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, 2016 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: 0-8084

**Connecticut Water Service, Inc.**
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Connecticut<br>(State or other jurisdiction of incorporation or organization) | 06-0739839<br>(I.R.S. Employer Identification No.) |
| 93 West Main Street, Clinton, CT<br>(Address of principal executive offices) | 06413<br>(Zip Code) |

(860) 669-8636
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 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 (Section 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, 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 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer ☐ | Accelerated filer ☒ |
| Non-accelerated filer ☐<br>(Do not check if a smaller reporting company) | Smaller reporting company ☐ |

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
11,231,037
Number of shares of common stock outstanding, July 1, 2016
(Includes 217,141 common stock equivalent shares awarded under the Performance Stock Programs)

**CONNECTICUT WATER SERVICE, INC. AND SUBSIDIARIES**

Financial Report
June 30, 2016

**TABLE OF CONTENTS**

**Part I, Item 1:** Financial Statements (Unaudited)

Table of Contents

**CONNECTICUT WATER SERVICE, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED BALANCE SHEETS**
**(Unaudited)**
**(In thousands, except share data)**

| **ASSETS** | **June 30, 2016** | **December 31, 2015** |
|---|---|---|
| Utility Plant | $ 742,327 | $ 722,447 |
| Construction Work in Progress | 32,188 | 23,298 |
| | 774,515 | 745,745 |
| Accumulated Provision for Depreciation | (206,109) | (199,461) |
| Net Utility Plant | 568,406 | 546,284 |
| Other Property and Investments | 8,731 | 8,126 |
| Cash and Cash Equivalents | 1,143 | 731 |
| Accounts Receivable (Less Allowance, 2016 - $1,027; 2015 - $947) | 11,573 | 11,012 |
| Accrued Unbilled Revenues | 9,074 | 8,259 |
| Materials and Supplies, at Average Cost | 1,735 | 1,617 |
| Prepayments and Other Current Assets | 7,416 | 5,393 |
| Total Current Assets | 30,941 | 27,012 |
| Restricted Cash | 198 | 846 |
| Unrecovered Income Taxes - Regulatory Asset | 84,793 | 77,510 |
| Pension Benefits - Regulatory Asset | 11,587 | 12,414 |
| Post-Retirement Benefits Other Than Pension - Regulatory Asset | 349 | 468 |
| Goodwill | 30,427 | 30,427 |
| Deferred Charges and Other Costs | 9,809 | 7,628 |
| Total Regulatory and Other Long-Term Assets | 137,163 | 129,293 |
| **Total Assets** | $ 745,241 | $ 710,715 |
| **CAPITALIZATION AND LIABILITIES** | | |
| Common Stockholders' Equity: | | |
| Common Stock Without Par Value: Authorized - 25,000,000 Shares | | |
| Issued and Outstanding: 2016 - 11,231,037; 2015 - 11,192,882 | $ 144,025 | $ 144,534 |
| Retained Earnings | 87,284 | 80,378 |
| Accumulated Other Comprehensive (Loss) | (870) | (935) |
| Common Stockholders' Equity | 230,439 | 223,977 |
| Preferred Stock | 772 | 772 |
| Long-Term Debt | 200,861 | 171,868 |
| Total Capitalization | 432,072 | 396,617 |
| Current Portion of Long-Term Debt | 2,862 | 2,842 |
| Interim Bank Loans Payable | 11,200 | 16,085 |
| Accounts Payable and Accrued Expenses | 11,577 | 11,882 |
| Accrued Interest | 860 | 727 |
| Current Portion of Refund to Customers - Regulatory Liability | 1,632 | 2,994 |
| Other Current Liabilities | 2,142 | 2,409 |
| Total Current Liabilities | 30,273 | 36,939 |
| Advances for Construction | 20,720 | 21,444 |
| Deferred Federal and State Income Taxes | 50,382 | 48,036 |
| Unfunded Future Income Taxes | 82,116 | 74,712 |
| Long-Term Compensation Arrangements | 30,793 | 34,389 |
| Unamortized Investment Tax Credits | 1,226 | 1,264 |
| Refund to Customers - Regulatory Liability | 255 | 993 |
| Other Long-Term Liabilities | 4,978 | 5,273 |
| Total Long-Term Liabilities | 190,470 | 186,111 |
| Contributions in Aid of Construction | 92,426 | 91,048 |
| Commitments and Contingencies | — | — |
| **Total Capitalization and Liabilities** | $ 745,241 | $ 710,715 |

*The accompanying footnotes are an integral part of these condensed consolidated financial statements.*

**CONNECTICUT WATER SERVICE, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**
**For the Three Months Ended June 30, 2016 and 2015**
**(Unaudited)**
**(In thousands, except per share amounts)**

| | 2016 | 2015 |
|---|---|---|
| Operating Revenues | $ 26,055 | $ 26,624 |
| Operating Expenses | | |
| Operation and Maintenance | 8,840 | 11,179 |
| Depreciation | 3,359 | 3,161 |
| Income Tax Expense | 589 | 453 |
| Taxes Other Than Income Taxes | 2,238 | 2,082 |
| Total Operating Expenses | 15,026 | 16,875 |
| Net Operating Revenues | 11,029 | 9,749 |
| Other Utility Income, Net of Taxes | 188 | 205 |
| Total Utility Operating Income | 11,217 | 9,954 |
| Other Income (Deductions), Net of Taxes | | |
| Non-Water Sales Earnings | 406 | 375 |
| Allowance for Funds Used During Construction | 289 | 108 |
| Other | (283) | (104) |
| Total Other Income, Net of Taxes | 412 | 379 |
| Interest and Debt Expense | | |
| Interest on Long-Term Debt | 1,830 | 1,763 |
| Other Interest Income, Net | (174) | (132) |
| Amortization of Debt Expense and Premium, Net | 30 | 27 |
| Total Interest and Debt Expense | 1,686 | 1,658 |
| Net Income | 9,943 | 8,675 |
| Preferred Stock Dividend Requirement | 10 | 10 |
| Net Income Applicable to Common Stock | $ 9,933 | $ 8,665 |
| Weighted Average Common Shares Outstanding: | | |
| Basic | 11,004 | 10,958 |
| Diluted | 11,223 | 11,157 |
| Earnings Per Common Share: | | |
| Basic | $ 0.90 | $ 0.79 |
| Diluted | $ 0.89 | $ 0.77 |
| Dividends Per Common Share | $ 0.2825 | $ 0.2575 |

*The accompanying footnotes are an integral part of these condensed consolidated financial statements.*

**CONNECTICUT WATER SERVICE, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**
**For the Six Months Ended June 30, 2016 and 2015**
**(Unaudited)**
**(In thousands, except per share amounts)**

| | 2016 | 2015 |
|---|---|---|
| Operating Revenues | $ 47,607 | $ 46,654 |
| Operating Expenses | | |
| Operation and Maintenance | 20,129 | 22,503 |
| Depreciation | 6,757 | 6,297 |
| Income Tax Expense | 982 | (488) |
| Taxes Other Than Income Taxes | 4,687 | 4,428 |
| Total Operating Expenses | 32,555 | 32,740 |
| Net Operating Revenues | 15,052 | 13,914 |
| Other Utility Income, Net of Taxes | 343 | 360 |
| Total Utility Operating Income | 15,395 | 14,274 |
| Other Income (Deductions), Net of Taxes | | |
| Non-Water Sales Earnings | 801 | 744 |
| Allowance for Funds Used During Construction | 521 | 198 |
| Other | (315) | (111) |
| Total Other Income, Net of Taxes | 1,007 | 831 |
| Interest and Debt Expense | | |
| Interest on Long-Term Debt | 3,566 | 3,537 |
| Other Interest Income, Net | (316) | (264) |
| Amortization of Debt Expense and Premium, Net | 61 | 54 |
| Total Interest and Debt Expense | 3,311 | 3,327 |
| Net Income | 13,091 | 11,778 |
| Preferred Stock Dividend Requirement | 19 | 19 |
| Net Income Applicable to Common Stock | $ 13,072 | $ 11,759 |
| Weighted Average Common Shares Outstanding: | | |
| Basic | 10,998 | 10,941 |
| Diluted | 11,217 | 11,151 |
| Earnings Per Common Share: | | |
| Basic | $ 1.19 | $ 1.07 |
| Diluted | $ 1.17 | $ 1.05 |
| Dividends Per Common Share | $ 0.5500 | $ 0.5150 |

*The accompanying footnotes are an integral part of these condensed consolidated financial statements.*

**CONNECTICUT WATER SERVICE, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**For the Three Months Ended June 30, 2016 and 2015**
**(Unaudited)**
**(In thousands)**

| | 2016 | 2015 |
|---|---|---|
| Net Income | $ 9,943 | $ 8,675 |
| Other Comprehensive Income/(Loss), net of tax | | |
| Reclassification to Pension and Post-Retirement Benefits Other than Pension, net of tax (expense) benefit of $(27) and $24 in 2016 and 2015 | 43 | (28) |
| Unrealized gain (loss) on investments, net of tax (expense) benefit of $(2) and $39 in 2016 and 2015 | 2 | (62) |
| Other Comprehensive Income/(Loss), net of tax | 45 | (90) |
| Comprehensive Income | $ 9,988 | $ 8,585 |

**CONNECTICUT WATER SERVICE, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**For the Six Months Ended June 30, 2016 and 2015**
**(Unaudited)**
**(In thousands)**

| | 2016 | 2015 |
|---|---|---|
| Net Income | $ 13,091 | $ 11,778 |
| Other Comprehensive Income, net of tax | | |
| Reclassification to Pension and Post-Retirement Benefits Other than Pension, net of tax (expense) of $(49) and $(61) in 2016 and 2015 | 78 | 69 |
| Unrealized (loss) on investments, net of tax benefit of $8 and $31 in 2016 and 2015 | (13) | (48) |
| Other Comprehensive Income, net of tax | 65 | 21 |
| Comprehensive Income | $ 13,156 | $ 11,799 |

*The accompanying footnotes are an integral part of these condensed consolidated financial statements.*

**CONNECTICUT WATER SERVICE, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF RETAINED EARNINGS**
**For the Three Months Ended June 30, 2016 and 2015**
**(Unaudited)**
**(In thousands, except per share amounts)**

| | 2016 | 2015 |
|---|---|---|
| Balance at Beginning of Period | $ 80,521 | $ 69,595 |
| Net Income | 9,943 | 8,675 |
| | 90,464 | 78,270 |
| Dividends Declared: | | |
| Cumulative Preferred, Class A, $0.20 per share | 3 | 3 |
| Cumulative Preferred, Series $0.90, $0.225 per share | 7 | 7 |
| Common Stock - 2016 $0.2825 per share; 2015 $0.2575 per share | 3,170 | 2,874 |
| | 3,180 | 2,884 |
| Balance at End of Period | $ 87,284 | $ 75,386 |

**CONNECTICUT WATER SERVICE, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF RETAINED EARNINGS**
**For the Six Months Ended June 30, 2016 and 2015**
**(Unaudited)**
**(In thousands, except per share amounts)**

| | 2016 | 2015 |
|---|---|---|
| Balance at Beginning of Period | $ 80,378 | $ 69,370 |
| Net Income | 13,091 | 11,778 |
| | 93,469 | 81,148 |
| Dividends Declared: | | |
| Cumulative Preferred, Class A, $0.40 per share | 6 | 6 |
| Cumulative Preferred, Series $0.90, $0.45 per share | 13 | 13 |
| Common Stock - 2016 $0.5500 per share; 2015 $0.5150 per share | 6,166 | 5,743 |
| | 6,185 | 5,762 |
| Balance at End of Period | $ 87,284 | $ 75,386 |

*The accompanying footnotes are an integral part of these condensed consolidated financial statements.*

**CONNECTICUT WATER SERVICE, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**For the Six Months Ended June 30, 2016 and 2015**
**(Unaudited)**
**(In thousands)**

| | 2016 | 2015 |
|---|---|---|
| Operating Activities: | | |
| Net Income | $ 13,091 | $ 11,778 |
| Adjustments to Reconcile Net Income to Net Cash and Cash Equivalents Provided by | | |
| Operating Activities: | | |
| Deferred Revenues | (2,667) | (2,344) |
| Provision for Deferred Income Taxes and Investment Tax Credits, Net | 2,125 | (6,341) |
| Allowance for Funds Used During Construction | (521) | (198) |
| Depreciation and Amortization (including $571 and $387 in 2016 and 2015, respectively, charged to other accounts) | 7,328 | 6,684 |
| Change in Assets and Liabilities: | | |
| Increase in Accounts Receivable and Accrued Unbilled Revenues | (1,376) | (603) |
| (Increase) Decrease in Prepaid Income Taxes and Prepayments and Other Current Assets | (1,854) | 1,626 |
| (Increase) Decrease in Other Non-Current Items | (5,049) | 7,279 |
| Decrease in Accounts Payable, Accrued Expenses and Other Current Liabilities | (1,613) | (576) |
| Total Adjustments | (3,627) | 5,527 |
| Net Cash and Cash Equivalents Provided by Operating Activities | 9,464 | 17,305 |
| Investing Activities: | | |
| Net Additions to Utility Plant Used | (28,627) | (14,238) |
| Release of Restricted Cash | 649 | — |
| Net Cash and Cash Equivalents Used in Investing Activities | (27,978) | (14,238) |
| Financing Activities: | | |
| Net Proceeds from Interim Bank Loans | 11,200 | 3,718 |
| Net Repayment of Interim Bank Loans | (16,085) | (1,991) |
| Proceeds from the Issuance of Long-Term Debt | 30,000 | 1,630 |
| Costs to Issue Long-Term Debt and Common Stock | (27) | (5) |
| Proceeds from Issuance of Common Stock | 852 | 753 |
| Repayment of Long-Term Debt Including Current Portion | (1,021) | (943) |
| Advances from Others for Construction | 192 | 123 |
| Cash Dividends Paid | (6,185) | (5,762) |
| Net Cash and Cash Equivalents Provided by (Used in) Financing Activities | 18,926 | (2,477) |
| Net Increase in Cash and Cash Equivalents | 412 | 590 |
| Cash and Cash Equivalents at Beginning of Period | 731 | 2,475 |
| Cash and Cash Equivalents at End of Period | $ 1,143 | $ 3,065 |
| Non-Cash Investing and Financing Activities: | | |
| Non-Cash Contributed Utility Plant | $ 558 | $ 616 |
| Supplemental Disclosures of Cash Flow Information: | | |
| Cash Paid for: | | |
| Interest | $ 3,208 | $ 3,356 |
| State and Federal Income Taxes | $ 255 | $ 360 |

*The accompanying footnotes are an integral part of these condensed consolidated financial statements.*

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

### 1. Basis of Preparation of Financials

The condensed consolidated financial statements included herein have been prepared by Connecticut Water Service, Inc. (the "Company") and its wholly-owned subsidiaries, pursuant to the rules and regulations of the Securities and Exchange Commission and reflect all adjustments that are of a normal recurring nature which are, in the opinion of management, necessary to a fair statement of the results for interim periods. Certain information and footnote disclosures have been omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. The Company's primary operating subsidiaries are: The Connecticut Water Company ("Connecticut Water") and The Maine Water Company ("Maine Water"). The Condensed Consolidated Balance Sheet at December 31, 2015 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. It is suggested that these condensed consolidated financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's latest Annual Report on Form 10-K for the year ended December 31, 2015 (the "10-K") and as updated in the Company's Quarterly Report on Form 10-Q for the period ending March 31, 2016.

The results for interim periods are not necessarily indicative of results to be expected for the year since the consolidated earnings are subject to seasonal factors.

During the preparation of the Condensed Consolidated Financial Statements for the quarter ended June 30, 2016, the Company identified two errors related to the accounting treatment of stock based performance awards granted to officers of the Company. First, the Company had mistakenly classified all stock based performance awards as equity awards and, secondly, incorrectly marked those awards to the market price of the Company's common stock price at the end of each reporting period. A portion of these awards should have been classified as liability awards and only those awards should have been marked-to-market based on the Company's common stock price. During the second quarter of 2016, the Company reversed all of the incorrectly recorded mark-to-market expense as a cumulative out-of-period adjustment resulting in a one-time benefit of approximately $2.6 million on the Operation and Maintenance line item on its Condensed Consolidated Statements of Income for the three and six months ended June 30, 2016. Approximately $1.6 million of the out of period adjustment pertained to years prior to 2016, with the remaining $1.0 million related to the first quarter of 2016. Additionally, the Company decreased its Common Stock Without Par Value and increased its Long-Term Compensation Arrangement line items on the Condensed Consolidated Balance Sheet as of June 30, 2016 by approximately $0.6 million to reflect both the awards that should have been classified as liability awards and their corresponding mark-to-market adjustments.

The Company performed various quantitative and qualitative analyses and determined that these errors were not material to the previously reported quarterly and annual results. The Company also determined that recording these entries as an out-of- period adjustment during the second quarter of 2016 is not expected to be material to the projected results for the full year ended December 31, 2016.

Certain previously reported information has been reclassified to conform to the current period presentation.

*Regulatory Matters*

The rates we charge our water customers in Connecticut and Maine are established under the jurisdiction of and are approved by the Connecticut Public Utilities Regulatory Authority ("PURA") and the Maine Public Utilities Commission ("MPUC"), respectively. It is our policy to seek rate relief as necessary to enable us to achieve an adequate rate of return. Connecticut Water's allowed return on equity and return on rate base, effective June 30, 2016 , were 9.75% and 7.32% , respectively. Maine Water's average allowed return on equity and return on rate base, effective June 30, 2016 , were 9.50% and 7.96% , respectively. The PURA establishes rates in Connecticut on a company-wide basis while the MPUC approves Maine Water's rates on a division-by-division basis. Both Connecticut Water and Maine Water are allowed to add surcharges to customers' bills in order to recover certain approved capital projects in between full rate cases.

Heritage Village Water Company Acquisition

On May 10, 2016, the Company entered into an Agreement and Plan of Merger (the "Agreement") with Heritage Village Water Company, a specially-chartered Connecticut corporation ("HVWC"). Founded in 1969, HVWC is based in Southbury, Connecticut, and serves approximately 4,700 water and 3,000 waste water customers in the southern Connecticut communities of Southbury, Middlebury and Oxford.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

The Boards of Directors of the Company and HVWC have each unanimously approved the Agreement. Consummation of the Merger is subject to regulatory, HVWC shareholder and other specified approvals described below and is expected to be completed during either the fourth quarter of 2016 or the first quarter of 2017.

Under the terms of the Agreement, each share of HVWC common stock issued and outstanding at the time of the closing of the Merger will be exchanged and converted into the right to receive 240 shares of the common stock of the Company, without par value (the "Company Common Stock"), provided that the Company's Share Price (as defined below) over a specified period prior to the closing date of the Merger is equal to or greater than $39.45 but less than or equal to $41.45. If the the Company's Share Price is less than $39.45 as of the closing date, each share of HVWC common stock issued and outstanding at the time of the closing of the Merger will be exchanged and converted into the right to receive that number of shares of Company Common Stock equal to $9,468 divided by the Company's Share Price. If the the Company's Share Price is more than $41.45 as of the closing date, each share of HVWC common stock issued and outstanding at the time of the closing of the Merger will be exchanged and converted into the right to receive that number of shares of the Company's Common Stock equal to $9,948 divided by the Company's Share Price. The "Company's Share Price" is determined by calculation an average of the closing prices for shares of the Company's Common Stock on the Nasdaq Stock Market, LLC for the twenty trading days immediately preceding the third business day prior to the closing of the Merger. Holders of HVWC common stock prior to the Merger will receive cash in lieu of fractional shares of Company Common Stock.

The Agreement contains customary representations and warranties regarding, on the one hand, HVWC, its business and operations and related matters, and, on the other hand, the Company, made by the parties as of specified dates, and customary affirmative and negative covenants with respect to the conduct of HVWC's business prior to the closing. In the Agreement, HVWC has agreed that its Board of Directors will, subject to certain exceptions, recommend adoption of the Agreement by HVWC shareholders and the transactions contemplated by the Agreement. HVWC has also agreed: (i) to cause a special meeting of shareholders of HVWC to be held to consider the approval and adoption of the Agreement and the transactions contemplated thereby; and (ii) not to solicit proposals relating to alternative business combination transactions or, subject to certain exceptions, enter into discussions concerning confidential information in connection with alternative business combination transactions.

The obligation of the parties to complete the Merger is subject to the satisfaction or waiver on or prior to the closing date of certain specified conditions, including the following: (i) receipt of a final and non-appealable order of PURA approving the Merger in form and substance reasonably acceptable to the parties; (ii) approval of the Merger by the affirmative vote of the holders of not less than two-thirds (66 2/3rd%) HVWC's issued and outstanding shares of common stock as required under the Connecticut Business Corporation Act and by a super-majority vote of ninety (90%) percent of HVWC's issued and outstanding shares; (iii) the completion of certain specified corporate governance steps regarding HVWC's Board of Directors, including the appointment of up to three additional directors; (iv) the receipt of all other necessary consents or approvals to the Merger; (v) approval for listing of the Company Common Stock to be issued in the Merger on the Nasdaq Stock Market, LLC; (vi) the absence of laws, orders, judgments and injunctions that restrain, enjoin or otherwise prohibit consummation of the Merger; (vii) effectiveness under the Securities Act of 1933 (the "Securities Act") of the Company's registration statement on Form S-4 relating to the issuance of the Company Common Stock in the Merger and absence of any stop order in respect thereof or proceedings by the Securities and Exchange Commission ("SEC") for that purpose; (viii) the receipt of customary tax opinions from counsel to HVWC and the Company that will state that the Merger will qualify as a tax-free reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986; (ix) the accuracy of representations and warranties with respect to the businesses of HVWC and the Company and compliance by HVWC and the Company with their respective covenants contained in the Merger Agreement; (x) no event(s) occurring that could reasonably be expected to result in a "Company Material Adverse Effect" (as defined in the Agreement) and (xi) holders of no more than 5% of HVWC's common stock have exercised appraisal rights under Connecticut law.

The parties' obligation to complete the Merger is also subject to a closing condition related to HVWC's enabling legislation adopted in 1969. The special act of the Connecticut legislature that formed HVWC provides a right of first refusal ("ROFR") to the Town of Southbury, Connecticut to purchase HVWC on the same terms and conditions as those set forth in the Agreement. The Town has a statutory period of ninety (90) days following receipt of notice from HVWC to exercise its right to purchase HVWC on such same terms and conditions. This notice was delivered to the Town on May 10, 2016.

The Agreement contains certain termination rights for both the Company and HVWC and further provides that, in connection with the termination of the Agreement under specified circumstances, HVWC may be required to pay to the Company, or the Company may be required to pay to HVWC, a termination fee of $100,000 in cash, as liquidated damages.

On July 7, 2016, Connecticut Water filed an application with PURA seeking approval of the acquisition.

On July 28, 2016, the Town of Southbury filed a lawsuit against HVWC and Connecticut Water in Connecticut state court seeking a preliminary injunction to preclude the parties from completing the merger or taking other actions that the Town believes will prevent the Town from fully enforcing its ROFR rights. On August 5, 2016, a hearing was held in Waterbury Superior Court at which the Court ordered that its ROFR deadline be extended to November 11, 2016. The order allows the Company to continue the approval process, with both state utility regulators and the SEC.

Maine Water Land Sale

On March 11, 2016, Maine Water entered into a purchase and sale agreement with the Coastal Mountains Land Trust, a Maine nonprofit corporation (the "Land Trust") pursuant to which Maine Water agreed to sell two conservation easements to the Land Trust on approximately 1,300 acres of land located in the towns of Rockport, Camden and Hope, in Knox County, Maine valued in the aggregate at $3.1 million. The land had a book value of approximately $600,000 at December 31, 2015 and is included in "Utility Plant" on the Company's "Consolidated Balance Sheets". The easements and purchase prices are as follows:

1. Ragged Mountain Mirror Lake Conservation Easement: $1,875,000; and
2. Grassy Pond conservation Easement: $600,000.

The two easement sale and donation transactions are expected to close no later than December 31, 2017 and December 31, 2019, respectively. Maine Water will make a $200,000 contribution to the Land Trust upon completion of the closing of the first easement sale. Maine Water also expects to claim a charitable deduction for the $600,000 in excess of the fair market value of the second easement over the $600,000 sale price.

Connecticut Rates

In Connecticut, the Water Infrastructure Conservation Adjustment ("WICA") was 3.04% and 5.12% at June 30, 2015 and 2016 , respectively. On July 27, 2016, Connecticut Water filed a WICA application with the PURA requesting a 2.01% surcharge to customers' bills, representing approximately $12.8 million in WICA related projects. If approved as filed, the Company's cumulative WICA surcharge, effective October 1, 2016, will be 7.13%. WICA surcharges are capped at 10% between general rate cases.

Since 2013, Connecticut law has authorized a Water Revenue Adjustment ("WRA") to reconcile actual water demands with the demands projected in the last general rate case and allows companies to adjust rates as necessary to recover the revenues approved by PURA in the last general rate case. The WRA removes the financial disincentive for water utilities to develop and implement effective water conservation programs. The WRA allows water companies to defer on the balance sheet, as a regulatory asset or liability, for later collection from or crediting to customers the amount by which actual revenues deviate from the revenues allowed in the most recent general rate proceedings, including WICA proceedings. Additionally, projects eligible for WICA surcharges were expanded to include energy conservation projects, improvements required to comply with streamflow regulations, and improvements to acquired systems.

Connecticut Water's allowed revenues for the six months ended June 30, 2016 , as approved by PURA during our 2010 general rate case and including subsequently approved WICA surcharges, are approximately $36.8 million. Through normal billing for the six months ended June 30, 2016 , revenue for Connecticut Water would have been approximately $34.0 million had the WRA not been implemented. As a result of the implementation of the WRA, Connecticut Water recorded $2.8 million in additional revenue for the six months ended June 30, 2016 .

Maine Rates

In Maine, the overall, cumulative Water Infrastructure Charge ("WISC") for all divisions was 1.13% and 4.08% as of June 30, 2015 and 2016, respectively.

In 2014 and 2015, Maine Water petitioned the MPUC for approval of accounting orders that would address (1) the return to its customers a federal income tax refund stemming from the adoption of the Internal Revenue Service ("IRS") Revenue Procedure 2012-19 ("Repair Regulations"), and (2) the treatment of any benefit resulting from the elimination of deferred tax liabilities previously recorded on these qualifying fixed assets that are now deducted under these new repair regulations.

On February 26, 2015, the MPUC approved a stipulation between Maine Water and the Office of the Public Advocate that refunds $2.9 million to the customers of the eight divisions over a two year period starting no later than July 1, 2015, and allows the flow-through treatment of the repair deduction as of January 1, 2014. In addition, Maine Water agreed not to file a general rate case during the two year refund period in any of the eight divisions that were allowed the refund.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

On June 22, 2015, the MPUC approved a settlement agreement between Maine Water and the Office of the Public Advocate that allowed for the amortization of the deferred tax liabilities over a one to nine year period, depending on the division. Maine Water commenced amortization per the agreed upon schedule.

With the completion of these two dockets, Maine Water recorded in the quarter ended June 30, 2015 the retroactive benefit associated with the flow-through of Repair Regulations from January 1, 2014. The 2014 benefit, reflected in the second quarter of 2015, was approximately $931,000, or $0.09 per basic share outstanding.

A newly passed water revenue adjustment mechanism law in Maine became available to regulated water utilities in Maine on October 15, 2015. Maine Water is currently precluded from seeking new rates due to various agreements with the MPUC, but is evaluating how and when this new mechanism can be implemented.

## 2. Pension and Other Post-Retirement Benefits

The following tables set forth the components of pension and other post-retirement benefit costs for the three and six months ended June 30, 2016 and 2015 .

**Pension Benefits**
Components of Net Periodic Cost (in thousands):

| | Three Months | | Six Months | |
|---|---|---|---|---|
| **Period ended June 30,** | **2016** | **2015** | **2016** | **2015** |
| Service Cost | $ 426 | $ 506 | $ 947 | $ 1,076 |
| Interest Cost | 812 | 786 | 1,606 | 1,557 |
| Expected Return on Plan Assets | (1,061) | (958) | (2,040) | (1,924) |
| Amortization of: | | | | |
| Prior Service Cost | 4 | 4 | 8 | 8 |
| Net Recognized Loss | 514 | 799 | 1,025 | 1,490 |
| Net Periodic Benefit Cost | $ 695 | $ 1,137 | $ 1,546 | $ 2,207 |

The Company has made a total contribution of approximately $5,525,000 in 2016 for the 2015 plan year during the six months ended June 30, 2016 .

**Post-Retirement Benefits Other Than Pension (PBOP)**
Components of Net Periodic Cost (in thousands):

| | Three Months | | Six Months | |
|---|---|---|---|---|
| **Period ended June 30,** | **2016** | **2015** | **2016** | **2015** |
| Service Cost | $ 85 | $ 77 | $ 188 | $ 229 |
| Interest Cost | 135 | 135 | 271 | 282 |
| Expected Return on Plan Assets | (85) | (81) | (170) | (162) |
| Other | 56 | 56 | 112 | 112 |
| Amortization of: | | | | |
| Prior Service Credit | (100) | (144) | (200) | (286) |
| Recognized Net Loss | 11 | 83 | 19 | 193 |
| Net Periodic Benefit Cost | $ 102 | $ 126 | $ 220 | $ 368 |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

## 3. Earnings per Share

Earnings per weighted average common share are calculated by dividing net income applicable to common stock by the weighted average number of shares of common stock outstanding during the respective periods as detailed below (diluted shares include the effect of stock awards):

| **Three months ended June 30,** | **2016** | **2015** |
|---|---|---|
| Common Shares Outstanding End of Period: | 11,231,037 | 11,167,637 |
| Weighted Average Shares Outstanding (Days Outstanding Basis): | | |
| Basic | 11,004,331 | 10,957,571 |
| Diluted | 11,222,989 | 11,156,798 |
| | | |
| Basic Earnings per Share | $ 0.90 | $ 0.79 |
| Dilutive Effect of Stock Awards | (0.01) | (0.02) |
| Diluted Earnings per Share | $ 0.89 | $ 0.77 |
| | | |
| **Six months ended June 30,** | | |
| Weighted Average Shares Outstanding (Days Outstanding Basis): | | |
| Basic | 10,998,408 | 10,941,043 |
| Diluted | 11,217,136 | 11,150,583 |
| | | |
| Basic Earnings per Share | $ 1.19 | $ 1.07 |
| Dilutive Effect of Stock Awards | (0.02) | (0.02) |
| Diluted Earnings per Share | $ 1.17 | $ 1.05 |

Total unrecognized compensation expense for all stock awards was approximately $1.0 million as of June 30, 2016 and will be recognized over a weighted average period of 1.4 years .

## 4. Recently Adopted and New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, “Revenue from Contracts with Customers,” (“No. 2014-09”) which amends its guidance related to revenue recognition. ASU No. 2014-09 requires an entity to recognize revenue as performance obligations are met, in order to reflect the transfer of promised goods or services to customers in an amount that reflects the consideration the entity is entitled to receive for those goods or services. The following steps are applied in the updated guidance: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation. ASU No. 2014-09 is effective for public companies for fiscal years, and interim periods within those years, beginning after December 15, 2016, and can be adopted either retrospectively to each prior reporting period presented or as a cumulative-effect adjustment as of the date of adoption, however early adoption is not permitted. On April 1, 2015, the FASB voted for a one-year deferral of the effective date of ASU No. 2014-09, making ASU No. 2014-09 effective for public companies for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company is currently determining its implementation approach and assessing the impact that this guidance may have on our consolidated financial position, including its impact on the Company’s contracted services provided to water and wastewater utilities.

In April 2015, the FASB issued ASU 2015-03, “Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs” (“ASU No. 2015-03”). The update requires debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability instead of being presented as an asset. Debt disclosures will include the face amount of the debt liability and the effective interest rate. The update requires retrospective application and represents a change in accounting principle. The update is effective for fiscal years beginning after December 15, 2015. The Company has adopted ASU No. 2015-03, effective January 1, 2016, which had the effect of reducing the December 31, 2015 Long-Term Debt balance by $5,786,000 on the Condensed Consolidated Balance Sheet.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

In July 2015, the FASB issued ASU 2015-11, “Inventory (Topic 330): Simplifying the Measurement of Inventory,” (“ASU No. 2015-11”) which applies to inventory that is measured using first-in, first-out (“FIFO”) or average cost. Under the updated guidance, an entity should measure inventory that is within scope at the lower of cost or net realizable value, which is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. Subsequent measurement is unchanged under the updated guidance for inventory that is measured using last-in, last-out (“LIFO”). This ASU is effective for annual and interim periods beginning after December 15, 2016, and should be applied prospectively with early adoption permitted at the beginning of an interim or annual reporting period. The Company uses average cost to value its inventory and, therefore, ASU No. 2015-11 is expected to have no impact on the Company.

In November 2015, the FASB issued ASU No. 2015-17, “Income Taxes (Topic 740), Balance Sheet Classification of Deferred Taxes” (“ASU No. 2015-17”). ASU No. 2015-17 requires net deferred tax assets and liabilities to be classified as non-current on the Company’s Consolidated Balance Sheets. Prior to adoption of the new standard, net deferred tax assets and liabilities were presented separately as current and non-current on the Consolidated Balance Sheets. ASU No. 2015-17 is effective for financial statements issued for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted. The Company has adopted ASU No. 2015-17, effective January 1, 2016, which had the effect of reducing the December 31, 2015 Prepayments and Other Current Assets and Deferred Federal and State Income Taxes balances by $17,000 on the Condensed Consolidated Balance Sheet.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842)”, (“ASU No. 2016-02”), which will require lessees to recognize the following for all leases at the commencement date of a lease: a) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and b) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Public business entities should apply the amendments in ASU No. 2016-02 for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted for all public business entities and all nonpublic business entities upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently assessing the impact of this standard on its consolidated financial statements and footnote disclosures, but does not expect that the adoption of this guidance will materially impact our consolidated financial position.

In March 2016, the FASB issued ASU 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” (“ASU No. 2016-09”). ASU No. 2016-09 impacts several aspects of the accounting for share-based payment transactions, including classification of certain items on the Consolidated Statement of Cash Flows and accounting for income taxes. Specifically, ASU No. 2016-09 requires that excess tax benefits and tax deficiencies (the difference between the deduction for tax purposes and the compensation cost recognized for financial reporting purposes) be recognized as income tax expense or benefit in the Consolidated Statements of Income, introducing a new element of volatility to the provision for income taxes. ASU No. 2016-09 is effective for fiscal years beginning after December 15, 2016, with early adoption permitted. The Company adopted ASU No. 2016-09 during the second quarter of 2016, which had the effect of decreasing the Other line item on the Condensed Consolidated Statement of Income for the three and six months ended June 30, 2016 by approximately $19,000.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

## 5. Accumulated Other Comprehensive Income

The changes in Accumulated Other Comprehensive Income (Loss) ("AOCI") by component, net of tax, for the three and six months ended June 30, 2016 and 2015 are as follows (in thousands):

| Three months ended June 30, 2016 | Unrealized Gains on Investments | Defined Benefit Items | Total |
|---|---|---|---|
| Beginning Balance (a) | $ 185 | $ (1,100) | $ (915) |
| Other Comprehensive (Loss) Income Before Reclassification | (8) | — | (8) |
| Amounts Reclassified from AOCI | 10 | 43 | 53 |
| Net current-period Other Comprehensive (Loss) Income | 2 | 43 | 45 |
| Ending Balance | $ 187 | $ (1,057) | $ (870) |

| Three months ended June 30, 2015 | Unrealized Gains on Investments | Defined Benefit Items | Total |
|---|---|---|---|
| Beginning Balance (a) | $ 312 | $ (1,804) | $ (1,492) |
| Other Comprehensive (Loss) Income Before Reclassification | (137) | (65) | (202) |
| Amounts Reclassified from AOCI | 75 | 37 | 112 |
| Net current-period Other Comprehensive (Loss) Income | (62) | (28) | (90) |
| Ending Balance | $ 250 | $ (1,832) | $ (1,582) |

| Six months ended June 30, 2016 | Unrealized Gains on Investments | Defined Benefit Items | Total |
|---|---|---|---|
| Beginning Balance (a) | $ 200 | $ (1,135) | $ (935) |
| Other Comprehensive (Loss) Income Before Reclassification | (23) | — | (23) |
| Amounts Reclassified from AOCI | 10 | 78 | 88 |
| Net current-period Other Comprehensive (Loss) Income | (13) | 78 | 65 |
| Ending Balance | $ 187 | $ (1,057) | $ (870) |

| Six months ended June 30, 2015 | Unrealized Gains on Investments | Defined Benefit Items | Total |
|---|---|---|---|
| Beginning Balance (a) | $ 298 | $ (1,901) | $ (1,603) |
| Other Comprehensive (Loss) Income Before Reclassification | (123) | (65) | (188) |
| Amounts Reclassified from AOCI | 75 | 134 | 209 |
| Net current-period Other Comprehensive (Loss) Income | (48) | 69 | 21 |
| Ending Balance | $ 250 | $ (1,832) | $ (1,582) |

(a) All amounts shown are net of tax. Amounts in parentheses indicate loss.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

The following table sets forth the amounts reclassified from AOCI by component and the affected line item on the Condensed Consolidated Statements of Income for the three and six months ended June 30, 2016 and 2015 (in thousands):

| Details about Other AOCI Components | Amounts Reclassified from AOCI Three Months Ended June 30, 2016(a) | Amounts Reclassified from AOCI Three Months Ended June 30, 2015(a) | Affected Line Items on Income Statement |
|---|---|---|---|
| Realized Gains on Investments | $ 17 | $ 128 | Other Income |
| Tax expense | (7) | (53) | Other Income |
| | 10 | 75 | |
| Amortization of Recognized Net Gain from Defined Benefit Items | 71 | 61 | Other Income (b) |
| Tax expense | (28) | (24) | Other Income |
| | 43 | 37 | |
| Total Reclassifications for the period, net of tax | $ 53 | $ 112 | |

| Details about Other AOCI Components | Amounts Reclassified from AOCI Six Months Ended June 30, 2016(a) | Amounts Reclassified from AOCI Six Months Ended June 30, 2015(a) | Affected Line Items on Income Statement |
|---|---|---|---|
| Realized Gains on Investments | $ 17 | $ 128 | Other Income |
| Tax expense | (7) | (53) | Other Income |
| | 10 | 75 | |
| Amortization of Recognized Net Gain from Defined Benefit Items | 128 | 196 | Other Income (b) |
| Tax expense | (50) | (62) | Other Income |
| | 78 | 134 | |
| Total Reclassifications for the period, net of tax | $ 88 | $ 209 | |

(a) Amounts in parentheses indicate loss/expense.

(b) Included in computation of net periodic pension cost (see Note 2 for additional details).

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

## 6. Long-Term Debt

Long-Term Debt at June 30, 2016 and December 31, 2015 consisted of the following (in thousands):

| | | 2016 | 2015 |
|---|---|---|---|
| Connecticut Water Service, Inc.: | | | |
| 4.09% | Term Loan Note | $ 13,960 | $ 14,472 |
| The Connecticut Water Company: | | | |
| Var. | 2004 Series Variable Rate, Due 2029 | 12,500 | 12,500 |
| Var. | 2004 Series A, Due 2028 | 5,000 | 5,000 |
| Var. | 2004 Series B, Due 2028 | 4,550 | 4,550 |
| 5.10% | 2009 A Series, Due 2039 | 19,930 | 19,930 |
| 5.00% | 2011 A Series, Due 2021 | 23,210 | 23,303 |
| 3.16% | CoBank Note Payable, Due 2020 | 8,000 | 8,000 |
| 3.51% | CoBank Note Payable, Due 2022 | 14,795 | 14,795 |
| 4.29% | CoBank Note Payable, Due 2028 | 17,020 | 17,020 |
| 4.72% | CoBank Note Payable, Due 2032 | 14,795 | 14,795 |
| 4.75% | CoBank Note Payable, Due 2033 | 14,550 | 14,550 |
| 4.36% | CoBank Note Payable, Due 2036 | 30,000 | — |
| Total The Connecticut Water Company | | 164,350 | 134,443 |
| The Maine Water Company: | | | |
| 8.95% | 1994 Series G, Due 2024 | 8,100 | 8,100 |
| 2.68% | 1999 Series J, Due 2019 | 254 | 339 |
| 0.00% | 2001 Series K, Due 2031 | 615 | 656 |
| 2.58% | 2002 Series L, Due 2022 | 68 | 75 |
| 1.53% | 2003 Series M, Due 2023 | 341 | 361 |
| 1.73% | 2004 Series N, Due 2024 | 401 | 401 |
| 0.00% | 2004 Series O, Due 2034 | 120 | 127 |
| 1.76% | 2006 Series P, Due 2026 | 391 | 411 |
| 1.57% | 2009 Series R, Due 2029 | 217 | 227 |
| 0.00% | 2009 Series S, Due 2029 | 605 | 628 |
| 0.00% | 2009 Series T, Due 2029 | 1,697 | 1,760 |
| 0.00% | 2012 Series U, Due 2042 | 154 | 160 |
| 1.00% | 2013 Series V, Due 2033 | 1,335 | 1,360 |
| 2.52% | CoBank Note Payable, Due 2017 | 1,965 | 1,965 |
| 4.24% | CoBank Note Payable, Due 2024 | 4,500 | 4,500 |
| 7.72% | Series L, Due 2018 | 2,250 | 2,250 |
| 2.40% | Series N, Due 2022 | 1,101 | 1,176 |
| 1.86% | Series O, Due 2025 | 830 | 830 |
| 2.23% | Series P, Due 2028 | 1,294 | 1,324 |
| 0.01% | Series Q, Due 2035 | 1,771 | 1,864 |
| 1.00% | Series R, Due 2025 | 2,488 | 2,488 |
| Various | Various Capital Leases | 12 | 17 |
| Total The Maine Water Company | | 30,509 | 31,019 |
| Add: Acquisition Fair Value Adjustment | | 442 | 562 |
| Less: Current Portion | | (2,862) | (2,842) |
| Less: Unamortized Debt Issuance Expense | | (5,538) | (5,786) |
| Total Long-Term Debt | | $ 200,861 | $ 171,868 |

There are no mandatory sinking fund payments required on Connecticut Water's outstanding bonds. However, certain fixed rate Unsecured Water Facilities Revenue Refinancing Bonds provide for an estate redemption right whereby the estate of

deceased bondholders or surviving joint owners may submit bonds to the trustee for redemption at par, subject to a $25,000 per individual holder and a 3% annual aggregate limitation.

On March 17, 2015, Maine Water completed the issuance of $1,864,050 aggregate principal amount of its First Mortgage Bonds, Series Q, 0.01% due March 17, 2035 (the "Series Q Bonds"). The Series Q Bonds were issued by Maine Water to the Bank and the proceeds of the issuance were loaned (the "Series Q Loan") by the Bank to Maine Water pursuant to a Loan Agreement by and between Maine Water and the Bank dated as of March 17, 2015. The proceeds of the Series Q Loan were used by Maine Water to fund various water facilities projects, including the replacement of a booster station and modifications to a treatment plant, each located in the City of Biddeford, Maine.

On November 25, 2015, Maine Water completed the issuance of $2,487,630 aggregate principal amount of its First Mortgage Bonds, Series R, 1.0% due November 25, 2025 (the "Series R Bonds"). The Series R Bonds were issued by Maine Water to the Bank and the proceeds of the issuance were loaned (the "Series R Loan") by the Bank to Maine Water pursuant to a Loan Agreement by and between Maine Water and the Bank dated as of November 25, 2015. The remaining proceeds of the Series R Loan will be used by Maine Water to fund the construction of a 3 million gallon water storage tank, located in the City of Biddeford, Maine, which will replace an existing in-ground 7.5 million gallon reservoir.

In April 2016, Connecticut Water filed an application with PURA to issue promissory notes in the aggregate principal amount of up to $49,930,000 with CoBank, ACB ("CoBank") under its existing Master Loan Agreement by and between Connecticut Water and CoBank dated October 29, 2012, in order for Connecticut Water to redeem its $19,930,000 2009A Series of outstanding Water Facility Revenue Bonds previously issued by the Connecticut Development Authority (the "2009A Bonds") and to provide $30,000,000 to partially fund its ongoing construction program. On June 1, 2016, Connecticut Water issued $30,000,000, at 4.36%, in debt under its existing Master Loan Agreement with CoBank, with a maturity date of May 20, 2036. On July 7, 2016, Connecticut Water issued $19,930,000, at 4.04%, in debt under its existing Master Loan Agreement with CoBank, with a maturity date of July 7, 2036. Connecticut Water used the proceeds to immediately pay off the the $19,930,000 2009A Series of outstanding Water Facility Revenue Bonds.

During the first six months of 2016 , the Company paid approximately $512,000 related to Connecticut Water Service's Term Note Payable issued as part of the 2012 acquisition of Maine Water and approximately $510,000 in sinking funds related to Maine Water's outstanding bonds.

**Financial Covenants** – The Company and its subsidiaries are required to comply with certain covenants in connection with various long term loan agreements. The most restrictive of these covenants is to maintain a consolidated debt to capitalization ratio of not more than 60%. Additionally, Maine Water has restrictions on cash dividends paid based on restricted net assets. The Company and its subsidiaries were in compliance with all covenants at June 30, 2016 .

## 7. Fair Value Disclosures

FASB Accounting Standards Codification ("ASC") 820, *Fair Value Measurements and Disclosures* ("FASB ASC 820") provides enhanced guidance for using fair value to measure assets and liabilities and expands disclosure with respect to fair value measurements.

FASB ASC 820 establishes a fair value hierarchy that distinguishes between assumptions based on market data (observable inputs) and the Company's assumptions (unobservable inputs). The hierarchy consists of three broad levels, as follows:

Level 1 – Quoted market prices in active markets for identical assets or liabilities.

Level 2 – Inputs other than Level 1 that are either directly or indirectly observable.

Level 3 – Unobservable inputs developed using the Company's estimates and assumptions, which reflect those that the Company believes market participants would use.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

The following table summarizes our financial instruments measured at fair value on a recurring basis within the fair value hierarchy as of June 30, 2016 (in thousands):

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Asset Type: | | | | |
| Company Owned Life Insurance | $ — | $ 2,989 | $ — | $ 2,989 |
| Money Market Fund | 123 | — | — | 123 |
| Mutual Funds: | | | | |
| Equity Funds (1) | 1,364 | — | — | 1,364 |
| Fixed Income Funds (2) | 469 | — | — | 469 |
| Total | $ 1,956 | $ 2,989 | $ — | $ 4,945 |

The following table summarizes our financial instruments measured at fair value on a recurring basis within the fair value hierarchy as of December 31, 2015 (in thousands):

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Asset Type: | | | | |
| Company Owned Life Insurance | $ — | $ 2,909 | $ — | $ 2,909 |
| Money Market Fund | 122 | — | — | 122 |
| Mutual Funds: | | | | |
| Equity Funds (1) | 1,441 | — | — | 1,441 |
| Fixed Income Funds (2) | 485 | — | — | 485 |
| Total | $ 2,048 | $ 2,909 | $ — | $ 4,957 |

(1) Mutual funds consist primarily of equity securities and are presented on the Other Property and Investments line item of the Company's Condensed Consolidated Balance Sheets.

(2) Mutual funds consist primarily of fixed income securities and are presented on the Other Property and Investments line item of the Company's Condensed Consolidated Balance Sheets.

The fair value of Company Owned Life Insurance is based on the cash surrender value of the contracts. These contracts are based principally on a referenced pool of investment funds that actively redeem shares and are observable and measurable and are presented on the Other Property and Investments line item of the Company's Condensed Consolidated Balance Sheets.

The following methods and assumptions were used to estimate the fair value of each of the following financial instruments, which are not recorded at fair value on the financial statements.

*Cash and cash equivalents* – Cash equivalents consist of highly liquid instruments with original maturities at the time of purchase of three months or less. The carrying amount approximates fair value. Under the fair value hierarchy the fair value of cash and cash equivalents is classified as a Level 1 measurement.

*Restricted Cash* – As part of Maine Water's November 2015 bond offering, the Company recorded unused proceeds from this bond issuance as restricted cash as the funds can only be used for certain capital expenditures. The Company expects to use the remainder of the proceeds during 2016, as the approved capital expenditures are completed. The carrying amount approximates fair value. Under the fair value hierarchy the fair value of restricted cash is classified as a Level 1 measurement.

*Long-Term Debt* – The fair value of the Company's fixed rate long-term debt is based upon borrowing rates currently available to the Company. As of June 30, 2016 and December 31, 2015 , the estimated fair value of the Company's long-term debt was $227,057,000 and $191,616,000 , respectively, as compared to the carrying amounts of $206,399,000 and $177,654,000 , respectively. The estimated fair value of long term debt was calculated using a discounted cash flow model that uses comparable interest rates and yield curve data based on the A-rated MMD (Municipal Market Data) Index which is a benchmark of current municipal bond yields. Under the fair value hierarchy, the fair value of long term debt is classified as a Level 2 measurement.

*Advances for Construction* – Customer advances for construction had a carrying amount of $20,720,000 and $21,444,000 at June 30, 2016 and December 31, 2015 , respectively. Their relative fair values cannot be accurately estimated since future refund payments depend on several variables, including new customer connections, customer consumption levels and future rate increases.

The fair values shown above have been reported to meet the disclosure requirements of FASB ASC 825, "Financial Instruments" ("FASB ASC 825") and do not purport to represent the amounts at which those obligations would be settled.

## 8. Segment Reporting

The Company operates principally in three business segments: Water Operations, Real Estate Transactions, and Services and Rentals. Financial data for the segments is as follows (in thousands):

**Three months ended June 30, 2016**

| Segment | Revenues | Pre-Tax Income | Income Tax Expense | Net Income |
|---|---|---|---|---|
| Water Operations | $ 26,376 | $ 10,173 | $ 636 | $ 9,537 |
| Real Estate Transactions | — | — | — | — |
| Services and Rentals | 1,212 | 563 | 157 | 406 |
| Total | $ 27,588 | $ 10,736 | $ 793 | $ 9,943 |

**Three months ended June 30, 2015**

| Segment | Revenues | Pre-Tax Income | Income Tax Expense(Benefit) | Net Income |
|---|---|---|---|---|
| Water Operations | $ 26,967 | $ 8,698 | $ 398 | $ 8,300 |
| Real Estate Transactions | — | — | — | — |
| Services and Rentals | 1,463 | 566 | 191 | 375 |
| Total | $ 28,430 | $ 9,264 | $ 589 | $ 8,675 |

**Six months ended June 30, 2016**

| Segment | Revenues | Pre-Tax Income | Income Tax Expense | Net Income |
|---|---|---|---|---|
| Water Operations | $ 48,231 | $ 13,123 | $ 833 | $ 12,290 |
| Real Estate Transactions | — | — | — | — |
| Services and Rentals | 2,443 | 1,100 | 299 | 801 |
| Total | $ 50,674 | $ 14,223 | $ 1,132 | $ 13,091 |

**Six months ended June 30, 2015**

| Segment | Revenues | Pre-Tax Income | Income Tax Expense(Benefit) | Net Income |
|---|---|---|---|---|
| Water Operations | $ 47,307 | $ 10,385 | $ (649) | $ 11,034 |
| Real Estate Transactions | — | — | — | — |
| Services and Rentals | 2,825 | 1,195 | 451 | 744 |
| Total | $ 50,132 | $ 11,580 | $ (198) | $ 11,778 |

The revenues shown in Water Operations above consisted of revenues from water customers of $26,055,000 and $26,624,000 for the three months ended June 30, 2016 and 2015 , respectively. Additionally, there were revenues associated with utility plant leased to others of $321,000 and $343,000 for the three months ended June 30, 2016 and 2015 , respectively. The revenues from water customers for the three months ended June 30, 2016 and 2015 include $2,386,000 and $2,652,000 in additional revenues related to the application of the WRA, respectively. The revenues shown in Water Operations above consisted of revenues from water customers of $47,607,000 and $46,654,000 for the six months ended June 30, 2016 and 2015 , respectively. Additionally, there were revenues associated with utility plant leased to others of $624,000 and $653,000 for the six months ended June 30, 2016 and 2015 , respectively. The revenues from water customers for the six months ended June 30, 2016 and 2015 include $2,786,000 and $2,463,000 in additional revenues related to the application of the WRA, respectively.

The Company owns various small, discrete parcels of land that are no longer required for water supply purposes. From time to time, the Company may sell or donate these parcels, depending on various factors, including the current market for land, the amount of tax benefits received for donations and the Company's ability to use any benefits received from donations.

Assets by segment (in thousands):

| | June 30, 2016 | December 31, 2015 |
|---|---|---|
| *Total Plant and Other Investments:* | | |
| Water Operations | $ 576,175 | $ 553,773 |
| Non-Water | 962 | 637 |
| | 577,137 | 554,410 |
| *Other Assets:* | | |
| Water Operations | 164,204 | 154,090 |
| Non-Water | 3,900 | 2,215 |
| | 168,104 | 156,305 |
| Total Assets | $ 745,241 | $ 710,715 |

**9. Income Taxes**

FASB ASC 740 Income Taxes ("FASB ASC 740") addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FASB ASC 740, the Company must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution.

On June 11, 2013, the Company was notified by the Connecticut Department of Revenue Services that its state tax filings for the years 2009 through 2011 would be reviewed beginning in the fourth quarter of 2013. On March 24, 2015, the Company was notified by the Connecticut Department of Revenue Services that the audit was expanded to include the 2012 and 2013 tax years. The State focused its review on tax credits associated with fixed capital investment. The Company and the State came to an agreement ("Closing Agreement") regarding investments eligible for the credit. The Closing Agreement was executed on May 4, 2015. The Company had previously recorded a provision for the possible disallowance of these credits and, therefore, there was minimal impact in 2015.

On the 2012 tax return, filed in September 2013, Connecticut Water filed a change in accounting method to adopt the Internal Revenue Service's ("IRS") temporary tangible property regulations. On the 2013 Federal tax return, filed in September 2014, Maine Water filed the same change in accounting method. This method change allowed the Company to take a current year deduction for expenses that were previously capitalized for tax purposes. Since the filing of the 2012 tax return, the IRS has issued final regulations. On February 11, 2014, the Company was notified by the IRS that its Federal tax filing for 2012 would be reviewed. This review, which began in the first quarter of 2014 and was completed in the first quarter of 2015, resulted in no change to the tax liability. Since the Company had previously recorded a provision for the possible disallowance of the repair deduction in prior periods, the completion of the audit resulted in the reversal of the provision in the amount of $1,185,000 in the first quarter of 2015. While the Company maintains the belief that the deduction taken on its tax return is appropriate, the methodology for determining the deduction has not been agreed to by the taxing authorities. Through June 30, 2016 , the Company has recorded, as required by FASB ASC 740, a provision of $1.1 million for a portion of the benefit that is not being returned to customers resulting from any possible tax authority challenge. The Company had previously recorded a provision of $6.3 million in the prior year for a cumulative total of $7.4 million.

From time to time, the Company may be assessed interest and penalties by taxing authorities. In those cases, the charges would appear on the Other line item within the Other Income (Deductions), Net of Taxes section of the Company's Condensed Consolidated Statements of Income. There were no such charges for the six months ended June 30, 2016 and 2015 . Additionally, there were no accruals relating to interest or penalties as of June 30, 2016 and December 31, 2015 . The Company remains subject to examination by federal tax authorities for the 2013 and 2014 tax years; the State of Maine's tax authorities for the 2012 through 2014 tax years; and the State of Connecticut's tax authorities for the 2014 tax year.

The Company is currently engaged in an analysis to determine the amount of expenditures related to tangible property that will be reflected on its 2016 Federal Tax Return to be filed in September 2017. As a result, through the second quarter of 2016 , the Company has estimated the portion of its infrastructure investment that will qualify as a repair deduction for 2016 and has reflected that deduction in its effective tax rate, net of any reserves. Consistent with other differences between book and tax

expenditures, the Company is required to use the flow-through method to account for any timing differences not required by the IRS to be normalized.

The Company's effective income tax rate for the three months ended June 30, 2016 and 2015 was 7.4% and 6.4% , respectively. The Company's effective tax rate, excluding discrete items recorded during the three months ended June 30, 2016 , was 5.2% . These discrete items include adjustments related to uncertain tax positions for the repair deduction in both Connecticut and Maine and a change in estimate of prior year tax expense. The blended Federal and State statutory income tax rates during each period were 41% . In determining its annual estimated effective tax rate for interim periods, the Company reflects its estimated permanent and flow-through tax differences for the taxable year, including the basis difference for the adoption of the tangible property regulations.

The Company's effective income tax rate for the six months ended June 30, 2016 and 2015 was 8.0% and (1.7)% , respectively. The Company's effective tax rate, excluding discrete items recorded during the six months ended June 30, 2016 , was 3.4% . These discrete items include adjustments related to uncertain tax positions for the repair deduction in both Connecticut and Maine and a change in estimate of prior year tax expense. The blended Federal and State statutory income tax rates during each period were 41% . In determining its annual estimated effective tax rate for interim periods, the Company reflects its estimated permanent and flow-through tax differences for the taxable year, including the basis difference for the adoption of the tangible property regulations.

**10. Lines of Credit**

As of June 30, 2016 , the Company maintained a $15.0 million line of credit agreement with CoBank, that is currently scheduled to expire on July 1, 2020 . The Company maintained an additional line of credit of $45.0 million with RBS Citizens, N.A., with an expiration date of April 25, 2021 . As of June 30, 2016 , the total lines of credit available to the Company were $60.0 million . As of June 30, 2016 and December 31, 2015 , the Company had $11.2 million and $16.1 million , respectively, of Interim Bank Loans Payable. As of June 30, 2016 , the Company had $48.8 million in unused lines of credit. Interest expense charged on lines of credit will fluctuate based on market interest rates.

**Part I, Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion should be read in conjunction with the accompanying unaudited financial statements and related notes thereto and the audited financial statements and the notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2015 .*

**General Information**

*Regulatory Matters*

The rates we charge our water customers in Connecticut and Maine are established under the jurisdiction of and are approved by the Connecticut Public Utilities Regulatory Authority ("PURA") and the Maine Public Utilities Commission ("MPUC"), respectively. It is our policy to seek rate relief as necessary to enable us to achieve an adequate rate of return. Connecticut Water's allowed return on equity and return on rate base, effective June 30, 2016 , were 9.75% and 7.32% , respectively. Maine Water's average allowed return on equity and return on rate base, effective June 30, 2016 , were 9.50% and 7.96% , respectively. The PURA establishes rates in Connecticut on a company-wide basis while the MPUC approves Maine Water's rates on a division-by-division basis. Both Connecticut Water and Maine Water are allowed to add surcharges to customers' bills in order to recover certain approved capital projects in between full rate cases.

Heritage Village Water Company Acquisition

On May 10, 2016, the Company entered into an Agreement and Plan of Merger (the "Agreement") with Heritage Village Water Company, a specially-chartered Connecticut corporation ("HVWC"). Founded in 1969, HVWC is based in Southbury, Connecticut, and serves approximately 4,700 water and 3,000 waste water customers in the southern Connecticut communities of Southbury, Middlebury and Oxford.

The Boards of Directors of the Company and HVWC have each unanimously approved the Agreement. Consummation of the Merger is subject to regulatory, HVWC shareholder and other specified approvals described below and is expected to be completed during either the fourth quarter of 2016 or the first quarter of 2017.

Under the terms of the Agreement, each share of HVWC common stock issued and outstanding at the time of the closing of the Merger will be exchanged and converted into the right to receive 240 shares of the common stock of the Company, without par

value (the "Company Common Stock"), provided that the Company's Share Price (as defined below) over a specified period prior to the closing date of the Merger is equal to or greater than $39.45 but less than or equal to $41.45. If the the Company's Share Price is less than $39.45 as of the closing date, each share of HVWC common stock issued and outstanding at the time of the closing of the Merger will be exchanged and converted into the right to receive that number of shares of Company Common Stock equal to $9,468 divided by the Company's Share Price. If the the Company's Share Price is more than $41.45 as of the closing date, each share of HVWC common stock issued and outstanding at the time of the closing of the Merger will be exchanged and converted into the right to receive that number of shares of the Company's Common Stock equal to $9,948 divided by the Company's Share Price. The "Company's Share Price" is determined by calculation an average of the closing prices for shares of the Company's Common Stock on the Nasdaq Stock Market, LLC for the twenty trading days immediately preceding the third business day prior to the closing of the Merger. Holders of HVWC common stock prior to the Merger will receive cash in lieu of fractional shares of Company Common Stock.

The Agreement contains customary representations and warranties regarding, on the one hand, HVWC, its business and operations and related matters, and, on the other hand, the Company, made by the parties as of specified dates, and customary affirmative and negative covenants with respect to the conduct of HVWC's business prior to the closing. In the Agreement, HVWC has agreed that its Board of Directors will, subject to certain exceptions, recommend adoption of the Agreement by HVWC shareholders and the transactions contemplated by the Agreement. HVWC has also agreed: (i) to cause a special meeting of shareholders of HVWC to be held to consider the approval and adoption of the Agreement and the transactions contemplated thereby; and (ii) not to solicit proposals relating to alternative business combination transactions or, subject to certain exceptions, enter into discussions concerning confidential information in connection with alternative business combination transactions.

The obligation of the parties to complete the Merger is subject to the satisfaction or waiver on or prior to the closing date of certain specified conditions, including the following: (i) receipt of a final and non-appealable order of PURA approving the Merger in form and substance reasonably acceptable to the parties; (ii) approval of the Merger by the affirmative vote of the holders of not less than two-thirds (66 2/3rd%) HVWC's issued and outstanding shares of common stock as required under the Connecticut Business Corporation Act and by a super-majority vote of ninety (90%) percent of HVWC's issued and outstanding shares; (iii) the completion of certain specified corporate governance steps regarding HVWC's Board of Directors, including the appointment of up to three additional directors; (iv) the receipt of all other necessary consents or approvals to the Merger; (v) approval for listing of the Company Common Stock to be issued in the Merger on the Nasdaq Stock Market, LLC; (vi) the absence of laws, orders, judgments and injunctions that restrain, enjoin or otherwise prohibit consummation of the Merger; (vii) effectiveness under the Securities Act of 1933 (the "Securities Act") of the Company's registration statement on Form S-4 relating to the issuance of the Company Common Stock in the Merger and absence of any stop order in respect thereof or proceedings by the Securities and Exchange Commission ("SEC") for that purpose; (viii) the receipt of customary tax opinions from counsel to HVWC and the Company that will state that the Merger will qualify as a tax-free reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986; (ix) the accuracy of representations and warranties with respect to the businesses of HVWC and the Company and compliance by HVWC and the Company with their respective covenants contained in the Merger Agreement; (x) no event(s) occurring that could reasonably be expected to result in a "Company Material Adverse Effect" (as defined in the Agreement) and (xi) holders of no more than 5% of HVWC's common stock have exercised appraisal rights under Connecticut law.

The parties' obligation to complete the Merger is also subject to a closing condition related to HVWC's enabling legislation adopted in 1969. The special act of the Connecticut legislature that formed HVWC provides a right of first refusal ("ROFR") to the Town of Southbury, Connecticut to purchase HVWC on the same terms and conditions as those set forth in the Agreement. The Town has a statutory period of ninety (90) days following receipt of notice from HVWC to exercise its right to purchase HVWC on such same terms and conditions. This notice was delivered to the Town on May 10, 2016.

The Agreement contains certain termination rights for both the Company and HVWC and further provides that, in connection with the termination of the Agreement under specified circumstances, HVWC may be required to pay to the Company, or the Company may be required to pay to HVWC, a termination fee of $100,000 in cash, as liquidated damages.

On July 7, 2016, Connecticut Water filed an application with PURA seeking approval of the acquisition.

On July 28, 2016, the Town of Southbury filed a lawsuit against HVWC and Connecticut Water in Connecticut state court seeking a preliminary injunction to preclude the parties from completing the merger or taking other actions that the Town believes will prevent the Town from fully enforcing its ROFR rights. On August 5, 2016, a hearing was held in Waterbury Superior Court at which the Court ordered that its ROFR deadline be extended to November 11, 2016. The order allows the Company to continue the approval process, with both state utility regulators and the SEC.

Maine Water Land Sale

On March 11, 2016, Maine Water entered into a purchase and sale agreement with the Coastal Mountains Land Trust, a Maine nonprofit corporation (the "Land Trust") pursuant to which Maine Water agreed to sell two conservation easements to the Land Trust on approximately 1,300 acres of land located in the towns of Rockport, Camden and Hope, in Knox County, Maine valued in the aggregate at $3.1 million. The land had a book value of approximately $600,000 at December 31, 2015 and is included in "Utility Plant" on the Company's "Consolidated Balance Sheets". The easements and purchase prices are as follows:

1. Ragged Mountain Mirror Lake Conservation Easement: $1,875,000; and
2. Grassy Pond conservation Easement: $600,000.

The two easement sale and donation transactions are expected to close no later than December 31, 2017 and December 31, 2019, respectively. Maine Water will make a $200,000 contribution to the Land Trust upon completion of the closing of the first easement sale. Maine Water also expects to claim a charitable deduction for the $600,000 in excess of the fair market value of the second easement over the $600,000 sale price.

Connecticut Rates

In Connecticut, the Water Infrastructure Conservation Adjustment ("WICA") was 3.04% and 5.12% at June 30, 2015 and 2016 , respectively. On July 27, 2016, Connecticut Water filed a WICA application with the PURA requesting a 2.01% surcharge to customers' bills, representing approximately $12.8 million in WICA related projects. If approved as filed, the Company's cumulative WICA surcharge, effective October 1, 2016, will be 7.13%. WICA surcharges are capped at 10% between general rate cases.

Since 2013, Connecticut law has authorized a Water Revenue Adjustment ("WRA") to reconcile actual water demands with the demands projected in the last general rate case and allows companies to adjust rates as necessary to recover the revenues approved by PURA in the last general rate case. The WRA removes the financial disincentive for water utilities to develop and implement effective water conservation programs. The WRA allows water companies to defer on the balance sheet, as a regulatory asset or liability, for later collection from or crediting to customers the amount by which actual revenues deviate from the revenues allowed in the most recent general rate proceedings, including WICA proceedings. Additionally, projects eligible for WICA surcharges were expanded to include energy conservation projects, improvements required to comply with streamflow regulations, and improvements to acquired systems.

Connecticut Water's allowed revenues for the six months ended June 30, 2016 , as approved by PURA during our 2010 general rate case and including subsequently approved WICA surcharges, are approximately $36.8 million. Through normal billing for the six months ended June 30, 2016 , revenue for Connecticut Water would have been approximately $34.0 million had the WRA not been implemented. As a result of the implementation of the WRA, Connecticut Water recorded $2.8 million in additional revenue for the six months ended June 30, 2016 .

Maine Rates

In Maine, the overall, cumulative Water Infrastructure Charge ("WISC") for all divisions was 1.13% and 4.08% as of June 30, 2015 and 2016, respectively.

In 2014 and 2015, Maine Water petitioned the MPUC for approval of accounting orders that would address (1) the return to its customers a federal income tax refund stemming from the adoption of the Internal Revenue Service ("IRS") Revenue Procedure 2012-19 ("Repair Regulations"), and (2) the treatment of any benefit resulting from the elimination of deferred tax liabilities previously recorded on these qualifying fixed assets that are now deducted under these new repair regulations.

On February 26, 2015, the MPUC approved a stipulation between Maine Water and the Office of the Public Advocate that refunds $2.9 million to the customers of the eight divisions over a two year period starting no later than July 1, 2015, and allows the flow-through treatment of the repair deduction as of January 1, 2014. In addition, Maine Water agreed not to file a general rate case during the two year refund period in any of the eight divisions that were allowed the refund.

On June 22, 2015, the MPUC approved a settlement agreement between Maine Water and the Office of the Public Advocate that allowed for the amortization of the deferred tax liabilities over a one to nine year period, depending on the division. Maine Water commenced amortization per the agreed upon schedule.

With the completion of these two dockets, Maine Water recorded in the quarter ended June 30, 2015 the retroactive benefit associated with the flow-through of Repair Regulations from January 1, 2014. The 2014 benefit, reflected in the second quarter of 2015, was approximately $931,000, or $0.09 per basic share outstanding.

A newly passed water revenue adjustment mechanism law in Maine became available to regulated water utilities in Maine on October 15, 2015. Maine Water is currently precluded from seeking new rates due to various agreements with the MPUC, but is evaluating how and when this new mechanism can be implemented.

**Critical Accounting Policies and Estimates**

The Company maintains its accounting records in accordance with accounting principles generally accepted in the United States of America and as directed by the PURA and the MPUC to which Connecticut Water and Maine Water, respectively, the Company's regulated water utility subsidiaries, are subject. Significant accounting policies employed by the Company, including the use of estimates, were presented in the Notes to Consolidated Financial Statements of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2015 .

Critical accounting policies are those that are the most important to the presentation of the Company's financial condition and results of operations. The application of such accounting policies requires management's most difficult, subjective, and complex judgments and involves uncertainties and assumptions. The Company's most critical accounting policies pertain to public utility regulation related to ASC 980 "Regulated Operations", revenue recognition (including the WRA), goodwill impairment, income taxes and accounting for pension and other post-retirement benefit plans. Each of these accounting policies and the application of critical accounting policies and estimates were discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 .

During the preparation of the Condensed Consolidated Financial Statements for the quarter ended June 30, 2016, the Company identified two errors related to the accounting treatment of stock based performance awards granted to officers of the Company. First, the Company had mistakenly classified all stock based performance awards as equity awards and, secondly, incorrectly marked those awards to the market price of the Company's common stock price at the end of each reporting period. A portion of these awards should have been classified as liability awards and only those awards should have been marked-to-market based on the Company's common stock price. During the second quarter of 2016, the Company reversed all of the incorrectly recorded mark-to-market expense as a cumulative out-of-period adjustment resulting in a one-time benefit of approximately $2.6 million on the Operation and Maintenance line item on its Condensed Consolidated Statements of Income for the three and six months ended June 30, 2016. Approximately $1.6 million of the out of period adjustment pertained to years prior to 2016, with the remaining $1.0 million related to the first quarter of 2016. Additionally, the Company decreased its Common Stock Without Par Value and increased its Long-Term Compensation Arrangement line items on the Condensed Consolidated Balance Sheet as of June 30, 2016 by approximately $0.6 million to reflect both the awards that should have been classified as liability awards and their corresponding mark-to-market adjustments.

Management must use informed judgments and best estimates to properly apply these critical accounting policies. Because of the uncertainty in these estimates, actual results could differ from estimates used in applying the critical accounting policies. The Company is not aware of any reasonably likely events or circumstances which would result in different amounts being reported that would materially affect its financial condition or results of operations.

**Outlook**

The following modifies and updates the "Outlook" section of the Company's 2015 Annual Report on Form 10-K for the fiscal year ended December 31, 2015 .

The Company's earnings and profitability are primarily dependent upon the sale and distribution of water. In Maine, water revenues can be dependent on seasonal weather fluctuations, particularly during the summer months when water demand will vary with rainfall and temperature levels. This risk has been mitigated in Connecticut with the implementation of the WRA. The Company's earnings and profitability in future years will also depend upon a number of other factors, such as the ability to control our operating costs, customer growth in the Company's core regulated water utility businesses, growth in revenues attributable to non-water sales operations, availability and desirability of land no longer needed for water delivery for land sales, and the timing and adequacy of rate relief when requested, from time to time, by our regulated water companies.

The Company expects Net Income from its Water Operations segment to increase in 2016 over 2015 levels, primarily due to revenue increases due to expected rate increases and the utilization of WISC in Maine and WICA in Connecticut, continued cost containment efforts and modest growth in its Services and Rentals segment. The Company currently does not expect to complete any Real Estate transactions during the year ending December 31, 2016.

The Company believes that the factors described above and those described in detail under the heading “Commitments and Contingencies” below may have significant impact, either alone or in the aggregate, on the Company’s earnings and profitability in fiscal years 2016 and beyond. Please also review carefully the risks and uncertainties described in the sections entitled Item 1A – Risk Factors, “Commitments and Contingencies” in Item 7 of the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2015 and the risks and uncertainties described in the “Forward-Looking Information” section below.

**Liquidity and Capital Resources**

The Company is not aware of demands, events, or uncertainties that will result in a decrease of liquidity or a material change in the mix or relative cost of its capital resources, other than those outlined below.

*Borrowing Facilities*

As of June 30, 2016 , the Company maintained a $15.0 million line of credit agreement with CoBank, that is currently scheduled to expire on July 1, 2020 . The Company maintained an additional line of credit of $45.0 million with RBS Citizens, N.A., with an expiration date of April 25, 2021 . As of June 30, 2016 , the total lines of credit available to the Company were $60.0 million . As of June 30, 2016 and December 31, 2015 , the Company had $11.2 million and $16.1 million , respectively, of Interim Bank Loans Payable. As of June 30, 2016 , the Company had $48.8 million in unused lines of credit. Interest expense charged on lines of credit will fluctuate based on market interest rates.

On March 17, 2015, Maine Water completed the issuance of $1,864,050 aggregate principal amount of its First Mortgage Bonds, Series Q, 0.01% due March 17, 2035 (the “Series Q Bonds”). The Series Q Bonds were issued by Maine Water to the Bank and the proceeds of the issuance were loaned (the “Series Q Loan”) by the Bank to Maine Water pursuant to a Loan Agreement by and between Maine Water and the Bank dated as of March 17, 2015. The proceeds of the Series Q Loan were used by Maine Water to fund various water facilities projects, including the replacement of a booster station and to fund modifications to a treatment plant, each located in the City of Biddeford, Maine.

On November 25, 2015, Maine Water completed the issuance of $2,487,630 aggregate principal amount of its First Mortgage Bonds, Series R, 1.0% due November 25, 2025 (the “Series R Bonds”). The Series R Bonds were issued by Maine Water to the Bank and the proceeds of the issuance were loaned (the “Series R Loan”) by the Bank to Maine Water pursuant to a Loan Agreement by and between Maine Water and the Bank dated as of November 25, 2015. The remaining proceeds of the Series R Loan will be used by Maine Water to fund the construction of a 3 million gallon water storage tank, located in the City of Biddeford, Maine, which will replace an existing in-ground 7.5 million gallon reservoir.

In April 2016, Connecticut Water filed an application with PURA to issue promissory notes in the aggregate principal amount of up to $49,930,000 with CoBank, ACB (“CoBank”) under its existing Master Loan Agreement by and between Connecticut Water and CoBank dated October 29, 2012, in order for Connecticut Water to redeem its $19,930,000 2009A Series of outstanding Water Facility Revenue Bonds previously issued by the Connecticut Development Authority (the “2009A Bonds”) and to provide $30,000,000 to partially fund its ongoing construction program. On June 1, 2016, Connecticut Water issued $30,000,000, at 4.36%, in debt under its existing Master Loan Agreement with CoBank, with a maturity date of May 20, 2036. On July 7, 2016, Connecticut Water issued $19,930,000, at 4.04%, in debt under its existing Master Loan Agreement with CoBank, with a maturity date of July 7, 2036. Connecticut Water used the proceeds to immediately pay of the the $19,930,000 2009A Series of outstaning Water Facility Revenue Bonds.

During the first six months of 2016 , the Company paid approximately $512,000 related to Connecticut Water Service’s Term Note Payable issued as part of the 2012 acquisition of Maine Water and approximately $510,000 in sinking funds related to Maine Water’s outstanding bonds.

*Credit Rating*

On February 11, 2016, Standard & Poor’s Ratings Services (“S&P”) affirmed its ‘A’ corporate credit rating on the Company. Additionally, S&P also affirmed the Company’s ratings outlook as stable.

*Stock Plans*

The Company offers a dividend reinvestment and stock purchase plan ("DRIP") for all registered shareholders and for the customers and employees of our regulated water companies, whereby participants can opt to have cash dividends directly reinvested into additional shares of the Company. In August 2011, the Board of Directors approved amendments to the DRIP (effective as of January 1, 2012) that permit the Company to add, at the Company's discretion, an "up to 5.00% purchase price discount" feature to the DRIP which is intended to encourage greater shareholder, customer and employee participation in the DRIP. In August 2014, the Board of Directors approved further amendments to the DRIP to reflect the Company's appointment of a new common stock transfer agent. During the six months ended June 30, 2016 and 2015 , plan participants invested $852,000 and $753,000, respectively, in additional shares as part of the DRIP.

*2016 Construction Budget*

The Board of Directors approved a $65.9 million construction budget for 2016 , net of amounts to be financed by customer advances and contributions in aid of construction. The Company will use a combination of its internally generated funds, borrowing under its available lines of credit and proceeds from recently completed debt issuances.

As the Company looks forward to the remainder of 2016 and 2017, it anticipates continued reinvestment to replace aging infrastructure and to seek recovery of these costs through periodic WICA and WISC applications. The total cost of that investment may exceed the amount of internally generated funds. The Company expects to rely upon its internally generated funds and short-term borrowing facilities and proceeds from recently completed debt issuances.

**Results of Operations**

***Three months ended June 30***

Net Income for the three months ended June 30, 2016 increased from the same period in the prior year by $1,268,000 to $9,943,000 . Earnings per basic average common share were $0.90 and $0.79 during the three months ended June 30, 2016 and 2015 , respectively.

This increase in Net Income is broken down by business segment as follows (in thousands):

| Business Segment | June 30, 2016 | June 30, 2015 | Increase/(Decrease) |
|---|---|---|---|
| Water Operations | $ 9,537 | $ 8,300 | $ 1,237 |
| Real Estate Transactions | — | — | — |
| Services and Rentals | 406 | 375 | 31 |
| Total | $ 9,943 | $ 8,675 | $ 1,268 |

The Net Income from Water Operations for the three months ended June 30, 2016 and 2015 were each impacted positively by non-recurring items. During three months ended June 30, 2016 , the Company reversed incorrectly recorded mark-to-market expense as an out-of-period adjustment resulting in a one-time benefit (reduction) of approximately $2.6 million in Operation and Maintenance expense. During three months ended June 30, 2015 , the Company recorded an approximate $0.9 million reduction to Income Tax expense related to a June 2015 MPUC approval of a settlement agreement between Maine Water and the State of Maine's Office of Public Advocate that in part allowed for the flow through benefit of Maine Water's adoption of the IRS's repair tax accounting regulations. The items discussed in detail below reflect the approximate $0.4 million decrease in Net Income during the three months ended June 30, 2016 after the impact of the above non-recurring items.

*Revenue*

Revenue from our water customers decreased by $569,000, or 2.1%, to $26,055,000 for the three months ended June 30, 2016 when compared to the same period in 2015 . The primary driver for this decrease is related to the treatment of unbilled revenues when applying the WRA. During the three months ended June 30, 2016 , the Company's unbilled revenues decreased by $921,000 due primarily to the average number of days unbilled decreasing during the current period. When calculating the WRA, the Company is required to ignore the impact of unbilled revenues when calculating allowed revenues for a given period, therefore, with all things being equal, a period where there are higher unbilled revenues will result in a higher WRA. Partially off-setting the decrease in unbilled revenues were increases due to higher WISC and WICA surcharges in Maine and Connecticut, respectively.

*Operation and Maintenance Expense*

Operation and Maintenance ("O&M") expense decreased by $2,339,000 , or 20.9%, for the three months ended June 30, 2016 when compared to the same period of 2015 . The following table presents the components of O&M expense (in thousands):

| Expense Components | June 30, 2016 | June 30, 2015 | Increase / (Decrease) |
|---|---|---|---|
| Mark-to-market | $ (2,389) | $ (331) | $ (2,058) |
| Pension | 693 | 1,127 | (434) |
| Maintenance | 811 | 879 | (68) |
| Medical | 569 | 622 | (53) |
| Payroll | 3,947 | 3,975 | (28) |
| Property and liability insurance | 359 | 378 | (19) |
| Investor relations | 218 | 236 | (18) |
| Post-retirement medical | 101 | 118 | (17) |
| Outside services | 802 | 798 | 4 |
| Water treatment (including chemicals) | 668 | 657 | 11 |
| Utility costs | 914 | 903 | 11 |
| Vehicles | 441 | 332 | 109 |
| Customer | 508 | 333 | 175 |
| Other benefits | 692 | 386 | 306 |
| Other | 506 | 766 | (260) |
| Total | $ 8,840 | $ 11,179 | $ (2,339) |

The changes in individual items are described below:

- The decrease in mark-to-market expense is related to an out-of-period adjustment made during the second quarter of 2016 related to the incorrect accounting treatment of stock based performance awards granted to officers of the Company. The Company had mistakenly classified all stock based performance awards as equity awards and, secondly, incorrectly marked those awards to the market price of the Company's common stock price at the end of each reporting period. During the second quarter of 2016, the Company reversed all of the incorrectly recorded mark-to-market expense as an out-of-period adjustment resulting in a one-time benefit of $2.6 million;
- Pension and post-retirement medical costs decreased primarily due to an increase in the discount rate used in determining 2016 expense compared to the discount rate used to determine the 2015 expense;
- Medical costs decreased primarily due to a reduction in claims made by employees and their families during the second quarter of 2016 when compared to the same period in 2015;
- Payroll costs decreased primarily due to an increase in the amount of employee time charged to capital projects in the period ended June 30, 2016; and
- Investor relations costs decreased primarily due to a reduction in directors fees due to the retirement of a member of the Board of Directors and a reduction in costs associated with the preparation of the Company's annual Proxy statement.

The decreases described above were partially offset by the following increases to O&M expense:

- Other benefits increased primarily due to costs associated with the Company's performance stock plan available to officers and certain members of the senior management team of the Company; and
- Customer costs increased primarily as a result of an increase in the allowance for uncollectible accounts.

The Company saw an approximate $198,000, or 6.3%, increase in its Depreciation expense from the three months ended June 30, 2016 compared to the same period in 2015 . The increase was primarily due to higher Utility Plant in Service as of June 30, 2016 compared to June 30, 2015 driven by spending on WICA and WISC projects in Connecticut and Maine, respectively.

Income Tax expense increased by $136,000 in the second quarter of 2016 when compared to the same period in 2015 due to a higher effective income tax rate. The Company's effective tax rate increased from 6.4% to 7.4% in the three months ended June 30, 2016 compared to the same period in 2015 . The primary drivers of the increased effective tax rate was related to the June 2015 MPUC approval of a settlement agreement between Maine Water and the State of Maine's Office of Public Advocate that in part allowed for the flow through benefit of Maine Water's adoption of the IRS's repair tax accounting regulations.

Other Income (Deductions), Net of Taxes increased for the three months ended June 30, 2016 by $33,000. The primary driver of this increase was an increase in AFUDC during the three months ended June 30, 2016 related primarily to an increase in the monthly balances of Construction Work in Progress through June 30, 2016 when compared to the same period in 2015 .

Total Interest and Debt Expense increased by $28,000 in the three months ended June 30, 2016 when compared to the same period in 2015 . The primary reason for the increase in Interest and Debt Expense was the result of higher debt balances outstanding at June 30, 2016 when compared to June 30, 2015 .

***Six months ended June 30***

Net Income for the six months ended June 30, 2016 increased from the same period in the prior year by $1,313,000 to $13,091,000 . Earnings per basic average common share increased by $0.12 to $1.19 during the six months ended June 30, 2016 .

This increase in Net Income is broken down by business segment as follows (in thousands):

| Business Segment | June 30, 2016 | June 30, 2015 | Increase/(Decrease) |
|---|---|---|---|
| Water Operations | $ 12,290 | $ 11,034 | $ 1,256 |
| Real Estate Transactions | — | — | — |
| Services and Rentals | 801 | 744 | 57 |
| Total | $ 13,091 | $ 11,778 | $ 1,313 |

The Net Income from Water Operations for the six months ended June 30, 2016 and 2015 were each impacted positively by non-recurring items. During six months ended June 30, 2016 , the Company reversed incorrectly recorded mark-to-market expense as an out-of-period adjustment resulting in a one-time benefit (reduction) of approximately $2.6 million in Operation and Maintenance expense. Approximately $1.6 million of the out of period adjustment pertained to years prior to 2016, with the remaining $1.0 million related to the first quarter of 2016. During six months ended June 30, 2015 , the Company recorded an approximate $2.1 million reduction to Income Tax expense related to a June 2015 MPUC approval of a settlement agreement between Maine Water and the State of Maine's Office of Public Advocate that in part allowed for the flow through benefit of Maine Water's adoption of the IRS's repair tax accounting regulations and the reversal of previously established reserves after the completion of an IRS audit of the Company's 2012 federal tax return. The items discussed in detail below reflect the approximate $1.8 million increase in Net Income during the six months ended June 30, 2016 after the impact of the above non-recurring items.

*Revenue*

Revenue from our water customers increased by $953,000, or 2.0%, to 47,607,000 for the six months ended June 30, 2016 when compared to the same period in 2015 . The Company saw an increase in revenues in Maine due to rate increases in certain Maine Water divisions through regular rate increases and WISC surcharges and increased WICA surcharges in Connecticut.

*Operation and Maintenance Expense*

O&M expense decreased by $2,374,000 , or 10.6%, for the six months ended June 30, 2016 when compared to the same period of 2015 . The following table presents the components of O&M expense (in thousands):

| Expense Components | June 30, 2016 | June 30, 2015 | Increase / (Decrease) |
|---|---|---|---|
| Mark-to-market | $ (1,393) | $ (351) | $ (1,042) |
| Pension | 1,542 | 2,191 | (649) |
| Outside services | 1,400 | 1,731 | (331) |
| Payroll | 7,718 | 7,877 | (159) |
| Post-retirement medical | 220 | 360 | (140) |
| Utility costs | 1,871 | 2,001 | (130) |
| Maintenance | 1,528 | 1,628 | (100) |
| Water treatment (including chemicals) | 1,254 | 1,297 | (43) |
| Property and liability insurance | 719 | 756 | (37) |
| Vehicles | 780 | 765 | 15 |
| Investor relations | 459 | 429 | 30 |
| Medical | 1,375 | 1,336 | 39 |
| Customer | 908 | 694 | 214 |
| Other benefits | 754 | 341 | 413 |
| Other | 994 | 1,448 | (454) |
| Total | $ 20,129 | $ 22,503 | $ (2,374) |

The changes in individual items are described below:

- The decrease in mark-to-market expense is related to an out-of-period adjustment made during the second quarter of 2016 related to the incorrect accounting treatment of stock based performance awards granted to officers of the Company. The Company had mistakenly classified all stock based performance awards as equity awards and, secondly, incorrectly marked those awards to the market price of the Company's common stock price at the end of each reporting period. During the second quarter of 2016, the Company reversed all of the incorrectly recorded mark-to-market expense as an out-of-period adjustment resulting in a one-time benefit of $2.6 million, including a reversal of approximately $1.0 million in expense related to the first quarter of 2016;
- Pension and post-retirement medical costs decreased primarily due to an increase in the discount rate used in determining 2016 expense compared to the discount rate used to determine the 2015 expense;
- Outside services decreased primarily due to a reduction in costs associated with outside contractors and consultants;
- Payroll costs decreased primarily due an increase in the amount of employee time charged to capital projects in the six months ended June 30, 2016;
- Utility costs decreased primarily due to a reduction in electric and heating costs in the six months ended June 30, 2016 when compared to the same period of 2015; and
- Water treatment costs decreased in the six months ended June 30, 2016 primarily due to a reduction in chemical costs due to procurement initiatives.

The decreases described above were partially offset by the following increases to O&M expense:

- Other benefits increased primarily due to costs associated with the Company's performance stock plan available to officers and certain members of the senior management team of the Company;
- Customer costs increased primarily as a result of an increase in the allowance for uncollectible accounts.
- Medical insurance costs grew primarily due to an increase in the costs of claims filed by covered employees and their families and an increase in the Company's costs associated with health spending accounts. These increases were partially off-set by an increase in employee contributions to the health plan, which has the effect of decreasing total medical costs; and
- Costs associated with investor relations increased due to changes in compensation for the Board of Directors and increased transfer agent costs, partially off-set by decreased costs associated with the preparation of the Company's annual Proxy statement.

The Company saw an approximate $460,000, or 7.3%, increase in its Depreciation expense from the six months ended June 30, 2016 compared to the same period in 2015 . The primary driver of this increase was due to higher Utility Plant in Service as of June 30, 2016 compared to June 30, 2015 .

Income Tax expense increased by $1,470,000 in the six months ended June 30, 2016 when compared to the same period in 2015 due to a higher effective income tax rate. The Company's effective tax rate increased from (1.7)% to 8.0% in the six months ended June 30, 2016 compared to the same period in 2015 . The primary drivers for the increase in the effective tax rate were the reversal of a previously established reserve in the amount of $1,185,000 relating to the completion of an IRS review of our 2012 Federal tax return and a credit of approximately $931,000 associated with the 2014 tax benefits being recognized as a result of the MPUC approval of a settlement agreement during the six months ended of June 30, 2015 .

Other Income (Deductions), Net of Taxes increased for the six months ended June 30, 2016 by $176,000. The primary driver of this increase was an increase in AFUDC during the six months ended June 30, 2016 related primarily to an increase in the monthly balances of Construction Work in Progress through June 30, 2016 when compared to the same period in 2015 .

Total Interest and Debt Expense decreased by $16,000 in the six months ended June 30, 2016 when compared to the same period in 2015 . The primary reason for the decrease in Interest and Debt Expense was the result of interest income related to patronage, partially off-set by higher debt balances outstanding at June 30, 2016 when compared to June 30, 2015 .

**Commitments and Contingencies**

On June 11, 2013, the Company was notified by the Connecticut Department of Revenue Services that its state tax filings for the years 2009 through 2011 would be reviewed during the fourth quarter of 2013. On March 24, 2015, the Company was notified by the Connecticut Department of Revenue Services that the audit was expanded to include the 2012 and 2013 tax years. The State focused its review on tax credits associated with fixed capital investment. The Company and the State have come to an agreement regarding investments eligible for the credit. The closing agreement was executed on May 4, 2015. The Company had previously recorded a provision for the possible disallowance of these credits and, therefore, there was minimal impact in 2015.

On the 2012 Federal tax return, filed in September 2013, Connecticut Water filed a change in accounting method to adopt the IRS' temporary tangible property regulations. This method change allowed the Company to take a current year deduction for expenses that were previously capitalized for tax purposes. Since the filing of the 2012 tax return, the IRS has issued final regulations. On February 11, 2014, the Company was notified by the IRS that its Federal tax filing for 2012 would be reviewed. This review, which began in the first quarter of 2014 and was completed in the first quarter of 2015, resulted in no change to the tax liability. Since the Company had previously recorded a provision for the possible disallowance of the repair deduction in prior periods, the completion of the audit resulted in the reversal of the reserves in the amount of $1,185,000. While the Company maintains the belief that the deduction taken on its tax return is appropriate, the methodology for determining the deduction has not been agreed to by the taxing authorities. On the 2013 Federal tax return, filed in September 2014, Maine Water filed the same change in accounting method. Through June 30, 2016 , the Company has recorded, as required by FASB ASC 740, a provision of $1.1 million for a portion of the benefit that is not being returned to customers resulting from any possible tax authority challenge. The Company had previously recorded a provision of $6.3 million in the prior year for a cumulative total of $7.4 million.

The Company remains subject to examination by federal tax authorities for the 2013 and 2014 tax years; the State of Maine's tax authorities for the 2012 through 2014 tax years; and the State of Connecticut's tax authorities for the 2014 tax year.

On July 28, 2016, the Town of Southbury filed a lawsuit against HVWC and Connecticut Water in Connecticut state court seeking a preliminary injunction to preclude the parties from completing the Company's acquisition of HVWC or taking other actions that the Town believes will prevent the Town from fully enforcing it ROFR rights. On August 5, 2016, a hearing was held in Waterbury Superior Court at which the Court ordered that its ROFR deadline be extended to November 11, 2016. The order allows the Company to continue the approval process, with both state utility regulators and the SEC.

There were no material changes under this subheading to any of the other items previously disclosed by the Company in its Annual Report on Form 10-K for the year December 31, 2015 .

**Forward-Looking Information**

Certain statements made in this Quarterly Report on Form 10-Q, ("10-Q") are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended ("Exchange Act") that are made based upon, among other things, our current assumptions, expectations and beliefs concerning future developments and their potential effect on us. These forward-looking statements involve risks, uncertainties and other factors, many of which are outside our control, which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. In some cases you can identify forward-looking statements where statements are preceded by, followed by or include the words "believes," "expects," "anticipates," "plans," "future," "potential," "probably," "predictions," "continue" or the negative of such terms or similar expressions. Forward-looking statements included in this 10-Q, include, but are not limited to, statements regarding:

- projected capital expenditures and related funding requirements;
- the availability and cost of capital;
- developments, trends and consolidation in the water and wastewater utility industries;
- dividend payment projections;
- our ability to successfully acquire and integrate regulated water and wastewater systems, as well as unregulated businesses, that are complementary to our operations and the growth of our business;
- the capacity of our water supplies, water facilities and wastewater facilities;
- the impact of limited geographic diversity on our exposure to unusual weather;
- the impact of conservation awareness of customers and more efficient plumbing fixtures and appliances on water usage per customer;
- our capability to pursue timely rate increase requests;
- our authority to carry on our business without unduly burdensome restrictions;
- our ability to maintain our operating costs at the lowest possible level, while providing good quality water service;
- our ability to obtain fair market value for condemned assets;
- the impact of fines and penalties;
- changes in laws, governmental regulations and policies, including environmental, health and water quality and public utility regulations and policies;
- the decisions of governmental and regulatory bodies, including decisions to raise or lower rates;
- our ability to successfully extend and expand our service contract work within our Service and Rentals Segment in both Connecticut and Maine;
- the development of new services and technologies by us or our competitors;
- the availability of qualified personnel;
- the condition of our assets;
- the impact of legal proceedings;
- general economic conditions;
- the profitability of our Real Estate Segment, which is subject to the amount of land we have available for sale and/or donation, the demand for any available land, the continuation of the current state tax benefits relating to the donation of land for open space purposes and regulatory approval for land dispositions;
- the amount of repair tax deductions and the Internal Revenue Service's ultimate acceptance of the deduction methodology;
- delays in completing the merger with HVWC, or difficulties in achieving anticipated benefits or cost savings from the merger; and
- acquisition-related costs and synergies.

Because forward-looking statements involve risks and uncertainties, there are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements, including but not limited to:

- changes in general economic, business, credit and financial market conditions;
- changes in environmental conditions, including those that result in water use restrictions;
- the determination of what qualifies for a repair expense tax deduction;
- abnormal weather conditions;
- increases in energy and fuel costs;
- unfavorable changes to the federal and/or state tax codes;
- significant changes in, or unanticipated, capital requirements;
- significant changes in our credit rating or the market price of our common stock;
- our ability to integrate businesses, technologies or services which we may acquire;

- our ability to manage the expansion of our business;
- the continuous reliable operation of our information technology systems, including the impact of cyber security attacks or other cyber-related events;
- the extent to which we are able to develop and market new and improved services;
- the continued demand by telecommunication companies for antenna site leases on our property;
- the effect of the loss of major customers;
- our ability to retain the services of key personnel and to hire qualified personnel as we expand;
- labor disputes;
- increasing difficulties in obtaining insurance and increased cost of insurance;
- cost overruns relating to improvements or the expansion of our operations;
- increases in the costs of goods and services;
- civil disturbance or terroristic threats or acts; and
- changes in accounting pronouncements.

Given these uncertainties, you should not place undue reliance on these forward-looking statements. You should read this 10-Q, the Annual Report on Form 10-K for the fiscal year ended December 31, 2015 ("10-K") and the documents that we incorporate by reference into the 10-K completely and with the understanding that our actual future results, performance and achievements may be materially different from what we expect. These forward-looking statements represent our assumptions, expectations and beliefs only as of the date of this 10-Q. Except for our ongoing obligations to disclose certain information under the federal securities laws, we are not obligated, and assume no obligation, to update these forward-looking statements, even though our situation may change in the future. For further information or other factors which could affect our financial results and such forward-looking statements, see Part I, Item 1A"Risk Factors" found in the 10-K. We qualify all of our forward-looking statements by these cautionary statements.

**Part I, Item 3: Quantitative and Qualitative Disclosure About Market Risk**

The primary market risk faced by the Company is interest rate risk. The Company has no exposure to derivative financial instruments or financial instruments with significant credit risk or off-balance-sheet risks. In addition, the Company is not subject, in any material respect, to any currency or other commodity risk.

The Company is subject to the risk of fluctuating interest rates in the normal course of business. The Company's exposure to interest fluctuations is managed at the Company and subsidiary operations levels through the use of a combination of fixed rate long-term debt, variable long-term debt and short-term variable borrowings under financing arrangements entered into by the Company and its subsidiaries. As of June 30, 2016 , the Company had $60.0 million of variable rate lines of credit with two banks, under which the Company had $11.2 million of interim bank loans payable at June 30, 2016 .

As of June 30, 2016 , the Company had $22.05 million of variable-rate long-term debt outstanding. Holding other variables constant, including levels of indebtedness, a one-percentage point change in interest rates would impact pre-tax earnings by approximately $0.2 million, annually. The Company monitors its exposure to variable rate debt and will make future financing decisions as the need arises.

**Part I, Item 4: Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

As of June 30, 2016 , management, including the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)). Based upon, and as of the date of that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective.

**Changes in Internal Control Over Financial Reporting**

During the quarter ended June 30, 2016 , there have been no changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Part II, Item 1: Legal Proceedings**

We are involved in various legal proceedings from time to time. Although the results of legal proceedings cannot be predicted with certainty, there are no pending legal proceedings to which we or any of our subsidiaries are a party or to which any of our properties is the subject that presents a reasonable likelihood of a material adverse impact on the Company.

**Part II, Item 1A: Risk Factors**

Except as set forth below, information about the material risks related to our business, financial condition and results of operations for the six months ended June 30, 2016 does not materially differ from that set out under Part I, Item 1A "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2015 . You should carefully consider the risk factors and other information discussed in our Annual Report on Form 10-K for the year ended December 31, 2015 , as well as the information provided elsewhere in this report. Additional risks, uncertainties and other factors not presently known to us or that we currently deem immaterial may also impair the Company's business operations, financial condition or operating results.

***The failure to consummate the pending acquisition of The Heritage Village Water Company could adversely affect our business.***

We recently entered into an agreement to acquire Heritage Village Water Company ("HVWC"). The transaction is subject to regulatory and other specified approvals, including a final order of the PURA approving the transaction and the effectiveness under the Securities Act of 1933 (the "Securities Act") of the Company's registration statement on Form S-4 which is expected to be filed by September 2016.

The completion of the transaction is subject to risks and uncertainties. First, if the required conditions and regulatory approvals are not satisfied or waived, then the acquisition likely would not be completed. Second, if the closing of the acquisition is substantially delayed or does not occur at all, or if the terms of the acquisition are required to be modified substantially due to regulatory concerns, we may not be able to realize the anticipated benefits of the acquisition fully or at all. Third, under certain circumstances specified in the purchase agreement, we may be required to pay HVWC a termination fee of $100,000 if under specified circumstances if the agreement is terminated under specified circumstances. Fourth, the failure to consummate the pending acquisition may result in negative publicity and a negative impression of us in the investment community. Fifth, the Town of Southbury Connecticut has filed a lawsuit in Connecticut state court challenging the transaction and seeking to protect its right of first refusal under HVWC's certificate of incorporation. There can be no assurance that our business, the price of our common stock or our financial condition will not be adversely affected, as compared to the condition prior to the announcement of the acquisition, if the acquisition is not consummated.

**Part II, Item 2: Unregistered Sales of Equity Securities and Use of Proceeds**

No stock repurchases were made during the quarter ended June 30, 2016 .

**Part II, Item 6: Exhibits**

| Exhibit Number | Description |
|---|---|
| 3.1 | Amended and Restated Certificate of Incorporation of Connecticut Water Service, Inc. dated May 11, 1998 (Exhibit 3.1 to Form 10-K for the year ended 12/31/98). |
| 3.2 | Certificate of Amendment to the Amended and Restated Certificate of Incorporation of Connecticut Water Service, Inc. dated August 27, 1998 (Exhibit 3 to Form 8-K filed on September 25, 1998). |
| 3.3 | Certificate of Amendment to the Amended and Restated Certificate of Incorporation of Connecticut Water Service, Inc. dated August 6, 2001 (Exhibit 3.3 to Form 10-K for the year ended 12/31/14). |
| 3.4 | Certificate of Amendment to the Amended and Restated Certificate of Incorporation of Connecticut Water Service, Inc. dated April 23, 2004. (Exhibit 3.5 to Form 10-Q for the quarter ended 3/31/04). |
| 3.5 | Certification of Incorporation of The Connecticut Water Company effective April, 1998. (Exhibit 3.3 to Form 10-K for the year ended 12/31/98). |
| 3.6 | By-Laws, as amended, of Connecticut Water Service, Inc. as amended and restated as of August 16, 2007. (Exhibit 3.1 to Form 8-K filed on August 21, 2007). |
| 10.1 | Promissory Note and Single Advance Term Loan Supplement (Loan No. RI1087T05) between The Connecticut Water Company and CoBank, ACB, dated June 1, 2016, incorporated by reference from Exhibit 10.1 to current report on Form 8-K filed on June 2, 2016. |
| 10.2 | Second Amendment to Guarantee of Payment (Limited) by Connecticut Water Service, Inc., incorporated by reference from Exhibit 10.1 to current report on Form 8-K filed on June 2, 2016. |
| 10.3 | Promissory Note and Single Advance Term Loan Supplement between The Connecticut Water Company and CoBank, ACB, dated July 7, 2016, incorporated by reference from Exhibit 10.1 to current report on Form 8-K filed on July 13, 2016. |
| 10.4 | Third Amendment to Guarantee of Payment (Limited) by Connecticut Water Service, Inc., dated July 7, 2016, incorporated by reference from Exhibit 10.2 to current report on Form 8-K filed on July 13, 2016. |
| 31.1* | Rule 13a-14 Certification of Eric W. Thornburg, Chief Executive Officer. |
| 31.2* | Rule 13a-14 Certification of David C. Benoit, Chief Financial Officer. |
| 32** | Certification of Eric W. Thornburg, Chief Executive Officer, and David C. Benoit, Chief Financial Officer, 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 |

* filed herewith

** furnished herewith

**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.

Connecticut Water Service, Inc.
(Registrant)

Date: August 9, 2016

By: /s/ David C. Benoit
David C. Benoit
Senior Vice President – Finance and
Chief Financial Officer

Date: August 9, 2016

By: /s/ Robert J. Doffek
Robert J. Doffek
Controller

Exhibit 31.1

**Certification of Chief Executive Officer**

I, Eric W. Thornburg, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Connecticut Water Service, Inc. (the "registrant").

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Eric W. Thornburg
Eric W. Thornburg
President and Chief Executive Officer
August 9, 2016

Exhibit 31.2

**Certification of Chief Financial Officer**

I, David C. Benoit, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Connecticut Water Service, Inc. (the "registrant").

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ David C. Benoit
David C. Benoit
Chief Financial Officer and Senior Vice President – Finance
August 9, 2016

Exhibit 32

**CERTIFICATION PURSUANT TO**
**18 U.S.C. Section 1350**
**As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report of Connecticut Water Service, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Eric W. Thornburg, the Chief Executive Officer of the Company, and David C. Benoit, the Chief Financial Officer of the Company, do each hereby certify, to the best of his knowledge, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Eric W. Thornburg
Eric W. Thornburg
August 9, 2016

/s/ David C. Benoit
David C. Benoit
August 9, 2016