased $466, or 16.7%, compared to the same period of 2016 due to a higher volume of asset improvements eligible for the tax benefit under the IRS TPR. The Company's effective tax rate was 29.7% for the first six months of 2017 and 34.4% for the first six months of 2016. The Company expects the effective tax rate to be approximately 28% to 32% for 2017 due to the continued expensing of asset improvements that would have been capitalized for tax purposes prior to the implementation of the TPR. The Company's effective tax rate will vary depending on the level of eligible assets improvements that are placed in service each period.

Rate Matters

See Note 11 to the financial statements included herein for a discussion of rate matters.

Effective July 1, 2017, the Company's tariff included a distribution system improvement charge on revenues of 2.96%. A partial month of this surcharge is included in results of operations for the three and six months ended June 30, 2017 for bills rendered after July 1, 2017 that included June consumption.

The benefit from the implementation of the IRS TPR impacts the rate matters of the Company. Reduced taxes have contributed to increased earnings, lengthening the amount of time between rate increase requests. When the Company does file for its next rate increase, the PPUC will take into account the lower income taxes which resulted from the implementation of the IRS TPR, effectively reducing the amount of revenue required in future years and lowering the Company's rate increase request. The Company does not expect to file a rate increase request in 2017.

Acquisitions and Growth

See Note 9 to the financial statements included herein for a discussion of completed acquisitions included in financial results.

On October 8, 2013, the Company signed an agreement to purchase the wastewater assets of SYC WWTP, L.P. in Shrewsbury and Springfield Townships, York County, Pennsylvania. Completion of the acquisition is contingent upon receiving approval from all required regulatory authorities. Closing is expected in 2018, at which time the Company will add approximately 30 commercial and industrial wastewater customers.

This acquisition is expected to be immaterial to Company results. The Company is also pursuing other bulk water contracts and acquisitions in and around its service territory to help offset any further declines in per capita water consumption and to grow its business.

On May 10, 2017, the Company signed an emergency interconnect agreement with Dallastown-Yoe Water Authority. The effectiveness of this agreement is contingent upon receiving approval from all required regulatory authorities. Approval is expected to be granted in the fourth quarter of 2017 at which time the Company will construct a water main extension to a single point of interconnection and supply an agreed upon amount of water to the authority at current tariff rates.

Capital Expenditures

For the six months ended June 30, 2017, the Company invested $13,867 in construction expenditures for routine items and an additional raw water pumping station and force main, as well as various replacements and improvements to infrastructure. In addition, the Company invested $472 in the acquisition of water and wastewater systems. The Company was able to fund construction expenditures using internally-generated funds, line of credit borrowings, proceeds from its stock purchase plans and customer advances and contributions.

The Company anticipates construction expenditures for the remainder of 2017 of approximately $9,000 exclusive of any potential acquisitions not yet approved. In addition to routine transmission and distribution projects, a portion of the anticipated expenditures will be for additional main extensions, completion of the additional raw water pumping station and force main, and various replacements and improvements to infrastructure. The Company intends to use primarily internally-generated funds for its anticipated construction and fund the remainder through line of credit borrowings, proceeds from its stock purchase plans and customer advances and contributions. Customer advances and contributions are expected to account for between 5% and 10% of funding requirements during the remainder of 2017. The Company believes it will have adequate credit facilities and access to the capital markets, if necessary, to meet its anticipated capital needs in 2017 and 2018.

Liquidity and Capital Resources

Cash

The Company manages its cash through a cash management account that is directly connected to one of its lines of credit. Excess cash generated automatically pays down outstanding borrowings under the line of credit arrangement. If there are no outstanding borrowings, the cash is used as an earnings credit to reduce banking fees. Likewise, if additional funds are needed beyond what is generated internally for payroll, to pay suppliers, to fund capital expenditures, or to pay debt service, funds are automatically borrowed under the line of credit. The Company fully utilized its cash on hand during the first six months of 2017 primarily as a result of higher capital expenditures and repurchase of common stock, incurring a cash overdraft on its cash management account of $1,083 as of June 30, 2017. In addition, the Company borrowed $3,507 under its lines of credit in the second quarter of 2017. The cash management facility and other lines of credit are expected to provide the necessary liquidity and funding for the Company's operations, capital expenditures, acquisitions and potential buybacks of stock for the foreseeable future.

Accounts Receivable

The accounts receivable balance tends to follow the change in revenues but is also affected by the timeliness of payments by customers and the level of the reserve for doubtful accounts. In the three months ended June 30, 2017, higher revenue levels as compared to the end of 2016 resulted in an increase in accounts receivable as reflected on the statement of cash flows. Timeliness of payments and the level of the reserve were not significant factors to the change. A reserve is maintained at a level considered adequate to provide for losses that can be reasonably anticipated based on inactive accounts with outstanding balances. Management periodically evaluates the adequacy of the reserve based on past experience, agings of the receivables, adverse situations that may affect a customer's ability to pay, current economic conditions, and other relevant factors. If the status of these factors deteriorates, the Company may incur additional expenses for uncollectible accounts and experience a reduction in its internally-generated funds.

Internally-generated Funds

The amount of internally-generated funds available for operations and construction depends on the Company's ability to obtain timely and adequate rate relief, changes in regulations including taxes, customers' water usage, weather conditions, customer growth and controlled expenses. During the first six months of 2017, the Company generated $9,366 internally from operations as compared to the $8,256 it generated during the first six months of 2016 due primarily to lower income taxes paid and an increase in depreciation and amortization, a non-cash expense.

Credit Lines

Historically, the Company has borrowed $15,000 to $20,000 under its lines of credit before refinancing with long-term debt or equity capital. As of June 30, 2017, the Company maintained unsecured lines of credit aggregating $41,500 with four banks at interest rates of LIBOR plus 1.20% and LIBOR plus 1.25%. The Company had $3,507 in outstanding borrowings under its lines of credit as of June 30, 2017. The interest rate on line of credit borrowings as of June 30, 2017 was 2.31%. In the second quarter of 2017, the Company renewed two of its committed lines of credit aggregating $24,000 and extended the maturity date to May 2019. In addition, the Company renewed its $7,500 committed line of credit and extended the maturity to June 2018. The Company plans to renew its $10,000 line of credit that expires in September 2017 for an additional year under similar terms and conditions.

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The Company has taken steps to manage the risk of reduced credit availability. It has maintained committed lines of credit that cannot be called on demand and obtained a 2-year revolving maturity on its larger facilities. There is no guarantee that the Company will be able to obtain sufficient lines of credit with favorable terms in the future. If the Company is unable to obtain sufficient lines of credit or to refinance its line of credit borrowings with long-term debt or equity when necessary, it may have to eliminate or postpone capital expenditures. Management believes the Company will have adequate capacity under its current lines of credit and access to capital markets, if necessary, to meet anticipated financing needs throughout 2017 and 2018.

Long-term Debt

The Company's loan agreements contain various covenants and restrictions. Management believes it is currently in compliance with all of these restrictions. See Note 4 to the Company's Annual Report on Form 10-K for the year ended December 31, 2016 for additional information regarding these restrictions.

The Company's total long-term debt as a percentage of the total capitalization, defined as total common stockholders' equity plus total long-term debt, was 44.1% as of June 30, 2017 and 43.4% as of December 31, 2016. The Company began using its line of credit in the second quarter of 2017 which increased the debt to total capitalization ratio. The Company expects to allow the debt percentage to trend upward until it approaches fifty percent before considering additional equity. A debt to total capitalization ratio between forty-six and fifty percent has historically been acceptable to the PPUC in rate filings. Due to its ability to generate and retain cash internally, the Company has been able to keep its ratio below fifty percent.

Income Taxes, Deferred Income Taxes and Uncertain Tax Positions

The Company has a substantial deferred income tax asset primarily due to the differences between the book and tax balances of the pension and deferred compensation plans. The Company does not believe a valuation allowance is required due to the expected generation of future taxable income during the periods in which those temporary differences become deductible.

The Company has seen an increase in its deferred income tax liability amounts primarily as a result of the accelerated and bonus depreciation deduction available for federal tax purposes which creates differences between book and tax depreciation expense. The Company expects this trend to continue as it makes significant investments in capital expenditures subject to accelerated and bonus depreciation or TPR.

The Company filed for a change in accounting method under the IRS TPR effective in 2014. Under the change in accounting method, the Company is permitted to deduct the costs of certain asset improvements that were previously being capitalized and depreciated for tax purposes as an expense on its income tax return. This ongoing deduction results in a reduction in the effective income tax rate, a net reduction in income tax expense, and a reduction in the amount of income taxes currently payable. It also results in increases to deferred tax liabilities and regulatory assets representing the appropriate book and tax basis difference on capital additions. The Company expects an effective tax rate of 28% to 32% each year based on current asset improvement estimates. The effective tax rate will vary depending on the level of eligible assets improvements that are placed in service each period.

The Company has determined there are no uncertain tax positions that require recognition as of June 30, 2017.

Common Stock

Common stockholders' equity as a percent of the total capitalization was 55.9% as of June 30, 2017 and 56.6% as of December 31, 2016. The ratio decreased during the six months ended June 30, 2017 due to share repurchases and higher debt from increased capital expenditures. Similar transactions, among other things, could further reduce this percentage in the future. It is the Company's general intent to target a ratio between fifty and fifty-four percent.

Credit Rating

On April 21, 2017, Standard & Poor's affirmed the Company's credit rating at A-, with a stable outlook and adequate liquidity. The Company's ability to maintain its credit rating depends, among other things, on adequate and timely rate relief, which it has been successful in obtaining, its ability to fund capital expenditures in a balanced manner using both debt and equity and its ability to generate cash flow. The Company's objectives are to continue to maximize its funds provided by operations and maintain a strong capital structure in order to be able to attract capital.

Environmental Matters

During its triennial testing completed in 2016, the Company determined it exceeded the action level for lead at the customer's tap as established by the Lead and Copper Rule, or LCR, issued by the U.S. Environmental Protection Agency. The rule allows the Company to have five samples of the 50 high-risk homes tested exceed the action level of 15 parts per billion, or PPB. The testing found that six properties with lead service lines, all built before 1935, exceeded the action level, and the reported exceedance amount was 1 PPB. The Company has determined that only 3% of the company-owned service lines in the system are lead. The Company will be required, per the LCR, to engage in more frequent testing for lead, public education, and annually replace 7% of the remaining company-owned lead service lines in its distribution system. The Company has announced plans to perform in excess of the required actions. Specifically, the Company will provide the affected customers with a free water test and a 200 gallon per month credit to flush their line in order to reduce any lead content until their lead service line has been replaced. The cost of the water tests and flushing credits was $4 for the three months ended June 30, 2017 and $11 for the six months ended June 30, 2017. Additional amounts for water tests and flushing credits are not expected to have a material impact on the financial position of the Company over the remaining three and a half years.

In addition, the Company has entered into a consent order agreement with the Pennsylvania Department of Environmental Protection. Under the agreement, the Company has committed to exceed the LCR replacement schedule by replacing all of the remaining company-owned lead service lines within the next three and a half years. The cost for these service line replacements was approximately $1,030 through June 30, 2017 and is included in utility plant. Additional replacements are expected to be approximately $1,600 over the next three and a half years, and will be integrated into the Company's annual capital budgets.

Finally, the Company has been granted approval by the PPUC to modify its tariff to include the cost of the replacement of lead customer-owned service lines that are discovered when the Company replaces its lead service lines over three and a half years, and to include the cost of the annual replacement of up to 400 lead customer-owned service lines whenever they are discovered, regardless of the material used for the Company-owned service line over nine years. The tariff modification allows the Company to replace customer-owned service lines at its own initial cost. The Company will record the costs as a regulatory asset to be recovered in future base rates to customers, over a reasonable period of at least four but not more than six years. The cost for the customer-owned lead service line replacements under the four-year tariff modification was approximately $93 through June 30, 2017 and is included as a regulatory asset. Additional replacements are expected to be approximately $130 under the four-year tariff modification, assuming the average percentage of customer-owned lead service lines that were replaced when company-owned lead service lines have been replaced through June 30, 2017 remains consistent over the entire replacement period. The Company is unable to predict how many lead customer-owned service lines are in use, and, therefore, its current estimate of $1,040 for replacements under the nine-year tariff modification is subject to adjustment as more facts become available.

Labor Relations

The current union contract expired on April 30, 2017. Management and the union leadership have agreed to honor the expired contract and continue to work under its terms. Both sides are negotiating in good faith and the Company expects to reach an operationally and fiscally responsible agreement with no interruption of service.

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Critical Accounting Estimates

The methods, estimates and judgments the Company used in applying its accounting policies have a significant impact on the results reported in its financial statements. The Company's accounting policies require management to make subjective judgments because of the need to make estimates of matters that are inherently uncertain. The Company's most critical accounting estimates include regulatory assets and liabilities, revenue recognition and accounting for its pension plans. There has been no significant change in accounting estimates or the method of estimation during the quarter ended June 30, 2017.

Off-Balance Sheet Arrangements

The Company does not use off-balance sheet transactions, arrangements or obligations that may have a material current or future effect on financial condition, results of operations, liquidity, capital expenditures, capital resources or significant components of revenues or expenses. The Company does not use securitization of receivables or unconsolidated entities. For risk management purposes, the Company uses a derivative financial instrument, an interest rate swap agreement discussed in Note 6 to the financial statements included herein. The Company does not engage in trading or other risk management activities, does not use other derivative financial instruments for any purpose, has no material lease obligations, no guarantees and does not have material transactions involving related parties.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's operations are exposed to market risks primarily as a result of changes in interest rates under its lines of credit. The Company has unsecured lines of credit with four banks having a combined maximum availability of $41,500. The first line of credit, in the amount of $13,000, is a committed line of credit with a revolving 2-year maturity (currently May 2019), and carries an interest rate of LIBOR plus 1.20%. The second line of credit, in the amount of $11,000, is a committed line of credit, which currently matures in May 2019 and carries an interest rate of LIBOR plus 1.25%. The third line of credit, in the amount of $7,500, is a committed line of credit, which matures in June 2018 and carries an interest rate of LIBOR plus 1.25%. The fourth line of credit, in the amount of $10,000, is a committed line of credit, which matures in September 2017 and carries an interest rate of LIBOR plus 1.20%. The Company had $3,507 in outstanding borrowings under its $13,000 line of credit as of June 30, 2017. The interest rate on line of credit borrowings as of June 30, 2017 was 2.31%. Other than lines of credit, the Company has long-term fixed rate debt obligations that are not subject to interest rate risk as shown in Note 5 to the financial statements included herein, and a variable rate PEDFA loan agreement, which is subject to minimal market risk, described below.

In May 2008, the PEDFA issued $12,000 aggregate principal amount of PEDFA Exempt Facilities Revenue Bonds, Series A (the "2008 Bonds"). The proceeds of this bond issue were used to refund the $12,000 PEDFA Exempt Facilities Revenue Bonds, Series B of 2004 which were refunded due to bond insurer downgrading issues. The PEDFA then loaned the proceeds to the Company pursuant to a variable interest rate loan agreement with a maturity date of October 1, 2029. The interest rate under this loan agreement averaged 0.86% during the three months ended June 30, 2017 and 0.78% during the six months ended June 30, 2017. In connection with the loan agreement, the Company retained its interest rate swap agreement whereby the Company exchanged its floating rate obligation for a fixed rate obligation. The purpose of the interest rate swap is to manage the Company's exposure to fluctuations in the interest rate. If the interest rate swap agreement works as intended, the receive rate on the swap should approximate the variable rate the Company pays on the PEDFA Series A 2008 Bond Issue, thereby minimizing its risk. See Note 6 to the financial statements included herein for additional information regarding the interest rate swap.

In addition to the interest rate swap agreement, the Company entered into a Reimbursement, Credit and Security Agreement with PNC Bank, National Association ("the Bank"), dated as of May 1, 2008, in order to enhance the marketability of and to minimize the interest rate on the 2008 Bonds. This agreement provides for a direct pay letter of credit issued by the Bank to the trustee for the 2008 Bonds. The current expiration date of the letter of credit is June 30, 2019. It is reviewed annually for a potential extension of the expiration date. The Company's responsibility under this agreement is to reimburse the Bank on a timely basis for interest payments made to the bondholders and for any tendered bonds that could not be remarketed. The Company has fourteen months from the time bonds are tendered to reimburse the Bank. If the direct pay letter of credit is not renewed, the Company would be required to pay the Bank immediately for any tendered bonds and reclassify a portion of the bonds as current liabilities. In addition, the interest rate swap agreement would terminate causing a potential payment by the Company to the counterparty. Both the letter of credit and the swap agreement can potentially be transferred upon this type of event.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company's management, with the participation of the Company's President and Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based upon this evaluation, the Company's President and Chief Executive Officer along with the Chief Financial Officer concluded that the Company's disclosure controls and procedures as of the end of the period covered by this report are effective such that the information required to be disclosed by the Company in reports filed under the Securities Exchange Act of 1934, as amended, is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to the Company's management, including the President and Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure. A controls system cannot provide absolute assurance, however, that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

No change in the Company's internal control over financial reporting occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II – OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On March 11, 2013, the Board of Directors authorized a share repurchase program granting the Company authority to repurchase up to 1,200,000 shares of the Company's common stock from time to time. The stock repurchase program has no specific end date and, under the stock repurchase program, the Company may repurchase shares in the open market or through privately negotiated transactions. The Company may suspend or discontinue the repurchase program at any time. The Company did not repurchase any shares that were not part of the publicly announced plan during the quarter ended June 30, 2017.

The following table summarizes the Company's purchases of its common stock for the quarter ended June 30, 2017.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as a Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
Apr. 1 – Apr. 30, 2017	-	$-	-	630,904
May 1 – May 31, 2017	12,900	$33.95	12,900	618,004
Jun. 1 – Jun. 30, 2017	-	$-	-	618,004
Total	12,900	$33.95	12,900	618,004

The Company will fund repurchases under the share repurchase program with internally generated funds and borrowings under its credit facilities, if necessary.

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Item 6. Exhibits

Exhibit No.	Description
3	Amended and Restated Articles of Incorporation. Incorporated herein by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 4, 2010.
3.1	Amended and Restated By-Laws. Incorporated herein by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 26, 2012.
31.1	Certification of Chief Executive Officer, pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer, pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934.
32.1	

	Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE YORK WATER COMPANY

Date: August 3, 2017	/s/Jeffrey R. Hines Jeffrey R. Hines Principal Executive Officer
Date: August 3, 2017	/s/Kathleen M. Miller Kathleen M. Miller Principal Financial and Accounting Officer

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