

ARTESIAN RESOURCES CORPORATION
ANNUAL REPORT



FINANCIAL DATA

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Management's Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

Our profitability is primarily attributable to the sale of water by Artesian Water, which comprises 91.1% of total operating revenues, the amount of which is subject to seasonal fluctuations, particularly during summer when water demand may vary with rainfall and temperature. In the event temperatures during the typically warmer months are cooler than expected, or rainfall is greater than expected, the demand for water may decrease and our revenues may be adversely affected. We believe the effects of weather are short term and do not materially affect the execution of our strategic initiatives.

Our water sales revenues were affected in 2006, 2005, and 2004 by rate increases associated with two separate base rate applications with the Delaware Public Service Commission (PSC). In February 2004, we requested an increase in rates of 24%. We recognized revenues reflecting a temporary increase of \$2.5 million on an annual basis between April and September 2004, and a second temporary increase of \$3.0 million on an annual basis effective September 2004, for a total of \$5.5 million on an annual basis. A portion of the second increase was held in reserve based on an estimated outcome and was not reflected in income. In May 2006, the PSC issued the final order in this case. Based on the PSC decision, Artesian Water's new rates would generate approximately \$4.9 million in additional revenue on an annual basis, or an increase of approximately 13.4% over rates in effect before the implementation of temporary rates in 2004. We were required by law to refund the portion of the temporary rate increase in excess of the 13.4% plus interest to our customers. The refund was completed in December 2006.

In May 2006, Artesian Water filed a petition with the PSC to implement new rates to meet a requested increase in revenue of 23%, or approximately \$9.9 million, on an annualized basis. This request was primarily due to the Company's significant investment in infrastructure, as well as an approximately 92% increase in purchased power expense due to the expiration of price caps imposed in 1999 when deregulation of the electric industry in Delaware was adopted. As permitted by law, in July 2006 we placed into effect temporary rates designed to generate an increase in annual operating revenue of approximately 5.9%, or \$2.5 million on an annual basis, until new rates were approved by the PSC.

On December 19, 2006 the PSC approved a Settlement Agreement in this case. The increase in annual revenue requirement under the Settlement Agreement of \$6 million will be recovered in two steps. The first step was placed in effect January 1, 2007 to generate approximately \$4.8 million in annual revenue. The second step will be designed to generate approximately \$1.2 million of annual revenue reflecting the issuance of additional equity not to exceed \$20 million. However, should the Company issue less than the projected \$20 million in equity, the increase will be adjusted to reflect the change in return associated with the Company's capital structure.

Artesian Water Pennsylvania, our wholly owned Pennsylvania water utility subsidiary, began operations in 2002, providing water service to a residential community in Chester County, consisting of 39 customers. In 2005, the Pennsylvania Public Utilities Commission approved our application to increase our service area to encompass four specific developments that are expected to add 350 customers over 10 years.

Our other regulated subsidiary, Artesian Wastewater, is an entity that owns wastewater infrastructure and began providing wastewater services in Delaware in July 2005. Our wastewater customers are billed a flat monthly fee, which contributes to providing a revenue stream unaffected by weather. As of December 2006, Artesian Wastewater had 171 customers in five communities.

Our other subsidiaries, neither of which is regulated, are Artesian Utility, which designs and builds wastewater infrastructure, provides contract wastewater services in Delaware and provides contract water and wastewater services outside Delaware; and Artesian Development, whose sole activity, after the sale of approximately four acres in 2006, is the ownership of a six-acre parcel of land. The sale of the four acre parcel of land in September 2006 resulted in a gain on sale of land of approximately \$1.3 million.

In addition to services discussed above, Artesian Resources initiated a Service Line Protection Plan, or SLP Plan, in March 2005. The SLP Plan covers all parts, material and labor required to repair or replace participants' leaking water service lines up to an annual limit. As of December 31, 2006, approximately 12% of our eligible water customers had signed up for the SLP Plan.

On February 1, 2007, Artesian Resources entered an agreement on the terms of purchase with Carpenters Point Water Company (Carpenters Point). Carpenters Point currently serves a 130 home community in Cecil County, Maryland near the Interstate 95 growth corridor between Philadelphia and Baltimore. The proposed acquisition is expected to provide sufficient groundwater supply and elevated water storage to serve additional customers in the undeveloped portions of the Carpenters Point franchise and surrounding area. The purchase is subject to a number of conditions, including the completion of Artesian Resources' due diligence, execution of definitive agreements and approvals by appropriate state regulatory agencies, including the Maryland Public Service Commission and the Maryland Department of the Environment. If the conditions are satisfied, we expect the acquisition will be completed in 2007.

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Cecil County has designated the Interstate 95 corridor as a preferred growth area for business and residential expansion. Recently, the federal Base Re-Alignment and Closure Commission announced the relocation of approximately 14,000 jobs to nearby Aberdeen, Maryland by 2011. The Wilmington Metropolitan Area Planning Commission projects Cecil County will grow at a rate of 86 percent between 2000 and 2030 and the Maryland Department of Planning projects that Cecil County will experience the highest rate of household growth through 2025 of any jurisdiction in the state.

While water sales revenues are our primary source of revenues, we continue to explore and develop relationships with developers and municipalities in order to increase revenues from contract water operations provided by Artesian Water and from wastewater management services provided by both Artesian Wastewater and Artesian Utility. Our contract operations and wastewater management services provide a revenue stream that is not affected by changes in weather patterns.

We plan to continue developing and expanding our contract operations and wastewater services in a manner that complements our growth in water service to new customers. Our anticipated growth in these areas is subject to changes in residential and commercial construction, which may be affected by interest rates, inflation and general housing and economic market conditions. We will continue to focus attention on expanding our contract operations opportunities with municipalities and private water providers in Delaware and surrounding areas.

Ensuring our customers have a dependable supply of safe, high-quality water has been, and will continue to be, our highest priority. In 2003, Delaware passed legislation requiring all water utilities to certify by July 2006 that they have sufficient sources of self-supply to serve their respective systems. We believe we have made the appropriate investment in infrastructure and on March 8, 2005, we filed our certification of self-sufficiency of supply with the PSC. The review was completed on June 20, 2006, and the PSC concluded that we demonstrated that we have sufficient water supply to meet the demands of our customers through 2006. Also on June 20, 2006, Artesian Water provided the City of Wilmington, Delaware (City) with notice of non-renewal of the interconnection agreement with the City upon its December 22, 2006 termination. Artesian Water is no longer required to purchase 200 million gallons annually from the City after December 22, 2006. At 2006 rates, that obligation was approximately \$336,000. As required by law, on June 30, 2006, we filed with the PSC a new certification of self-sufficiency for the period through 2009, which is currently under review by the PSC.

Water Industry

The Federal Environmental Protection Agency's May 2005 report states that the United States' water industry is comprised of approximately 54,000 community water systems, 84% of which serve less than 3,300 customers. Only 14% of all community water systems are run by investor-owned utilities. There are currently 12 publicly traded water utilities based in the United States. The rest are privately or municipally owned systems. The water industry is capital intensive, with the highest capital investment in plant and equipment per dollar of revenue among all utilities. Increasingly stringent drinking water regulations to meet the requirements of the Safe Drinking Water Act of 1974 have required the water industry to invest in more advanced treatment systems and processes, which require a heightened level of expertise. We are currently in full compliance with the requirements of the Safe Drinking Water Act. Even though our water utility was founded in 1905, the majority of our investment in infrastructure occurred in the last 30 years.

We believe that Delaware's generally lower cost of living in the region, availability of development sites in relatively close proximity to the Atlantic Ocean in Sussex County, and attractive financing rates for construction and mortgages have resulted, and will continue to result, in increases to our customer base. According to the US Census Bureau, Delaware's population increased an estimated 8.9% from 2000 to 2006, as compared to the nationwide growth rate of approximately 6.4%. Substantial portions of Delaware are not served by a public water system. Interest rates for mortgages have fallen from 7.16% on average in December 2001 to 6.18% through December 2006. Long-term interest rates for our recent First Mortgage Bond issuance (see Note 6 to our Financial Statements) reflect a similar trend, as we were able to reduce our overall weighted cost of debt from 7.93% in 2001 to 6.19% at the end of 2006.

Strategic Direction

We believe the effects of weather are short term and do not materially affect the execution of our strategic initiatives. As we anticipated, our initiatives south of the Chesapeake & Delaware Canal, or the "C&D Canal," that began in 1992 are now providing the greatest portion of our customer growth. This shift in growth is primarily the result of the build out of our service area in northern New Castle County. In 2006, we increased our customer base by 2.0% and increased our service territory by approximately 20.0 square miles, a 10.6% increase. We continued to increase our sources of supply, adding about 1.0 million gallons to our daily production capacity, to assure we have adequate high quality water supply to meet our customer growth expectations.

Our strategy is to focus on total resource management covering a wide spectrum of activities, which include identifying new and dependable sources of supply; developing the wells, treatment plants and delivery systems to get water to the customers; educating customers on the wise use of water; and providing responsible wastewater management to assist with recharge of

the aquifers. Our strategy includes focusing our efforts to expand in new regions added to our service territory over the last 10 years, where growth is strong and demand is increasing. These regions have provided approximately 70% of our growth in customers in 2006 and we expect growth to remain strong in these regions. We also foresee significant growth opportunities in our wastewater subsidiaries and will continue to seek strategic partnerships and relationships with developers and municipalities to complement existing agreements for the provision of wastewater service in Delaware and surrounding areas.

Regulatory Matters and Inflation

As of December 31, 2006, we had approximately 73,800 metered water customers, 171 wastewater customers, and served a population of approximately 243,000 (including contract services), representing approximately 29% of Delaware's total population. Increases in the number of customers served by Artesian Water and Artesian Wastewater contribute to increases in our operating revenues. The PSC regulates both Artesian Water's and Artesian Wastewater's rates charged for service, the sale and issuance of securities and other matters.

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

Delaware statute permits water utilities to put into effect, on a semi-annual basis, increases related to specific types of distribution system improvements through a Distribution System Improvement Charge or DSIC. This charge is available to water utilities to be implemented between general rate increase applications that normally recognize changes in a water utility's overall financial position. The DSIC approval process is less costly when compared to the approval process for general rate increase requests. On November 30, 2005, we requested from the PSC an increase to the DSIC surcharge from 0.35% to 1.17% for bills rendered subsequent to January 1, 2006. The 1.17% surcharge generated approximately \$225,000 in revenues between January and June of 2006. As required by law, this charge was set to zero when the temporary rate increase from our general rate case filed in May 2006 was put into effect in July 2006.

In 1999, the General Assembly passed legislation restructuring the electric industry in Delaware. Since the passage of electric restructuring legislation in 1999, electricity prices had been capped for customers of Delmarva Power and the Delaware Electric Cooperative. Those rate caps were lifted in 2005 for customers of the Delaware Electric Cooperative and in May 2006 for Delmarva Power customers. Our electric charges increased in 2005 due to higher billing rates charged by Delaware Electric Cooperative after the cap was removed. In 2006, our electric charges increased further due to the increase from Delmarva Power. Artesian sought to mitigate future increases by signing a two-year fixed price supply contract with Pepco Energy Services.

On April 10, 2006, the PSC made effective new Regulations Docket 15 that governs the terms and conditions under which water utilities require advances or contributions from customers or developers. These regulations require that developers pay for all water facilities within a new development, with such funding recorded as contributions in aid of construction by the water utility. In addition, the utility is required to receive a contribution in aid of construction of \$1,500 for each new residential connection to its system towards the cost of water supply, treatment and storage facilities. These required contributions are intended to place a greater burden upon new customers to pay for the cost of facilities required to serve them.

We are affected by inflation, most notably by the continually increasing costs required to maintain, improve and expand our service capability. The cumulative effect of inflation results in significantly higher facility costs compared to investments made 20 to 40 years ago, which must be recovered from future cash flows.

CRITICAL ACCOUNTING POLICIES

All additions to plant are recorded at cost. Cost includes direct labor, materials, and indirect charges for such items as transportation, supervision, pension, medical, and other fringe benefits related to employees engaged in construction activities. When depreciable units of utility plant are retired, the cost of retired property, together with any cost associated with retirement and less any salvage value or proceeds received, is charged to accumulated depreciation. Maintenance, repairs, and replacement of minor items of plant are charged to expense as incurred.

Management's Discussion and Analysis of Financial Condition and Results of Operations

We record water service revenue, including amounts billed to customers on a cycle basis and unbilled amounts, based upon estimated usage from the date of the last meter reading to the end of the accounting period. These estimates are made on an individual customer basis, based on one of three methods (the previous year's consumption in the same period, the previous billing period's consumption, or trending) and are adjusted to reflect current changes in water demand on a system-wide basis. While actual usage for individual customers may differ materially from the estimate, we believe the overall total estimate of consumption and revenue for the fiscal period will not differ materially from actual billed consumption, as the overall estimate has been adjusted to reflect any change in overall demand on the system for the period.

We record accounts receivable at the invoiced amounts. The reserve for bad debts is the Company's best estimate of the amount of probable credit losses in our existing accounts receivable, and is determined based on a five-year historical write-off experience. The Company reviews the reserve for bad debts on a quarterly basis. Account balances are written off against the reserve when it is probable the receivable will not be recovered.

We review for impairment of our long-lived assets, including Utility Plant in Service, in accordance with the requirements of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". We also review regulatory assets for the continued application of SFAS No. 71. Our review determines whether there have been changes in circumstances or events that have occurred that require adjustments to the carrying value of these assets. In accordance with SFAS No. 71, adjustments to the carrying value of these assets would be made in instances where the inclusion in the rate-making process is unlikely.

Our regulated utilities record deferred regulatory assets under Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation," which are costs that may be recovered over various lengths of time as prescribed by the PSC. As the utility incurs certain costs, such as expenses related to rate case applications, a deferred regulatory asset is created. Adjustments to these deferred regulatory assets are made when the PSC determines whether the expense is recoverable in rates, the length of time over which an expense is recoverable, or, because of changes in circumstances, whether a remaining balance of deferred expense is recoverable in rates charged to customers. Adjustments to reflect changes in recoverability of certain deferred regulatory assets may have a material effect on our financial results.

RESULTS OF OPERATIONS

2006 Compared to 2005

Operating Revenues

Revenues totaled \$48.6 million in 2006 and were 7.3% above revenues in 2005 of \$45.3 million, which is primarily due to an increase of \$2.6 million, or 6.3% in water sales revenue, and the \$1.3 million proceeds from the sale of land by Artesian Development. The increase in water sales revenue reflects a 2.0% increase in the number of customers served, rate increases placed in effect in 2006, and an adjustment in the fourth quarter reflecting the difference between estimated and actual customer refunds associated with the 2004 rate case. We realized 91.1% of our total revenue in 2006 from the sale of water, compared to 91.9% in 2005. The percentage decrease is primarily due to the sale of land by Artesian Development. These increases in revenue were partially offset by a \$849,000 decrease in non-utility revenue. Non-utility revenue totaled \$1.7 million in 2006 as compared to \$2.6 million in 2005. This revenue was primarily derived from the design, construction and operation of wastewater projects. AUDI records non-utility revenue associated with developer financed construction projects based upon the percent-of-completion method. The Company records deferred revenue for the unearned portion until realized or realizable and earned. For the year ended December 31, 2006, \$31,000 was charged to unearned revenue based on the stage of completion of the wastewater design and construction projects, as compared to \$21,000 for the year ended December 31, 2005.

Percentage of Operating Revenues

	2006	2005	2004
Residential	55.8 %	57.0 %	59.0 %
Commercial	22.2 %	22.6 %	23.7 %
Industrial	0.8 %	0.6 %	0.8 %
Government and Other	12.3 %	11.7 %	12.5 %
Other utility operating revenues	2.6 %	2.4 %	2.2 %
Non-utility operating revenues	3.6 %	5.7 %	1.8 %
Sale of land	2.7 %	0.0 %	0.0 %
Total	100.0 %	100.0 %	100.0 %

Residential

Residential water service revenues in 2006 amounted to \$27.1 million, an increase of \$1.3 million, or 5.0% over the \$25.8 million recorded in 2005, primarily due to a rate increase effective July 2006. The increase in 2006 follows an increase of \$2.5 million, or 10.5%, in 2005. The volume of water sold to residential customers increased slightly from 3,911 million gallons in 2005 to 3,934 million gallons in 2006. The number of residential customers served increased by 1,354 or 2.0% in 2006.

Commercial

Revenues from commercial customers in 2006 increased by 5.9%, from \$10.2 million in 2005 to \$10.8 million in 2006, due to rate increases in 2006. The number of commercial customers served increased by 33, or 0.9%, in 2006. We sold 2,272 million gallons of water to commercial customers in 2006, a marginal increase as compared to 2,221 million gallons sold in 2005.

Industrial

Revenues from industrial customers increased by 38.5%, from \$283,000 in 2005 to \$392,000. The volume of water sold to industrial customers increased by 51.7%, from 89 million gallons in 2005 to 135 million gallons in 2006, primarily as a result of increased usage by one industrial customer. This customer was required by contract to pay for minimum takes in 2005, and had a significant increase in usage in 2006. Therefore, the volumes of water sold increased more extensively than the revenues between 2006 and 2005.

Government and Other

Government and other revenues in 2006 increased by 13.2%, from \$5.3 million in 2005 to \$6.0 million in 2006. The increase was primarily driven by revenues derived from fire protection services, which totaled \$3.2 and \$2.8 million in 2006 and 2005, respectively. This increase in fire protection services revenue resulted from increases in rates.

Other Utility Operating Revenue

Other utility operating revenue, derived from contract operations, antenna leases on water tanks, finance/service charges and wastewater customer service revenues increased 18.2% in 2006, from \$1.1 million in 2005 to \$1.3 million in 2006. The increase is primarily the result of a 333% increase in wastewater customer service revenues, from \$89,000 in 2005 to \$385,000 in 2006.

Non-Utility Operating Revenue

Non-utility operating revenue, derived from non-regulated wastewater operations, decreased from \$2.6 million in 2005 to \$1.7 million in 2006. The decrease reflects lower contract revenues associated with wastewater treatment projects in southern Delaware. Although there are twelve new AUDI developer financed wastewater projects recording revenue in 2006, these projects are of a smaller magnitude than those in 2005. This decrease was partially off-set by an increase in SLP revenues, from \$21,000 in 2005 to \$246,000 in 2006.

Operating Expenses

Operating expenses, excluding depreciation and taxes, increased approximately \$1.2 million, or 4.7%, to \$25.7 million in 2006. The increase in operating expenses resulted primarily from increases in payroll and benefits and administrative expenses. Payroll and benefits increased \$1.1 million due to increased staffing and pay increases. Administrative expenses increased by approximately \$659,000. \$450,000 of this increase was as a result of increased power and electric charges due to the May 2006 expiration of price caps imposed in 1999 when deregulation of the electric industry in Delaware was adopted. Additional administrative expense increases occurred in outside services related to the implementation of the geographic information system used in system planning and operations. This system was brought on-line in 2006 and the expense associated with it increased by \$100,000 between 2005 and 2006. These increases were off-set by a \$891,000 decrease in non-utility operating expenses, primarily the result of smaller developer financed wastewater projects in AUDI.

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Percentage of Operating and Maintenance Expenses

	2006	2005	2004
Payroll and Associated Expenses	48.3 %	46.0 %	48.8 %
Purchased Water	12.3 %	12.8 %	14.4 %
Repair and Maintenance	6.3 %	5.9 %	6.6 %
Water Treatment	3.4 %	3.1 %	3.1 %
Administrative	24.2 %	22.7 %	24.6 %
Non-utility Operating	5.5 %	9.5 %	2.5 %
Total	100.0 %	100.0 %	100.0 %

Depreciation and amortization expense increased \$245,000, or 5.6%, due to increases in our utility plant in service during 2006. Income tax expense increased \$540,000, or 16.1%, due to higher profitability in 2006. Our total effective income tax rate (ETR) for 2006 and 2005 was 38.9% and 39.9%, respectively. The decrease in the ETR was due to the utilization of net operating losses (NOLs) used for the gain on the sale of land.

Other Income, Net

Other Income increased \$98,000, due to higher long-term construction activity subject to AFUDC and recording higher patronage income associated with our investment in CoBank in the first quarter of 2006 than in the first quarter of 2005.

Interest Charges

Interest charges increased \$216,000, or 3.5%, in 2006. Interest on our long-term debt increased \$146,000, or 2.6%, due to higher long-term debt balances. The average interest rate on our lines of credit also rose from 4.3% in 2005 to 5.4% in 2006, causing interest on our lines of credit to increase by \$91,000 in 2006 as compared to 2005.

Net Income

For the year ended December 31, 2006, our net income applicable to common stock increased \$1,036,000, or 20.6%, compared to 2005. The increase in net income was primarily due to the implementation of increases in water utility rates to recover investments made in utility plant, as well as the gain on sale of land by Artesian Development.

2005 Compared to 2004

Operating Revenues

Revenues totaled \$45.3 million in 2005 and were 14.4% above revenues in 2004 of \$39.6 million, which was primarily due to an increase of \$3.7 million, or 9.6% in water sales revenue, reflecting more favorable summer weather conditions in 2005, a 2.0% increase in the number of customers served and rate increases placed in effect in 2005 and 2004. The remaining increase in total revenues was due to a \$1.8 million increase in non-utility operating revenues primarily due to additional revenues generated by wastewater and contract operations services. We realized 91.9% of our total revenue in 2005 from the sale of water, compared to 96.0% in 2004. The percentage decrease is primarily due to an increase in non-utility contract revenues from Artesian Utility. Non-utility revenue totaled \$2,574,000 in 2005 as compared to \$729,000 in 2004. This revenue was derived from the design, construction and operation of wastewater projects. The non-utility revenue is recorded based upon the percent-of-completion method. The Company records deferred revenue for the unearned portion until realized or realizable and earned. For the year ended December 31, 2005, \$21,000 was charged to unearned revenue based on the stage of completion of the wastewater design and construction projects.

Residential

Residential water service revenues in 2005 amounted to \$25.8 million, an increase of \$2.5 million, or 10.5% over the \$23.4 million recorded in 2004, primarily due to rate increases in effect April and September 2004. The increase in 2005 followed an increase of \$1.7 million, or 7.7%, in 2004. The volume of water sold to residential customers increased from 3,680 million gallons in 2004 to 3,911 million gallons in 2005. The number of residential customers served increased by 1,327 or 2.0% in 2005.

Commercial

Revenues from commercial customers in 2005 increased by 9.3%, from \$9.4 million in 2004 to \$10.2 million in 2005, due to rate increases in 2005. The number of commercial customers served increased 0.9% in 2005 and 2,221 million gallons of water sold to commercial customers in 2005 increased marginally as compared to 2,159 million gallons sold in 2004.

Industrial

Revenues from industrial customers decreased by 8.9%, from \$311,000 in 2004 to \$283,000 in 2005, due to the loss of two customers. The volume of water sold to industrial customers increased by 30.9%, from 68 million gallons in 2004 to 89 million gallons in 2005, primarily as a result of increased usage by one industrial customer, which during 2004 experienced a plant shut down for retrofitting. This customer was required by contract to pay for a minimum amount of water in 2004, regardless of consumption. This increase in water volume did not result in additional revenue from this customer in 2005 compared to 2004.

Government and Other

Government and other revenues in 2005 increased by 7.2%, from \$4.9 million in 2004 to \$5.3 million in 2005. The increase was primarily driven by revenues derived from fire protection services, which totaled \$2.8 and \$2.6 million in 2005 and 2004, respectively. This increase in fire protection services revenue was a result of a rate increase.

Other Utility Operating Revenue

Other utility operating revenue, derived from contract operations, antenna leases on water tanks, finance/service charges and wastewater customer service revenues increased 23.7% in 2005, from \$868,000 in 2004 to \$1.1 million in 2005. The increase was a result of contract services work, wastewater customer service revenues, and an increase in the number of antenna leases.

Non-Utility Operating Revenue

Non-utility operating revenue, derived from non-regulated wastewater operations, increased from \$729,000 in 2004 to \$2.6 million in 2005. The increase reflected revenues associated with ten wastewater treatment projects in southern Delaware.

Operating Expenses

Operating expenses, excluding depreciation and taxes, increased approximately \$3.8 million, or 18.6%, to \$24.5 million in 2005. The increase in operating expenses resulted primarily from increases in non-utility operating expenses, payroll and benefits and administrative expenses. Non-utility operating expenses increased by \$1.8 million primarily due to contracted engineering design services and construction costs for new projects for Artesian Utility. Payroll and benefits increased \$1.2 million due to increased staffing and pay increases. Administrative expenses increased by approximately \$500,000 primarily as a result of fees associated with the implementation of the Sarbanes-Oxley Act of 2002, increased audit fees, and increased power and electric charges. As a percentage of total operating expense, payroll and associated expenses declined; however, actual expense for payroll and associated expenses increased for the reasons stated previously.

Depreciation and amortization expense increased \$320,000, or 7.9%, due to increases in our utility plant in service during 2005. Income tax expense increased \$455,000, or 15.7%, due to higher profitability in 2005. Our total effective income tax rate for 2005 and 2004 was 39.9% and 39.6%, respectively.

Other Income, Net

Other income increased \$44,000, primarily due to an increase in CoBank dividend income, from \$328,000 in 2004 to \$400,000 in 2005, as a result of the issuance of our 6.58%, 23 year Series P First Mortgage Bonds. This increase was offset by decline in AFUDC in 2005 as compared to 2004.

Interest Charges

Interest charges increased \$178,000, or 3.0%, in 2005. In August 2005, we issued the \$25 million Series R First Mortgage Bonds, the proceeds of which were used to retire our \$10 million, 7.84%, 10 year Series M First Mortgage Bonds, \$5 million, 7.56%, 10 year Series N First Mortgage Bonds and to repay our outstanding lines of credit. The additional net \$10 million in long-term debt resulted in an increase in interest expense of \$132,000. The amortization of bond issuance costs increased by \$36,000 related to the Series R issuance. Interest expense also increased \$39,000 to reflect interest due customers upon our estimated refund of temporary rates upon conclusion of the pending rate filing. Interest on our lines of credit decreased \$38,000 in 2005 compared to 2004. Although the average interest rate on our line of credit balances increased from 2.4% in 2004 to 4.3% in 2005 as general market rates rose and affected our variable rate, our average outstanding balance was \$6.4 million in 2005, compared to \$11.8 million in 2004.

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Net Income

For the year ended December 31, 2005, our net income applicable to common stock increased \$635,000, or 14.4%, compared to 2004. The increase in net income was primarily due to the implementation of increases in water utility rates to recover investments made in utility plant that result in increased depreciation and interest expense. Non-utility operations contributed \$104,000 to the increase in net income.

LIQUIDITY AND CAPITAL RESOURCES

Overview

Our primary sources of liquidity for 2006 were \$12.7 million provided by cash flow from operating activities and \$16.8 million from financing activities. The financing activities included \$12.3 million in contributions and advances and \$6.1 million of net borrowings under our lines of credit agreements. Cash flow from operating activities is primarily provided by our utility operations, and is impacted by the timeliness and adequacy of rate increases and changes in water consumption as a result of year-to-year variations in weather conditions, particularly during the summer. During 2006, our cash flows from operating activities were impacted by the refund of temporary rates plus interest, as required by law, as a result of Artesian Water's 2004 rate case.

We rely on our sources of liquidity for investments in our utility plant and to meet our various payment obligations. We expect that our aggregate investments in our utility plant and systems in 2007 will be approximately \$35.8 million. Our total obligations related to interest and principal payments on indebtedness, rental payments and water service interconnection agreements for 2007 are anticipated to be approximately \$9.2 million. We expect to fund our activities for the next year using our available cash balances and bank credit lines, and projected cash generated from operations and the capital markets.

Investment in Utility Plant and Systems

Capital expenditures increased by approximately \$10.7 million for the year ended December 31, 2006, or approximately 53%, from \$20.2 million in 2005 to \$30.9 million in 2006. This increase is the result of completing the Middletown tank project in Southern New Castle County coupled with completing several additional large capital projects in 2006.

Investment in utility plant, excluding advances and contributions in aid of construction received from real estate developers, increased by \$8.1 million, or 58.7%, from \$13.8 million in 2005 to \$21.9 million in 2006. Additionally, development activity also increased with developers financing \$9.3 million for the installation of water mains and hydrants serving their developments in 2006, compared to \$6.6 million in 2005.

We invested approximately \$13.0 million in new transmission and distribution facilities in 2006, including refunds of advances for developer-financed infrastructure. Of the \$13.0 million invested, we invested \$9.2 million in new infrastructure and \$3.8 million in our rehabilitation program for transmission and distribution facilities, replacing aging or deteriorating mains. Additionally, an investment of \$3.2 million was made to enhance or improve existing treatment facilities, rehabilitate pumping equipment and install new wells to increase supply capabilities.

Investment in Utility Plant and Systems

<i>In thousands</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
Source of supply	\$ 2,224	\$ 100	\$ 832
Treatment and pumping	973	1,660	6,546
Transmission and distribution	12,998	9,515	13,390
General plant and equipment	2,581	1,272	1,851
Developer financed utility plant	9,291	6,604	5,435
Wastewater facilities	3,111	1,236	844
Allowance for Funds Used During Construction, AFUDC	(288)	(223)	(302)
Total	\$ 30,890	\$ 20,164	\$ 28,596

We have planned to invest approximately \$35.8 million in utility plant in 2007. Developers are expected to finance an additional \$16.4 million in utility plant construction. Of the \$35.8 million we expect to invest in 2007, approximately \$8.8 million will be for new treatment facilities, equipment and wells throughout Delaware to identify, develop, treat and protect sources of water supply to assure uninterrupted service to our customers.

The largest portion of the projected investment in 2007, \$13.7 million, will be in transmission and distribution facilities. Approximately \$4.9 million of this amount will be invested in the relocations of facilities as a result of government mandates and renewals associated with the rehabilitation of aging infrastructure. The remaining \$8.8 million of this investment in new transmission and distribution facilities will be to improve our system hydraulics and address service needs in growth areas of our service territory.

We plan to invest \$2.3 million in an expansion project for our Bayville plant in Sussex County, Delaware, \$2 million for a storage tank in the Magnolia area in Kent County, Delaware, and \$1.5 million each on two water treatment plants, one in Kent County and one in Sussex County.

In addition, we plan to spend approximately \$5.6 million in 2007 of a total \$11.5 million to construct a new office building to meet our growing space requirements. A further \$1.2 million is planned to implement a new accounting system, which will integrate with our newly installed customer billing system, creating an Enterprise Business System. A further \$4.0 million will be spent in wastewater projects, including three large wastewater treatment plants in Sussex County, Delaware.

Financing

We have several sources of liquidity to finance our investment in utility plant and other fixed assets. We estimate that the projected investment of approximately \$35.8 million will be financed by our operations and external sources, including a combination of capital investment, short-term borrowings under our revolving credit agreements discussed below, as well as an equity issuance. Developers are expected to finance, through contributions in aid of construction, an additional \$16.4 million of capital expenditures, which includes the installation of mains and hydrants in new developments.

Our cash flows from operations are primarily derived from water sales revenues and may be materially affected by changes in water sales due to weather and the timing and extent of increases in rates approved by the PSC.

At December 31, 2006, Artesian Water had lines of credit of \$20.0 million each with two separate financial institutions totaling \$40.0 million to meet temporary cash requirements. These revolving credit facilities are unsecured. As of December 31, 2006, we had \$32.1 million of available funds under these lines. The interest rate for borrowings under each of these lines is the London Interbank Offering Rate, or "LIBOR," plus 1.0% or, at our discretion, the banks' federal funds rate plus 1.0%. Each bank reviews all of their facilities annually for renewal.

At December 31, 2006, Artesian Utility and Artesian Wastewater had lines of credit with a financial institution for \$3.5 million and \$1.5 million, respectively, to meet temporary cash requirements. These revolving credit facilities are unsecured. As of December 31, 2006, we had not borrowed funds under these lines. The interest rate for borrowings under each of these lines is the LIBOR plus 1.75%. The bank reviews its facilities annually for renewal.

We may, from time to time, sell our securities to meet capital requirements. The amount and timing of future sales of our securities will depend upon market conditions and our specific needs. Our trust indentures, which set certain criteria for the issuance of new long-term debt, limit long-term debt, including the short-term portion thereof, to 66 2/3% of total capitalization. Our debt to total capitalization, including the short-term portion thereof, was 60.0% at December 31, 2006.

On August 1, 2005, Artesian Water issued \$25 million aggregate principal amount of its 5.96%, 23-year Series R First Mortgage Bonds. Artesian Water recorded the total expense of approximately \$1.1 million, which included a redemption premium of \$865,000, in connection with the issuance of the bonds as a deferred asset. These bonds were issued for Artesian Water to CoBank, a cooperative bank, and the proceeds were used on August 1, 2005, to retire all of Artesian Water's outstanding \$10 million aggregate principal amount of 7.84%, 10-year, Series M First Mortgage Bonds and \$5 million aggregate principal amount of 7.56%, 10-year, Series N First Mortgage Bonds, and to satisfy the \$865,000 redemption premium required as a result of the early retirement of the Series M and Series N First Mortgage Bonds. The remainder of the bond proceeds were used to pay down Artesian Water's short-term line of credit, which was used to finance investments in utility plant and equipment. Artesian Water is amortizing the redemption premium over the life of its 5.96%, 23-year Series R First Mortgage Bonds as an interest expense.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Contractual Cash Obligations

In thousands	Payments Due by Period				
	Less than 1 year	2-3 years	4-5 years	After 5 years	Total
First Mortgage Bonds	\$ 5,501	\$ 11,001	\$ 11,001	\$ 160,496	\$ 187,999
State revolving fund loans	590	1,180	1,180	6,658	9,608
Operating leases	142	151	61	1,574	1,928
Unconditional purchase obligations	2,787	5,581	5,574	30,677	44,619
Tank painting contractual obligation	374	749	549	—	1,672
Total	\$ 9,394	\$ 18,662	\$ 18,365	\$ 199,405	\$ 245,824

Long-term debt obligations reflect the maturities of certain series of our first mortgage bonds, which we intend to refinance when due. The state revolving fund loan obligation has an amortizing mortgage payment payable over a 20-year period, and will be refinanced as future securities are issued. Both the long-term debt and the state revolving fund loan have certain financial covenant provisions, the violation of which could result in default and require the obligation to be immediately repaid, including all interest. We have not experienced conditions that would result in our default under these agreements, and we do not anticipate any such occurrence. Payments for unconditional purchase obligations reflect minimum water purchase obligations based on rates that are subject to change under our interconnection agreement with the Chester Water Authority.

Commitments	Committed	Less than 1 year	2-3 years	4-5 years	After 5 years
Lines of Credit	\$ 7,906	\$ 7,906	—	—	—

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, including any arrangements with any structured finance, special purpose or variable interest entities.

IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS

In February 2007, the Financial Accounting Standards Board, FASB, issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB No.115." This statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company expects to adopt this statement effective January 1, 2008 and does not expect it to have a material effect on the financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current year Financial Statements" ("SAB 108"), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 is effective as of the end of Artesian's 2006 fiscal year, allowing a one-time transitional cumulative effect adjustment to beginning retained earnings as of January 1, 2006 for errors that were not previously deemed material, but are material under the guidance in SAB 108. The adoption of this statement did not have a material impact on our financial condition or results of operations.

In September 2006, the Financial Accounting Standards Board, FASB, issued Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans", an amendment of FASB Statements No. 87, "Employers' Accounting for Pensions"; No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits"; No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions"; and No. 132(R), "Employers' Disclosures about Pensions and Other Postretirement Benefits". This statement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur. Employers, such as Artesian, with publicly traded equity securities are required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. The Company adopted this statement effective December 31, 2006. The adoption of this statement did not have a material impact on our financial condition or results of operations for 2006. According to our actuarial report, the funded status of our defined benefit postretirement plan was calculated contemplating FAS 158 and the obligation is recorded at that amount. There was no Other Comprehensive Income impact because we record a regulatory asset as provided by FAS 71.

In September 2006, FASB issued Statement No. 157, "Fair Value Measurements". This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements; however, the statement does not require any new fair value measurements. This statement is effective for fiscal years beginning after November 15, 2007 and interim periods within those years. The Company expects to adopt this statement effective January 1, 2008 and does not expect it to have a material effect on the financial statements.

In June 2006, FASB issued Interpretation No. 48 "Accounting for Uncertainty in Income Taxes", an interpretation of FASB Statement No. 109 "Accounting for Income Taxes". This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109. The Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation allows an enterprise to recognize economic benefits resulting from positions taken in income tax returns, as long as a more likely than not approach is taken. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company expects to adopt this statement effective January 1, 2007 and is currently evaluating its effect on the financial statements.

In March 2006, FASB issued Statement No. 156, "Accounting for Servicing of Financial Assets". This statement amends FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," with respect to the accounting for separately recognized servicing assets and servicing liabilities. This statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in some situations. It also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. This statement is effective for fiscal years beginning after September 15, 2006. The Company expects to adopt this statement effective January 1, 2007 and does not expect it to have a material effect on the financial statements.

In February 2006, FASB issued Statement No. 155, "Accounting for Certain Hybrid Financial Instruments". This statement amends FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities," and No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". This statement permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. This statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company expects to adopt this statement effective January 1, 2007 and does not expect it to have a material effect on the financial statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations

In December 2004, the FASB issued Statement No. 123 (revised 2004), Statement No. 123(R), "Share-Based Payment." This Statement is a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation". This Statement supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees", and its related implementation guidance. This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. According to the FASB, this Statement is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. However, during the first quarter of 2005, the Securities and Exchange Commission approved a new rule, Staff Accounting Bulletin 107, that delayed the adoption of this standard to the beginning of the next fiscal year, instead of the next reporting period that began after June 15, 2005. The rule does not change the accounting required by Statement No. 123(R), but recognizes that preparers will need to use considerable judgment when valuing employee stock options under this statement. SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Proforma disclosure is no longer an alternative upon adopting SFAS 123(R). SFAS 123(R) permits public companies to adopt its requirements using one of two methods:

- A "modified prospective" method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS 123(R) for all awards granted to employees prior to the effective date of SFAS 123(R) that remain unvested on the effective date; or
- A "modified retrospective" method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123(R) for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

We implemented SFAS 123(R) in the first quarter of 2006. We used the modified prospective method and estimated the fair value of each option grant using the Black-Scholes-Merton option pricing model.

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

Statements in this Annual Report on Form 10-K which express our "belief," "anticipation" or "expectation," as well as other statements which are not historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act, Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act and the Private Securities Litigation Reform Act of 1995. Statements regarding our goals, priorities, growth and expansion plans for our water and wastewater subsidiaries, customer base growth opportunities in Cecil County, Maryland, our belief regarding our capacity to provide water services for the foreseeable future to our customers, our belief relating to our compliance and the cost to achieve compliance with relevant governmental regulations, the impact of weather on our operations and the execution of our strategic initiatives, our expectation relating to the adoption of recent accounting pronouncements, contract operations opportunities, legal proceedings, our properties, our expectations regarding the acquisition of Carpenters Point, deferred tax assets, increases to purchased water and electricity expense, adequacy of our available sources of financing, the expected recovery of expenses related to our long-term debt, our expectation to be in compliance with financial covenants in our debt instruments, plans to increase our wastewater treatment operations and other revenue streams less affected by weather, appropriate investment in infrastructure regarding the filing of the certification of sufficient sources of self-supply, expected contributions in 2007 to our postretirement benefit plan, and our liquidity needs are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and involve risks and uncertainties that could cause actual results to differ materially from those projected. Certain factors as discussed under Item 1A -Risk Factors, such as changes in weather, changes in our contractual obligations, changes in government policies, the timing and results of our rate requests, changes in economic and market conditions generally, and other matters could cause results to differ materially from those in the forward-looking statements. While the Company may elect to update forward-looking statements, we specifically disclaim any obligation to do so and you should not rely on any forward-looking statement as representation of the Company's views as of any date subsequent to the date of the filing of this Annual Report on Form 10-K.

Consolidated Balance Sheet's

<i>In thousands</i>	<i>2006</i>	<i>December 31,</i> <i>2005</i>
ASSETS		
Utility plant, at original cost less accumulated depreciation	\$ 253,182	\$ 227,566
Current assets		
Cash and cash equivalents	1,414	1,359
Accounts receivable, net (less reserve for bad debts 2006-\$225; 2005-\$175)	3,416	4,281
Unbilled operating revenues	2,655	2,374
Materials and supplies - at cost on FIFO basis	1,054	1,008
Prepaid property taxes	924	851
Prepaid expenses and other	782	533
	10,245	10,406
Other assets		
Non-utility property (less accumulated depreciation 2006-\$152; 2005-\$129)	307	316
Other deferred assets	3,745	3,693
	4,052	4,009
Regulatory assets, net	1,881	1,873
	\$ 269,360	\$ 243,854
LIABILITIES AND STOCKHOLDERS' EQUITY		
Stockholders' equity		
Common stock	\$ 6,086	\$ 4,014
Additional paid-in-capital	45,052	43,469
Retained earnings	10,662	10,330
Total stockholders' equity	61,800	57,813
Long-term debt, net of current portion	92,073	92,379
	153,873	150,192
Current liabilities		
Lines of credit	7,906	1,786
Current portion of long-term debt	310	301
Accounts payable	2,790	2,790
Accrued expenses	3,287	1,948
Overdraft payable	1,990	1,417
Income tax payable	—	111
Deferred income taxes	284	269
Interest accrued	360	354
Customer deposits	472	469
Other	1,723	2,793
	19,122	12,238
Deferred credits and other liabilities		
Net advances for construction	24,991	24,404
Postretirement benefit obligation	927	1,097
Deferred investment tax credits	765	789
Deferred income taxes	21,505	17,784
Commitments and contingencies (Note 10)	48,188	44,074
Net contributions in aid of construction	48,177	37,350
	\$ 269,360	\$ 243,854

The notes are an integral part of the consolidated financial statements.

Consolidated Statements of Operations

In thousands, except per share amounts	For the Year Ended December 31,		
	2006	2005	2004
Operating revenues			
Water sales	\$44,272	\$41,638	\$ 37,985
Other utility operating revenue	1,268	1,073	868
Non-utility operating revenue	1,725	2,574	729
Sale of land	1,322	—	—
	48,587	45,285	39,582
Operating expenses			
Utility operating expenses	24,314	22,233	20,187
Non-utility operating expenses	1,419	2,310	513
Depreciation and amortization	4,610	4,365	4,046
Taxes			
State and federal income			
Currently payable	162	111	—
Deferred	3,725	3,236	2,892
Property and other	2,562	2,389	2,070
	36,792	34,644	29,708
Operating income	11,795	10,641	9,874
Other income, net			
Allowance for funds used during construction	288	223	302
Miscellaneous	325	292	169
	613	515	471
Income before interest charges	12,408	11,156	10,345
Interest charges	6,337	6,121	5,943
Net income	6,071	5,035	4,402
Redemption premium on preferred stock	—	—	2
Net income applicable to common stock	\$ 6,071	\$ 5,035	\$ 4,400
Income per common share:			
Basic	\$ 1.00	\$ 0.84	\$ 0.75
Diluted	\$ 0.97	\$ 0.81	\$ 0.72
Weighted average common shares outstanding:			
Basic	6,055	5,984	5,904
Diluted	6,235	6,182	6,099
Cash dividends per share of common stock	\$ 0.61	\$ 0.58	\$ 0.55

The notes are an integral part of the consolidated financial statements.

Financial Statements prior to 2005 were audited by another auditor whose report is not contained herein.

Consolidated Statements of Cash Flows

In thousands	For the Year Ended December 31,		
	2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	\$ 6,071	\$ 5,035	\$ 4,402
Adjustments to reconcile net cash provided by operating activities:			
Depreciation and amortization	4,609	4,364	4,046
Deferred income taxes, net	3,711	3,104	2,908
Allowance for funds used during construction	(288)	(223)	(302)
Stock compensation	322	—	—
Gain on sale of land	(1,322)	—	—
Changes in assets and liabilities:			
Accounts receivable, net of reserve for bad debts	865	(475)	(1,398)
Income tax receivable	—	—	841
Unbilled operating revenues	(281)	(3)	373
Materials and supplies	(46)	(75)	(131)
Prepaid property taxes	(73)	(86)	(54)
Prepaid expenses and other	(248)	32	12
Other deferred assets	(51)	(240)	(66)
Regulatory assets	(7)	230	19
Accounts payable	—	620	52
Accrued expenses	1,339	(83)	158
State and federal income taxes	(113)	111	—
Interest accrued	7	—	87
Customer deposits and other, net	(1,602)	1,634	550
Postretirement benefit obligation	(170)	(72)	(63)
Net cash provided by operating activities	12,723	13,873	11,434
CASH FLOWS USED IN INVESTING ACTIVITIES			
Capital expenditures (net of AFUDC)	(30,890)	(20,164)	(28,596)
Proceeds from sale of assets	33	6	11
Proceeds from sale of land	1,330	—	—
Investments from unconsolidated affiliates	37	—	(4)
Net cash used in investing activities	(29,490)	(20,158)	(28,589)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net borrowings (repayments) under lines of credit agreements	6,120	(7,427)	(3,286)
Increase (decrease) in overdraft payable	573	(394)	475
Net advances and contributions in aid of construction	12,334	7,496	5,912
Proceeds from issuance of long-term debt	—	25,000	2,929
Increase in restricted funds	—	502	13,716
Increase (decrease) deferred debt issuance costs	41	(827)	(12)
Net proceeds from issuance of common stock	1,766	1,304	1,117
Dividends	(3,714)	(3,470)	(3,267)
Principal repayments of long-term debt	(298)	(15,757)	(240)
Redemption of preferred stock	—	—	(100)
Net cash provided by financing activities	16,822	6,427	17,244
Net increase in cash and cash equivalents	55	142	89
Cash and cash equivalents at beginning of year	1,359	1,217	1,128
Cash and cash equivalents at end of year	\$ 1,414	\$ 1,359	\$ 1,217
Supplemental Disclosures of Cash Flow Information:			
Interest paid	\$ 4,542	\$ 6,001	\$ 5,771
Income taxes paid	\$ 261	\$ —	\$ —

See Note 1 (Stock Split) for a discussion of non-cash financing activity.

The notes are an integral part of the consolidated financial statements.

Financial Statements prior to 2005 were audited by another auditor whose report is not contained herein.

Consolidated Statements of Changes in Stockholders' Equity

<i>In thousands</i>	<i>Common Shares Outstanding Class A Non-Voting ^{(1) (4) (5)}</i>	<i>Common Shares Outstanding Class B Voting ^{(2) (4)}</i>	<i>\$1 Par Value Class A Non-Voting</i>	<i>\$1 Par Value Class B Voting</i>	<i>Additional Paid-in Capital</i>	<i>Retained Earnings ⁽²⁾</i>	<i>Total ⁽²⁾</i>
BALANCE AS OF DECEMBER 31, 2003	4,970	882	\$ 3,313	\$ 588	\$ 41,159	\$ 7,630	\$ 52,690
Net income						4,402	4,402
Cash dividends declared							
Common stock						(3,265)	(3,265)
Preferred stock						(2)	(2)
Issuance of common stock							
Officer bonus	2		2		48		50
Dividend reinvestment plan	18		12		322		334
Employee stock options	47		31		444		475
Employee Retirement Plan ⁽³⁾	15		10		249		259
		1					
BALANCE AS OF DECEMBER 31, 2004	5,052	882	\$ 3,368	\$ 588	\$ 42,222	\$ 8,765	\$ 54,943
Net income						5,035	5,035
Cash dividends declared – Common stock						(3,470)	(3,470)
Issuance of common stock							
Officer bonus	9		6		166		172
Dividend reinvestment plan	15		10		284		294
Employee stock options	52		35		612		647
Employee Retirement Plan ⁽³⁾	11		7		185		192
BALANCE AS OF DECEMBER 31, 2005	5,139	882	\$ 3,426	\$ 588	\$ 43,469	\$ 10,330	\$ 57,813
Net income						6,071	6,071
Cash dividends declared – Common stock						(3,714)	(3,714)
Issuance of common stock							
Stock Split			1,721	294		(2,025)	(10)
Officer bonus	9		6		183		189
Dividend reinvestment plan	15		14		321		335
Employee stock options	12		10		551		561
Employee Retirement Plan ⁽³⁾	29		27		528		555
BALANCE AS OF DECEMBER 31, 2006	5,204	882	\$ 5,204	\$ 882	\$ 45,052	\$ 10,662	\$ 61,800

(1) At December 31, 2006, 2005, and 2004, Class A Non-Voting Common Stock had 15 million shares authorized.

(2) At December 31, 2006, 2005, and 2004, Class B Common Stock had 1.04 million shares authorized.

(3) Artesian Resources registered 0.5 million shares of Class A Non-Voting Common Stock available for purchase through the Artesian Retirement Plan and the Artesian Supplemental Retirement Plan.

(4) Artesian Resources Corporation approved a three for two stock split on May 12, 2006 effected in the form of a 50% stock distribution. Each shareholder of record on May 30, 2006 received one additional share for each two shares held. All share and per share data for all prior periods have been restated to give effect to this stock split.

(5) Under the Equity Compensation Plan, effective May 25, 2005 Artesian Resources authorized up to 0.5 million shares of Class A Non-Voting Common Stock for issuance of grants in forms of stock options, stock units, dividend equivalents and other stock-based awards, subject to certain circumstances as discussed in the Plan.

The notes are an integral part of the consolidated financial statements.

Financial Statements prior to 2005 were audited by another auditor whose report is not contained herein.

Notes to Consolidated Financial Statements

NOTE 1

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The audited Consolidated Financial Statements are presented in accordance with the requirements of Form 10-K and consequently include all the disclosures required in the financial statements included in the Company's annual report on Form 10-K.

The consolidated financial statements include the accounts of Artesian Resources Corporation and its wholly owned subsidiaries, including its principal operating company, Artesian Water. Appropriate eliminations have been made for all inter-company transactions and account balances.

Utility Subsidiary Accounting

The accounting records of Artesian Water and Artesian Wastewater Management are maintained in accordance with the uniform system of accounts as prescribed by the Delaware Public Service Commission or the PSC. The accounting records of Artesian Water Pennsylvania, Inc. are maintained in accordance with the uniform system of accounts as prescribed by the Pennsylvania Public Utility Commission or the PAPUC. All three subsidiaries follow the provisions of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation," which provides guidance for companies in regulated industries.

Utility Plant

All additions to plant are recorded at cost. Cost includes direct labor, materials, and indirect charges for such items as transportation, supervision, pension, and other fringe benefits related to employees engaged in construction activities. When depreciable units of utility plant are retired, the cost of retired property, together with any cost associated with retirement and less any salvage value or proceeds received, is charged to accumulated depreciation. Maintenance, repairs, and replacement of minor items of plant are charged to expense as incurred.

In accordance with a rate order issued by the PSC, Artesian Water accrues an Allowance for Funds Used During Construction or AFUDC. AFUDC, which represents the cost of funds devoted to construction projects through the date the project is placed in service, is capitalized as part of construction work in progress. The rate used for the AFUDC calculation is based on Artesian Water's weighted average cost of debt and the rate of return on equity authorized by the PSC. The rate used to capitalize AFUDC in 2006, 2005, and 2004 was 7.8%, 8.0%, and 7.8%, respectively.

Utility plant comprises:

In thousands

	<i>Estimated Useful Life in Years</i>	<i>December 31,</i>	
		2006	2005
Utility plant at original cost			
Utility plant in service			
Intangible plant	—	\$ 140	\$ 140
Source of supply plant	45-85	14,759	14,462
Pumping and water treatment plant (Artesian Water)	35-62	42,495	39,747
Transmission and distribution plant			
Mains	81	145,794	131,119
Services	39	24,528	22,486
Storage tanks	76	17,094	13,603
Meters	26	10,061	9,412
Hydrants	60	7,633	6,757
Treatment and Disposal Plant (Artesian Wastewater)	35-62	4,006	1,932
General plant	3-31	26,456	21,460
Property held for future use	—	1,960	4,923
Construction work in progress	—	6,188	4,805
		301,114	270,846
Less – accumulated depreciation		47,932	43,280
		\$ 253,182	\$ 227,566

Depreciation and Amortization

For financial reporting purposes, depreciation is recorded using the straight-line method at rates based on estimated economic useful lives, which range from 3 to 85 years. Composite depreciation rates for utility plant were 2.12%, 2.12%, and 2.14%, for the years ended December 31, 2006, 2005 and 2004, respectively. In a rate order issued by the PSC, the Company was directed effective January 1, 1998 to begin using revised depreciation rates for utility plant. In rate orders issued by the PSC, Artesian Water was directed, effective May 28, 1991 and August 25, 1992, to offset depreciation recorded on utility plant by depreciation on utility property funded by Contributions in Aid of Construction, CIAC, and Advances for Construction, Advances, respectively. This reduction in depreciation expense is also applied to outstanding CIAC and Advances. Other deferred assets are amortized using the straight-line method over applicable lives, which range from 2 to 40 years.

Regulatory Assets

Certain expenses are recoverable through rates, without a return on investment, and are deferred and amortized during future periods using various methods as permitted by the PSC. Expenses related to rate proceedings are amortized on a straight-line basis over a period of 2 years. The postretirement benefit obligation (see Note 9 to our Financial Statements for a description of the Company's Postretirement Benefit Plan), which is being amortized over 20 years, is adjusted for the difference between the net periodic postretirement benefit costs and the cash payments. The deferred income taxes will be amortized over future years with the reversal of tax effects of temporary differences previously flowed through to the customers.

Notes to Consolidated Financial Statements

Regulatory assets at December 31, net of amortization, comprise:

<i>In thousands</i>	2006	2005
Postretirement benefit obligation	\$ 1,027	\$ 1,097
Deferred income taxes recoverable in future rates	582	597
Expense of rate proceedings	257	155
Other	15	24
	\$ 1,881	\$ 1,873

Impairment or Disposal of Long-Lived Assets

A review of our long-lived assets, including Utility Plant in Service, is performed in accordance with the requirements of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". In addition, the regulatory assets are reviewed for the continued application of SFAS No. 71. The review determines whether there have been changes in circumstances or events that have occurred requiring adjustments to the carrying value of these assets. In accordance with SFAS No. 71, adjustments to the carrying value of these assets would be made in instances where the inclusion in the rate-making process is unlikely.

Other Deferred Assets

Debt issuance costs are amortized over the term of the related debt.

Other deferred assets at December 31, net of amortization, comprise:

<i>In thousands</i>	2006	2005
Debt issuance expense	\$ 2,582	\$ 2,691
Other	1,163	1,002
	\$ 3,745	\$ 3,693

Advances for Construction

Water mains, services and hydrants, or cash advances to reimburse Artesian Water for its costs to construct water mains, services and hydrants are contributed to Artesian Water by customers, real estate developers and builders in order to extend water service to their properties. The value of these contributions is recorded as Advances for Construction. Artesian Water makes refunds on these advances over a specific period of time based on operating revenues generated by the specific plant or as new customers are connected to the mains. After all refunds are made, any remaining balance is transferred to CIAC.

Contributions in Aid of Construction

CIAC includes the non-refundable portion of advances for construction and direct contributions of water mains, services and hydrants, and wastewater collection systems, or cash to reimburse Artesian Water and Artesian Wastewater for costs to construct water mains, services and hydrants, and wastewater treatment and disposal plant.

Income Taxes

Deferred income taxes are provided in accordance with the provisions of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" on all differences between the tax basis of assets and liabilities and the amounts at which they are carried in the financial statements based on the enacted tax rates expected to be in effect when such temporary differences are expected to reverse.

The Tax Reform Act of 1986 mandated that Advances and CIAC received subsequent to December 31, 1986, generally are taxable income to Artesian Water. The 1996 Tax Act provided an exclusion from taxable income for CIAC and Advances received after June 12, 1996 by our utilities except for certain contributions for large services that are not included in rate base for rate-making purposes.

Investment tax credits were deferred through 1986 and are recognized as a reduction of deferred income tax expense over the estimated economic useful lives of the related assets.

Stock Compensation Plans

On May 25, 2005, the Company's stockholders approved a new Equity Compensation Plan, which authorizes up to 500,000 shares of Class A Non-Voting Common Stock for issuance. Since May 25, 2005, no additional grants have been made under the Company's other stock-based compensation plans that were previously available. The Company applied APB Opinion No. 25 and related interpretations in accounting for compensation expense under all its plans through 2005. Accordingly, the aggregate compensation cost incurred and charged against income for all plans, including bonuses, was \$146,000 and \$148,000 for 2005 and 2004, respectively. On January 1, 2006 the Company adopted Statement of Financial Accounting Standards No. 123R. Compensation costs in the amount of \$499,000 for awards granted in 2006 were determined based on the fair value at the grant dates and those costs are being charged to income over the service period associated with the grants. Of the \$499,000 in 2006, \$240,000 was associated with stock awards, \$177,000 was associated cash payments for taxes, and \$82,000 was the amount amortized for stock options awarded in 2006. Had compensation costs for the Company's plans in 2005 and 2004 been determined based on the fair value at the grant dates for awards under those plans consistent with the method required by Statement of Financial Accounting Standards No. 123, "Accounting for Stock Based Compensation," the Company's net income and net income per common share would have been reduced to the pro-forma amounts indicated below:

<i>In thousands, except per share data</i>	2005	2004
Net income applicable to common stock		
As reported	\$ 5,035	\$ 4,400
Add: compensation expense included in net income (net of tax)	(1)	89
Deduct: compensation expense using fair value based method (net of tax)	(329)	(275)
Pro-forma	\$ 4,705	\$ 4,214
Basic net income per common share		
As reported	\$ 0.84	\$ 0.75
Pro-forma	\$ 0.79	\$ 0.71
Diluted net income per common share		
As reported	\$ 0.81	\$ 0.72
Pro-forma	\$ 0.76	\$ 0.69

There was no compensation cost capitalized as part of an asset.

The fair value of each option grant is estimated using the Black-Scholes-Merton option pricing model with the following weighted-average assumptions used for grants issued in 2006, 2005, and 2004 under the 2005 Equity Compensation Plan (as defined in Note 8 to our Financial Statements) and the 1992 Non-Qualified Stock Option Plan (as defined in Note 8 to our Financial Statements). There were no options issued to employees in 2006.

	2006	2005	2004
Dividend Yield	2.9%	3.0%	3.0%
Expected Volatility	.24	.32	.32
Director and Officer Options			
Risk Free Interest Rate	5.03%	3.97%	1.04%
Expected Term	3.26 years	3.42 years	5 years
Employee Options			
Risk Free Interest Rate	—	2.92%	1.92%
Expected Term	—	1 year	.88 year

The expected dividend yield was based on a 12 month rolling average of the current dividend yield. The expected volatility is the standard deviation of the change in the natural logarithm of the stock price (expressed as an annual rate) for the expected term shown above. The expected life was based on historic exercise patterns for similar grants. The risk free interest rate for the Director and Officer Options is the 3-year Treasury Constant Maturity rate as of the date of the grant for 2006 and 2005 grants, and 5-year for 2004 grants. The risk free interest rate for the Employee Options is the 1-year Treasury Constant Maturity rate for 2005 and 2004.

Shares of Class A Stock have been reserved for future issuance under the 2005 Equity Compensation Plan.

Notes to Consolidated Financial Statements

Revenue Recognition and Unbilled Revenues

Water service revenue for financial statement purposes includes amounts billed to customers on a quarterly or monthly cycle basis, depending on class of customer, and unbilled amounts based upon estimated usage from the date of the last meter reading to the end of the accounting period. The Company uses the percent of completion method of revenue recognition for the long-term wastewater contracts of designing, building and operating wastewater facilities throughout Delaware and surrounding areas.

Accounts Receivable

Accounts receivable are recorded at the invoiced amounts. The reserve for bad debts is the Company's best estimate of the amount of probable credit losses in our existing accounts receivable, and is determined based on historical write-off experience. The Company reviews the reserve for bad debts on a quarterly basis. Account balances are written off against the reserve when it is probable the receivable will not be recovered.

Cash and Cash Equivalents

For purposes of the Consolidated Statement of Cash Flows, Artesian Resources considers all temporary cash investments with an original maturity of three months or less to be cash equivalents. Artesian Water, Artesian Wastewater Management, and Artesian Utility utilize their bank's zero balance account disbursement service to reduce the use of their lines of credit by funding checks as they are presented to the bank for payment rather than at issuance. If the checks currently outstanding, but not yet funded, exceed the cash balance on Artesian Water's books, the net liability is recorded as a current liability on the consolidated balance sheet in the Overdraft Payable account.

Use of Estimates in the Preparation of Consolidated Financial Statements

The consolidated financial statements were prepared in conformity with generally accepted accounting principles in the U.S., which require management to make estimates about the reported amounts of assets and liabilities including unbilled revenues, reserve for a portion of revenues received under temporary rates and regulatory asset recovery and contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management's estimate.

Stock Split

On May 12, 2006, the Company completed a three for two stock split on its Class A Non-Voting Common Stock and Class B Common Stock, which was effected in the form of a 50% stock dividend. Shareholders of record on May 30, 2006 received one additional share of stock for each two shares held. All share and per share data for all prior periods have been restated to give effect to this stock split.

Capitalization of the Costs of Computer Software Developed or Obtained for Internal Use

The Company capitalized payroll and related expense associated with our internal staff's development and configuration of our new customer information system programs (the "CIS programs"). In deciding to capitalize this expense, the Company used AICPA Statement of Position (SOP) 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use as its accounting policy for recording these costs.

NOTE 2

FAIR VALUE OF FINANCIAL INSTRUMENTS

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

Current Assets and Liabilities

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

Long-term Financial Liabilities

The fair value of Artesian Resources' long-term debt as of December 31, 2006 and 2005, determined by discounting their future cash flows using current market interest rates on similar instruments with comparable maturities as guided under FAS 107, are shown as below :

Fair value of financial instruments at December 31, comprised:

<i>In thousands</i>	<i>2006</i>		<i>2005</i>	
	<i>Carrying Amount</i>	<i>Estimated Fair Value</i>	<i>Carrying Amount</i>	<i>Estimated Fair Value</i>
Long-term debt	\$ 92,073	\$ 91,410	\$ 92,379	\$ 93,299

The fair value of Advances for Construction cannot be reasonably estimated due to the inability to accurately estimate future refunds expected to be paid over the life of the contracts. Refund payments are based on the water sales to new customers in the particular development constructed. Future refunds expected to be paid would have to be estimated on a per contract basis using the past history of refund payments. The fair value of Advances for Construction would be less than the carrying amount because these financial instruments are non-interest bearing.

Notes to Consolidated Financial Statements

NOTE 3

INCOME TAXES

Deferred income taxes reflect temporary differences between the valuation of assets and liabilities for financial and tax reporting.

As of December 31, 2006, Artesian Resources has federal net operating loss carry-forwards aggregating approximately \$12.6 million, which will expire if unused by 2024. As of December 31, 2006, Artesian Resources has separate company state net operating loss carry-forwards aggregating approximately \$19.5 million. These net operating loss carry-forwards will expire if unused between 2007 and 2026. Artesian Resources has recorded a valuation allowance to reflect the estimated amount of deferred tax assets that may not be realized due to the expiration of the state net operating loss carry-forwards. Management believes that it is more likely than not that the Company will realize the benefits of these net deferred tax assets. The valuation allowance decreased from approximately \$323,000 in 2005 to approximately \$121,000 in 2006.

At December 31, 2006, for federal income tax purposes, there were alternative minimum tax credit carry forwards aggregating \$1.9 million resulting from the payment of alternative minimum tax in current and prior years. These alternative minimum tax credit carry-forwards may be carried forward indefinitely to offset future regular federal income taxes.

Components of Income Tax Expense

In thousands	2006	For the Year Ended December 31,	
		2005	2004
<i>State income taxes</i>			
Current	\$ 42	\$ —	\$ —
Deferred	741	733	366
Total state income tax expense	\$ 783	\$ 733	\$ 366
<i>Federal income taxes</i>			
Current	\$ 120	\$ 111	\$ —
Deferred	2,984	2,503	2,526
Total federal income tax expense	\$ 3,104	\$ 2,614	\$ 2,526

Reconciliation of effective tax rate:

In thousands	2006 Amount	2006 %	For the Year Ended December 31,			
			2005 Amount	2005 %	2004 Amount	2004 %
Income before federal and state income taxes	\$ 9,993	100.0	\$ 8,383	100.0	\$ 7,294	100.0
Amount computed at statutory rate	3,398	34.0	2,850	34.0	2,480	34.0
Reconciling items						
State income tax-net of federal tax benefit	466	4.7	481	5.8	418	5.7
Other	23	0.2	16	0.1	(6)	(0.1)
Total income tax expense and effective rate	\$ 3,887	38.9	\$ 3,347	39.9	\$ 2,892	39.6

Deferred income taxes at December 31, 2006, 2005, and 2004 were comprised of the following:

In thousands	2006	For the Year Ended December 31,	
		2005	2004
Deferred tax assets related to:			
Federal alternative minimum tax credit carry forwards	\$ 1,941	\$ 1,822	\$ 1,691
Federal and state operating loss carry forwards	5,384	7,105	8,884
Bad debt allowance	83	70	93
Valuation allowance	(121)	(323)	(482)
Stock options	145	145	241
Other	247	281	58
Total deferred tax assets	\$ 7,679	\$ 9,100	\$ 10,485
Deferred tax liabilities related to:			
Property plant and equipment basis differences	\$ (28,766)	\$ (26,512)	\$ (24,739)
Expenses of rate proceedings	(102)	(62)	(115)
Property taxes	(368)	(338)	(304)
Other	(232)	(241)	(251)
Total deferred tax liabilities	\$ (29,468)	\$ (27,153)	\$ (25,409)
Net deferred tax liability	\$ (21,789)	\$ (18,053)	\$ (14,924)

Deferred taxes, which are classified into a net current and non-current balance, are presented in the balance sheet as follows:

In thousands	2006	For the Year Ended December 31,	
		2005	2004
Current deferred tax liability	\$ (284)	\$ (269)	\$ (150)
Non-current deferred tax liability	(21,505)	(17,784)	(14,774)
Net deferred tax liability	\$ (21,789)	\$ (18,053)	\$ (14,924)

Notes to Consolidated Financial Statements

NOTE 4

PREFERRED STOCK

As of December 31, 2006, Artesian Resources had no preferred stock outstanding. The 9.96% Series Cumulative Prior Preferred stock had an annual sinking fund provision (mandatory redemption requirements). Under the mandatory sinking fund provisions, on February 1, 2004 the Company redeemed the remaining 4,000 shares of the 9.96% Series for \$100,000. The Company also has 100,000 shares of \$1.00 par value Series Preferred stock authorized but unissued.

NOTE 5

COMMON STOCK AND ADDITIONAL PAID-IN CAPITAL

The Class A Non-Voting Common Stock, Class A Stock, of Artesian Resources trades on the Nasdaq National Market under the symbol ARTNA. The Class B Common Stock of Artesian Resources trades on the Nasdaq's OTC Bulletin Board under the symbol ARTNB.OB.

Under Artesian Resources' dividend reinvestment plan, which allows for reinvestment of cash dividends and optional cash payments, stockholders were issued 15,388, 14,921, and 18,540 shares (as adjusted for the June 30, 2006 three for two stock split) at fair market value for the investment of \$308,000, \$294,000, and \$334,000 of their monies in the years 2006, 2005, and 2004, respectively.

NOTE 6

DEBT

Artesian Water has available two unsecured lines of credit, with no financial covenant restrictions, totaling \$40.0 million at December 31, 2006, which are renewable annually at each of the bank's discretion. Borrowings under the lines of credit bear interest based on the London Interbank Offering Rate, LIBOR, plus 1.0% for 30, 60, 90, or 180 days or the banks' federal funds rate plus 1.0%, at the option of Artesian Water.

At December 31, 2006 and 2005 Artesian Water had \$7.9 million and \$1.8 million outstanding under these lines at average interest rates of 6.4% and 5.3% respectively. The maximum amount outstanding was \$9.3 million and \$18.7 million in 2006 and 2005 respectively. The twelve-month average amount outstanding was approximately \$6.1 million and \$6.4 million at weighted average annual interest rates of 5.4% and 4.3% in 2006 and 2005 respectively.

At December 31, 2006, Artesian Utility and Artesian Wastewater had lines of credit with a financial institution for \$3.5 million and \$1.5 million, respectively, to meet temporary cash requirements. These revolving credit facilities are unsecured. As of December 31, 2006, we had not borrowed funds under these lines. The interest rate for borrowings under each of these lines is the LIBOR plus 1.75%.

On August 1, 2005, Artesian Water issued \$25 million aggregate principal amount of its 5.96%, 23-year Series R First Mortgage Bonds. Artesian Water recorded the total expense of approximately \$1.1 million, which included a redemption premium of \$865,000, in connection with the issuance of the bonds, as a deferred asset. These bonds were issued for Artesian Water to CoBank, a cooperative bank, and the proceeds were used on August 1, 2005, to retire all of Artesian Water's outstanding \$10 million aggregate principal amount of 7.84%, 10-year, Series M First Mortgage Bonds and \$5 million aggregate principal amount of 7.56%, 10-year, Series N First Mortgage Bonds, and to satisfy the \$865,000 redemption premium required as a result of the early retirement of the Series M and Series N First Mortgage Bonds. The remainder of the bond proceeds were used to pay down Artesian Water's short-term line of credit, which was used to finance investments in utility plant and equipment. Artesian Water is amortizing the redemption premium over the life of its 5.96%, 23-year Series R First Mortgage Bonds as an interest expense.

As of December 31, 2006, 2005 and 2004, substantially all of Artesian Water's utility plant was pledged as security for the First Mortgage Bonds. In addition, the trust indentures relating to these First Mortgage Bonds contain covenants which limit long-term debt, including the current portion thereof, to 66 2/3% of total capitalization including the current portion of the long-term debt, and which, in certain circumstances, could restrict the payment of cash dividends. As of December 31, 2006, however, no dividend restrictions were imposed under these covenants.

Long-term debt consists of:

<i>In thousands</i>	<i>2006</i>	<i>December 31,</i>	<i>2005</i>
First mortgage bonds			
Series O, 8.17%, due December 29, 2020	20,000		20,000
Series P, 6.58%, due January 31, 2018	25,000		25,000
Series Q, 4.75%, due December 1, 2043	15,400		15,400
Series R, 5.96%, due December 1, 2028	25,000		25,000
	85,400		85,400
State revolving fund loans			
4.48%, due August 1, 2021	3,558		3,721
3.57%, due September 1, 2023	1,319		1,374
3.64%, due May 1, 2024	2,106		2,185
	6,983		7,280
Sub-total	\$ 92,383		\$ 92,680
Less current maturities (principal amount)	310		301
Total long-term debt	\$ 92,073		\$ 92,379

Payments of principal due during the next five years and thereafter:

<i>In thousands</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>Thereafter</i>
First mortgage bonds	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 85,400
State revolving fund loan	310	323	336	350	364	5,300
Total payments	\$ 310	\$ 323	\$ 336	\$ 350	\$ 364	\$ 90,700

Notes to Consolidated Financial Statements

NOTE 7

NON-UTILITY OPERATING REVENUE AND EXPENSES

Non-utility operating revenue consisted of \$1,458,000, \$2,553,000, and \$729,000 received by Artesian Utility in 2006, 2005 and 2004 respectively. Additional non-utility revenue in 2006 consisted of \$1,322,000 from ADC's sale of land, and \$267,000 from ARC's SLP Plan.

Artesian Utility is a one-third owner in AquaStructure Delaware, L.L.C., which markets proposals to design and construct wastewater treatment facilities. On July 17, 2002, Artesian Utility began contractual operations of a wastewater treatment plant for which AquaStructure has an agreement with a Delaware municipality that expires on February 1, 2021. This agreement shall be extended for an additional twenty years unless advance notice is given.

Non-utility operating expenses are as follows:

<i>In thousands</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
Artesian Utility	\$ 1,205	\$ 2,184	\$ 495
Artesian Resources	211	116	17
Artesian Development	3	10	1
Total	\$ 1,419	\$ 2,310	\$ 513

NOTE 8

STOCK COMPENSATION PLANS

In 1992, the Company instituted the 1992 Non-Qualified Stock Option Plan, or the 1992 Plan, which was subsequently amended in 1998. Under the 1992 Plan, options to purchase shares of Class A Stock could be granted to employees at prices not less than 85% of the fair market value on the date of grant. The number of authorized shares was 375,000. Employees who participated and who were not executive officers or directors of the Company could receive options to purchase up to 1,000 shares. Each director or officer who participated in any year could request an option to purchase 4,500 shares of Class A Stock. The option price for directors and officers of the Company was 90% of the fair market value on the date of grant. Options granted under this plan to employees who were not executive officers or directors extended for a period of one year. Options granted to officers and directors extended for a period of ten years. All options were exercisable after six months of service from the date of initial grant, and are adjusted for stock dividends and splits. Employees, officers and directors became eligible to exercise options under the 1992 plan after one year of service to the Company. Effective May 25, 2005, no additional grants will be made from this plan.

In 1996, the Company instituted the Incentive Stock Option Plan, or the ISO Plan, under which the Company was authorized to grant options up to 150,000 shares of Class A Stock to its key employees and officers. Options were granted at the fair market value on the date of grant. The option exercise period could not exceed ten years from the date of grant and was determined by the Stock Option Committee of the Board of Directors for each stock option granted. Options granted will vest in accordance with the terms and conditions determined by the Stock Option Committee of the Board of Directors and are adjusted for stock dividends and splits. The Company accelerated vesting for certain incentive stock options held by officers and directors in anticipation of the Company's adoption of FAS 123(R) effective January 1, 2006. Effective May 25, 2005, no additional grants will be made from this plan.

On May 25, 2005, the Company adopted the 2005 Equity Compensation Plan, or "the Plan." The Plan provides that grants may be in any of the following forms: incentive stock options, nonqualified stock options, stock units, stock awards, dividend equivalents and other stock-based awards. The Plan is administered and interpreted by the Compensation Committee of the Board of Directors (the "Committee"). The Committee has the authority to determine the individuals to whom grants will be made under the Plan, determine the type, size and terms of the grants, determine the time when grants will be made and the duration of any applicable exercise or restriction period (subject to the limitations of the Plan) and deal with any other matters arising under the Plan. The Committee presently consists of three directors, each of whom is a non-employee director of the Company. All of the employees of the Company and its subsidiaries are eligible for grants under the Plan. Non-employee directors of the Company are also eligible to receive grants under the Plan.

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

	<i>2006 Shares</i>	<i>2006 Weighted Average Exercise Price</i>	<i>2005 Shares</i>	<i>2005 Weighted Average Exercise Price</i>	<i>2004 Shares</i>	<i>2004 Weighted Average Exercise Price</i>
Plan options						
Outstanding at beginning of year	571,686	\$13.294	498,432	\$11.266	472,187	\$10.207
Granted	33,750	\$21.113	125,611	\$19.679	78,181	\$16.020
Exercised	(9,577)	\$7.283	(51,796)	\$9.62	(46,806)	\$8.208
Canceled	(160)	\$18.463	(561)	\$13.605	(5,130)	\$14.112
Outstanding at end of year	595,699	\$13.832	571,686	\$13.294	498,432	\$11.266
Options exercisable at year end	561,949	\$13.395	569,733	\$13.288	461,074	\$11.060
Weighted average fair value of options granted during the year		\$21.113		\$19.679		\$17.915

The weighted-average grant-date fair value of options granted during 2006, 2005, and 2004 were \$3.809, \$4.278, and \$4.357, respectively. The total intrinsic value of options exercised during 2006 was \$128,731. There were no fully vested shares granted during 2006. During 2006, we received \$69,750 in cash from the exercise of options, with a \$52,365 tax benefit realized during the period.

The following tables summarize information about employee and director stock options outstanding at December 31, 2005:

Options Outstanding

Range of Exercise Price	Shares Outstanding at December 31, 2006	Weighted Average Remaining Life	Weighted Average Exercise Price
\$ 6.900 – \$ 13.300	330,199	3.79 Years	\$ 10.267
\$ 14.849 – \$ 21.113	265,500	8.25 Years	\$ 18.267

Options Exercisable

Range of Exercise Price	Shares Exercisable at December 31, 2006	Weighted Average Exercise Price
\$ 6.900 – \$ 13.300	330,199	\$ 10.267
\$ 14.849 – \$ 21.113	231,750	\$ 17.851

As of December 31, 2006, there was \$46,488 of total unrecognized expense related to nonvested option shares granted under the Plan. That cost will be recognized over the remaining 0.5 years vesting period of the unvested options.

Notes to Consolidated Financial Statements

NOTE 9

EMPLOYEE BENEFIT PLANS

401(k) Plan

Artesian Resources has a defined contribution 401(k) Salary Deduction Plan, or the "401(k) Plan," which covers substantially all employees. Under the terms of the 401(k) Plan, Artesian Resources contributed 2% of eligible salaries and wages and matches employee contributions up to 6% of gross pay at a rate of 50%. Artesian Resources may, at its option, make additional contributions of up to 3% of eligible salaries and wages. No such additional contributions were made in 2006, 2005 and 2004. The 401(k) Plan expenses, which include Company contributions and administrative fees, for the years 2006, 2005 and 2004, were approximately \$527,000, \$486,000, and \$417,000, respectively.

Postretirement Benefit Plan

Artesian Water has a Postretirement Benefit Plan, or the "Benefit Plan," which provides medical and life insurance benefits to certain retired employees. Prior to the amendment of the Benefit Plan, substantially all employees could become eligible for these benefits if they reached retirement age while still working for Artesian Water.

Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions", SFAS 106, requires Artesian Water to accrue the expected cost of providing postretirement health care and life insurance benefits as employees render the services necessary to earn the benefits. Artesian Resources elected to defer recognition and amortize its transition obligation over twenty years beginning in 1993.

Artesian Water recognized an offsetting regulatory asset with respect to the SFAS 106 liability. This asset is recorded based on the PSC order, which permits Artesian Water to continue recovery of postretirement health care and life insurance expense on a pay-as-you-go basis for the remaining eligible employees. Artesian Water anticipates liquidating its SFAS 106 obligation and substantially recovering the expenses in rates over a period of approximately 20 years (based on the age and life expectancy of the remaining eligible participants). Further, expense recovery as a percentage of rates is expected to remain generally constant over the initial years, and then decline until the obligation is liquidated. Amounts charged to expense were \$70,000, \$72,000, and \$63,000 for 2006, 2005 and 2004, respectively.

Supplemental Pension Plan

Effective October 1, 1994, Artesian Water established a Supplemental Pension Plan, or the "Supplemental Plan," to provide additional retirement benefits to full-time employees hired prior to April 26, 1994. The Supplemental Plan is a defined contribution plan that enables employees to save for future retiree medical costs, which will be paid by employees. The Supplemental Plan accomplishes this objective by providing additional cash resources to employees upon a termination of employment or retirement, to meet the cost of future medical expenses. Artesian Water has established a contribution based upon each employee's years of service ranging from 2% to 6% of eligible salaries and wages. Artesian Water also provides additional benefits to individuals who were over age 50 as of January 1, 1994. These individuals are referred to as the "Transition Group." Effective November 1, 1994, individuals eligible for the Transition Group had the opportunity to defer compensation to the Supplemental Plan, and to receive a transition matching contribution for 5 years. Each one-dollar of eligible salaries and wages deferred by the Transition Group was matched with three, four, or five dollars by Artesian Water based on the employee's years of service subject to certain limitations under the federal tax rules. Plan expenses, which include Company contributions and administrative fees, for the years 2006, 2005 and 2004 were approximately \$276,000, \$275,000, and \$252,000, respectively.

The Company uses December 31 as the measurement date to determine the postretirement benefit obligation. According to our actuarial report, the funded status of our defined benefit postretirement plan was calculated contemplating FAS 158 and the obligation is recorded at that amount. There was no Other Comprehensive Income impact because we record a regulatory asset as provided by FAS 71. Additional disclosures required for our postretirement benefit obligation are presented.

Benefit Obligations and Funded Status

<i>In thousands</i>	<i>Fiscal Year Ending December 31</i>	
	<i>2006</i>	<i>2005</i>
Change in Accumulated Postretirement Benefit Obligation		
Accumulated Postretirement Benefit Obligation at the Beginning of the Year	\$ 909	\$ 946
Service Cost	—	—
Interest Cost	52	54
Actuarial (Gain) or Loss	4	10
Benefits Paid	(106)	(104)
Plan Participants' Contributions	3	4
Accumulated Postretirement Benefit Obligation at the End of the Year	862	910
Change in Plan Assets		
Fair Value of Plan Assets at the Beginning of the Year	—	—
Benefits Paid	(105)	(104)
Employer Contributions	102	100
Plan Participants' Contributions	3	4
Fair Value of Assets at the End of the Year	—	—
Net Amount Recognized		
Funded Status	(862)	(910)
Unrecognized Transition Obligation (Asset)	60	68
Unrecognized Net (Gain) or Loss	(225)	(255)
Net Amount Recognized	(1,027)	(1,097)
Amounts Recognized in the Statement of Financial Position		
Accrued Benefit Liability	(1,027)	(1,097)
Net Amount Recognized	\$ (1,027)	\$ (1,097)
Weighted Average Assumptions at the End of the Year		
Discount Rate	6.00%	6.00%
Assumed Health Care Cost Trend Rates		
Health Care Cost Trend Rate Assumed for Next Year	11.00%	11.00%
Ultimate Rate	5.00%	5.00%
Year that the Ultimate Rate is Reached	2013	2012

Net Periodic Benefit Cost

<i>In thousands</i>	<i>Fiscal Year Ending December 31</i>		
	<i>2006</i>	<i>2005</i>	<i>2004</i>
Interest Cost	\$ 51	\$ 54	\$ 57
Amortization of Net (Gain) or Loss	\$ (27)	\$ (34)	\$ (37)
Amortization of Transition Obligation/(Asset)	\$ 9	\$ 9	\$ 9
Total Net Periodic Benefit Cost	\$ 33	\$ 29	\$ 29
Weighted Average Assumptions			
Discount Rate	6.00%	6.00%	6.00%
Assumed Health Care Cost Trend Rates			
Health Care Cost Trend Rate Assumed for Current Year	11.00%	11.00%	12.00%
Ultimate Rate	5.00%	5.00%	5.00%
Year that the Ultimate Rate is Reached	2012	2011	2010

Impact of One-Percentage-Point Change in Assumed Health Care Cost Trend Rates

	<i>Increase</i>	<i>Decrease</i>
Effect on Service Cost & Interest Cost	\$ 3	\$ (3)
Effect on Postretirement Benefit Obligation	\$ 44	\$ (40)

The impact of Medicare Part D, although insignificant, was included in the determination of Accumulated Postretirement Benefit Obligation as of December 31, 2004, and Net Periodic Benefit Cost beginning in 2005.

Notes to Consolidated Financial Statements

Contributions

Artesian Water expects to contribute \$100,000 to its postretirement benefit plan in 2007. The following table represents the benefits expected to be paid:

<i>In thousands</i>	<i>Other Benefits</i>
2007	\$ 100
2008	100
2009	100
2010	100
2011	100
2012-2016	500

NOTE 10

COMMITMENTS AND CONTINGENCIES

In 1997, Artesian Water entered into a 33-year operating lease for a parcel of land with improvements located in South Bethany, a municipality in Sussex County, Delaware. The annual lease payments increase each year by the most recent increase in the Consumer Price Index for Urban Workers, CPI-U, as published by the U.S. Department of Labor, Bureau of Labor Statistics. Rental payments for 2006, 2005 and 2004 were \$11,400, \$11,000, and \$9,700, respectively. The future minimum rental payment as disclosed in the following table is calculated using CPI-U as of December 31, 2006.

During 1996, Artesian Water entered into a 10-year lease commitment for office space and this lease was further extended for two years ending February 29, 2008. Rent payments for 2006, 2005 and 2004 for the office space were \$72,000, \$76,000, and \$74,000, respectively.

During 1999, Artesian Water entered into the contract for office space located in Sussex County, Delaware. This contract was terminated in October 2006. Rent payments for 2006, 2005, and 2004 were \$24,000, \$28,000, and \$28,000, respectively. We entered into a new 3-year contract for office space located in Sussex County, Delaware in October 2006. Rent payments during 2006 were \$14,000.

During 2003, Artesian Resources, entered into a 40-year easement agreement with Broad Run Valley, Inc., a Pennsylvania corporation, to acquire an easement to access, operate, maintain, repair, improve, replace and connect Artesian's water system to a well, including a parcel of land around the well. Easement payments for 2006, 2005 and 2004 were \$27,000, \$26,000 and \$25,000, respectively.

Artesian Wastewater entered into a perpetual agreement with Farm Boys, LLC for the use of approximately 460 acres of land for wastewater disposal. Beginning in January 2007, Artesian Wastewater is required to pay a minimum of \$40,000 per year for the use of this land. Once disposal operations begin, the monthly fee will be contingent on the average number of gallons of wastewater disposed on the properties. The agreement can be terminated by giving 180-day notice prior to the termination date.

Future minimum annual rental payments under the above mentioned lease obligations for the years subsequent to 2006 are as follows:

<i>In thousands</i>	
2007	\$ 183
2008	97
2009	76
2010	42
2011	43
2012 through 2042	1,809
	<u>\$ 2,250</u>

Artesian Water has one water service interconnection agreement with a neighboring utility, Chester Water Authority, which requires minimum annual purchases. Rates charged under this agreement are subject to change. Effective August 1, 1997, Artesian Water renegotiated the contract with the Chester Water Authority to, among other things, reduce the minimum purchase requirements from 1,459 million gallons to 1,095 million gallons annually, calculated as 3 mgd times the number of calendar days in a year. The agreement is extended through the year 2021. A previous interconnection agreement with the City of Wilmington expired in December 2006.

The Chester Water Authority sent us a notice on February 15, 2006 of a rate increase, effective July 1, 2006. We received a second notice of a rate increase on February 14, 2007, effective July 1, 2007. The minimum annual purchase commitments for all interconnection agreements for 2007 through 2011 and the aggregate total for the years 2012 through 2021, calculated at the noticed rates, are as follows:

<i>In thousands</i>	
2007	\$ 2,810
2008	2,836
2009	2,828
2010	2,828
2011	2,828
2012 through 2021	28,304
	<u>\$ 42,434</u>

Expenses for purchased water were \$3,152,000, \$3,131,000, and \$2,995,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

In 2005, Artesian Water entered into a 6-year agreement with Utility Service Co., Inc. to clean and paint tanks from 2006 to 2011 for \$1,872,000. The tank painting expense for 2006, 2005 and 2004 was \$200,000, \$254,000, and \$278,000. The expenditures committed for the years subsequent to 2006 are as follows:

<i>In thousands</i>	
2007	\$ 374
2008	375
2009	374
2010	375
2011	174
	<u>\$ 1,672</u>

Budgeted mandatory utility plant expenditures, due to planned governmental highway projects, which require the relocation of Artesian Water's water service mains, expected to be incurred in 2007 through 2011 are as follows:

<i>In thousands</i>	<i>(unaudited)</i>
2007	\$ 1,200
2008	2,380
2009	2,950
2010	2,000
2011	1,400
	<u>\$ 9,930</u>

The exact timing and extent of these relocation projects is controlled primarily by the Delaware Department of Transportation.

Notes to Consolidated Financial Statements

NOTE 11

GEOGRAPHIC CONCENTRATION OF CUSTOMERS

Artesian Water and Artesian Water Pennsylvania provide water utility service to customers within their established service territory in all three counties of Delaware and in portions of Pennsylvania, pursuant to rates filed with and approved by the PSC and the PAPUC. As of December 31, 2006, Artesian Water was serving 73,800 customers and Artesian Water Pennsylvania was serving 39 customers.

Artesian Wastewater began providing wastewater services to a community in Sussex County, Delaware in July 2005. The PSC approved the temporary rates for this community on July 15, 2005, and on January 24, 2006, approved the rates and tariff. As of December 31, 2006, Artesian Wastewater was serving 171 customers.

NOTE 12

RATE PROCEEDINGS

In February 2004, Artesian Water filed a request with the Delaware PSC for an increase in rates of 24%. We recognized revenues reflecting a temporary increase of \$2.5 million on an annual basis between April and September 2004, and a second temporary increase of \$3.0 million on an annual basis effective September 2004, for a total of \$5.5 million on an annual basis. A portion of the second increase was held in reserve based on an estimated outcome and was not reflected in income. In May 2006, the PSC issued the final order in this case. Based on the PSC decision, Artesian Water's new rates would generate approximately \$4.9 million in additional revenue on an annual basis, or an increase of approximately 13.4% over rates in effect before the implementation of temporary rates in 2004. We were required by law to refund the portion of the temporary rate increase in excess of the 13.4% plus interest to our customers. The refund was completed in December 2006.

In May 2006, Artesian Water filed a petition with the PSC to implement new rates to meet a requested increase in revenue of 23%, or approximately \$9.9 million, on an annualized basis. This request was primarily due to the Company's significant investment in infrastructure, as well as an approximately 92% increase in purchased power expense due to the expiration of price caps imposed in 1999 when deregulation of the electric industry in Delaware was adopted. As permitted by law, in July 2006 we placed into effect temporary rates designed to generate an increase in annual operating revenue of approximately 5.9%, or \$2.5 million on an annual basis, until new rates were approved by the PSC.

On December 19, 2006 the PSC approved a Settlement Agreement in this case. The increase in annual revenue requirement under the Settlement Agreement of \$6 million will be recovered in two steps. The first step was placed in effect January 1, 2007 to recover approximately \$4.8 million in annual revenue. The second step will be designed to recover approximately \$1.2 million of annual revenue reflecting the issuance of additional equity not to exceed \$20 million. However, should the Company issue less than the projected \$20 million in equity, the increase will be adjusted to reflect the change in recovery associated with the Company's capital structure.

Delaware statute permits water utilities to put into effect, on a semi-annual basis, increases related to specific types of distribution system improvements through a Distribution System Improvement Charge, or DSIC. This charge is available to water utilities to be implemented between general rate increase applications that normally recognize changes in a water utility's overall financial position. The DSIC approval process is less costly when compared to the approval process for general rate increase requests. We requested on November 30, 2005, and subsequently implemented, a 1.17% DSIC for bills rendered after January 1, 2006. The 1.17% generated approximately \$225,000 in revenues during the first nine months of 2006. As required by law, the surcharge for DSIC was reset to zero upon the implementation of the temporary rates on July 10, 2006, as noted above.

Artesian Wastewater began providing wastewater services to a community in Sussex County, Delaware in July 2005. The PSC approved the temporary rates for this community on July 15, 2005, and on January 24, 2006, approved the rates and tariff.

NOTE 13

SALE OF LAND

On May 2, 2005, Artesian Development signed a Letter of Intent with The Commonwealth Group, Ltd., or Commonwealth, for the sale of a parcel of land of approximately four acres. Subsequently, on August 5, 2005, Artesian Development entered into an Agreement of Sale with Commonwealth for the sale of this land. The sale was completed on September 14, 2006. The sale price was \$1.4 million and the gain on the sale of the parcel of land after expenses, but before income taxes, was approximately \$1.3 million.

NOTE 14

NET INCOME PER COMMON SHARE AND EQUITY PER COMMON SHARE

Basic net income per common share is based on the weighted average number of common shares outstanding. Diluted net income per common share is based on the weighted average number of common shares outstanding and potentially dilutive effect of employee stock options.

The following table summarizes the shares used in computing basic and diluted net income per common share

<i>In thousands</i>	<i>2006</i>	<i>Years Ended December 31,</i>	
		<i>2005</i>	<i>2004</i>
Average common shares outstanding during the period for Basic computation	6,055	5,984	5,904
Dilutive effect of employee stock options	180	198	195
Average common shares outstanding during the period for Diluted computation	6,235	6,182	6,099

Equity per common share was \$10.21, \$9.66, and \$9.31 at December 31, 2006, 2005, and 2004, respectively. These amounts were computed by dividing stockholders' equity excluding preferred stock by the number of basic shares of common stock outstanding at the end of each year, as restated for the 2006 stock split.

NOTE 15

SELECTED CONSOLIDATED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table presents certain historical consolidated statements of operations data for each quarter for the fiscal years ended December 31, 2006 and 2005:

<i>In thousands</i> <i>(except per share data)</i>	<i>First Quarter</i>		<i>Second Quarter</i>		<i>Third Quarter</i>		<i>Fourth Quarter</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
Operating revenues	\$10,489	\$ 9,902	\$12,014	\$11,502	\$14,194	\$12,380	\$11,891	\$11,501
Operating income	\$ 2,053	\$ 2,007	\$ 2,889	\$ 2,707	\$ 4,181	\$ 3,164	\$ 2,672	\$ 2,764
Net income applicable to common stock	\$ 995	\$ 954	\$ 1,360	\$ 1,204	\$ 2,607	\$ 1,679	\$ 1,109	\$ 1,198
Income per common share								
Basic	\$ 0.17	\$ 0.16	\$ 0.22	\$ 0.20	\$ 0.43	\$ 0.28	\$ 0.18	\$ 0.20
Diluted	\$ 0.16	\$ 0.16	\$ 0.22	\$ 0.19	\$ 0.42	\$ 0.27	\$ 0.17	\$ 0.19

NOTE 16

IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS

In February 2007, the Financial Accounting Standards Board, FASB, issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB No.115." This statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company expects to adopt this statement effective January 1, 2008 and does not expect it to have a material effect on the financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current year Financial Statements" ("SAB 108"), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 is effective as of the end of Artesian's 2006 fiscal year, allowing a one-time transitional cumulative effect adjustment to beginning retained earnings as of January 1, 2006 for errors that were not previously deemed material, but are material under the guidance in SAB 108. The adoption of this statement did not have a material impact on our financial condition or results of operations.

In September 2006, the Financial Accounting Standards Board, FASB, issued Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans", an amendment of FASB Statements No. 87, "Employers' Accounting for Pensions"; No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits"; No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions"; and No. 132(R), "Employers' Disclosures about Pensions and Other Postretirement Benefits". This statement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur. Employers, such as Artesian, with publicly traded equity securities are required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. The Company adopted this statement effective December 31, 2006. The adoption of this statement did not have a material impact on our financial condition or results of operations for 2006. According to our actuarial report, the funded status of our defined benefit postretirement plan was calculated contemplating FAS 158 and the obligation is recorded at that amount. There was no Other Comprehensive Income impact because we record a regulatory asset as provided by FAS 71.

In September 2006, FASB issued Statement No. 157, "Fair Value Measurements". This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements; however, the statement does not require any new fair value measurements. This statement is effective for fiscal years beginning after November 15, 2007 and interim periods within those years. The Company expects to adopt this statement effective January 1, 2008 and does not expect it to have a material effect on the financial statements.

In June 2006, FASB issued Interpretation No. 48 "Accounting for Uncertainty in Income Taxes", an interpretation of FASB Statement No. 109 "Accounting for Income Taxes". This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109. The Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation allows an enterprise to recognize economic benefits resulting from positions taken in income tax returns, as long as a more likely than not approach is taken. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company expects to adopt this statement effective January 1, 2007 and is currently evaluating its effect on the financial statements.

In March 2006, FASB issued Statement No. 156, "Accounting for Servicing of Financial Assets". This statement amends FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," with respect to the accounting for separately recognized servicing assets and servicing liabilities. This statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in some situations. It also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. This statement is effective for fiscal years beginning after September 15, 2006. The Company expects to adopt this statement effective January 1, 2007 and does not expect it to have a material effect on the financial statements.

In February 2006, FASB issued Statement No. 155, "Accounting for Certain Hybrid Financial Instruments". This statement amends FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities," and No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". This statement permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. This statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company expects to adopt this statement effective January 1, 2007 and does not expect it to have a material effect on the financial statements.

In December 2004, the FASB issued Statement No. 123 (revised 2004), Statement No. 123(R), "Share-Based Payment." This Statement is a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation". This Statement supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees", and its related implementation guidance. This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. According to the FASB, this Statement is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. However, during the first quarter of 2005, the Securities and Exchange Commission approved a new rule, Staff Accounting Bulletin 107, that delayed the adoption of this standard to the beginning of the next fiscal year, instead of the next reporting period that began after June 15, 2005. The rule does not change the accounting required by Statement No. 123(R), but recognizes that preparers will need to use considerable judgment when valuing employee stock options under this statement. SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Proforma disclosure is no longer an alternative upon adopting SFAS 123(R). SFAS 123(R) permits public companies to adopt its requirements using one of two methods:

- A "modified prospective" method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS 123(R) for all awards granted to employees prior to the effective date of SFAS 123(R) that remain unvested on the effective date; or
- A "modified retrospective" method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123(R) for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

We implemented SFAS 123(R) in the first quarter of 2006. We used the modified prospective method and estimated the fair value of each option grant using the Black-Scholes-Merton option pricing model.

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Artesian Resources Corporation
Newark, Delaware

We have audited the accompanying consolidated balance sheets of Artesian Resources Corporation and subsidiaries as of December 31, 2006 and 2005 and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The consolidated balance sheet of Artesian Resources Corporation and subsidiaries as of December 31, 2004, and related consolidated statement of operations, changes in stockholders' equity and cash flows for the year then ended, were audited by other auditors whose report dated March 30, 2005, expressed an unqualified opinion on those statements.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Artesian Resources Corporation and subsidiaries at December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Artesian Resources Corporation's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 14, 2007 expressed an unqualified opinion thereon.

BDO Seidman, LLP

BDO Seidman, LLP
Bethesda, Maryland
March 14, 2007

Management's Report on Internal Control Over Financial Reporting

The Management of Artesian Resources Corporation is responsible for establishing and maintaining adequate internal control over its financial reporting. Artesian Resources Corporation's internal control over financial reporting is a process designed under the supervision of the Corporation's chief executive officer and chief financial officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Corporation's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

Artesian Resources Corporation's Management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2006 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in "Internal Control Integrated Framework." Based on this assessment, Management determined that at December 31, 2006, the Corporation's internal control over financial reporting was effective. Management's assessment of the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2006 has been audited by BDO Seidman, LLP, an independent registered public accounting firm, and BDO Seidman, LLP has issued an attestation report, which is included herein, regarding Management's assessment.

Date: March 16, 2007

CHIEF EXECUTIVE OFFICER:

Dian C. Taylor

Dian C. Taylor

CHIEF FINANCIAL OFFICER:

David B. Spacht

David B. Spacht

Report of Independent Registered Public Accounting Firm On Internal Control Over Financial Reporting

Board of Directors and Stockholders
Artesian Resources Corporation
Newark, Delaware

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Artesian Resources Corporation maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria)". Artesian Resources Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Artesian Resources Corporation maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also in our opinion, Artesian Resources Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Artesian Resources Corporation and subsidiaries as of December 31, 2006 and 2005 and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2006 and our report dated March 14, 2007 expressed an unqualified opinion thereon.

BDO Seidman, LLP

BDO Seidman, LLP
Bethesda, Maryland
March 14, 2007

Summary of Ten Years of Operations

<i>In thousands, except per share and operating data</i>	<i>2006</i>	<i>For the year ended December 31,</i>		<i>2003</i>	<i>2002</i>	<i>2001</i>	<i>For the year ended December 31,</i>		<i>1998</i>	<i>1997</i>
		<i>2005</i>	<i>2004</i>				<i>2000</i>	<i>1999</i>		
STATEMENT OF OPERATIONS DATA										
Operating revenues										
Water sales	\$ 44,272	\$ 41,638	\$ 37,985	\$ 35,164	\$ 33,644	\$ 31,362	\$ 27,090	\$ 26,310	\$ 25,096	\$ 22,003
Other revenue	4,315	3,647	1,597	1,131	953	625	461	467	370	337
Total operating revenues	\$ 48,587	\$ 45,285	\$ 39,582	\$ 36,295	\$ 34,597	\$ 31,987	\$ 27,551	\$ 26,777	\$ 25,466	\$ 22,340
Operating expenses										
Utility operating expenses	\$ 25,733	\$ 24,543	\$ 20,700	\$ 19,629	\$ 18,334	\$ 17,619	\$ 15,399	\$ 14,690	\$ 14,273	\$ 12,775
Depreciation and amortization	4,610	4,365	4,046	3,635	3,392	3,001	2,706	2,417	2,183	2,441
State and federal income taxes	3,887	3,347	2,892	2,387	2,825	2,184	1,619	1,960	1,808	1,278
Property and other taxes	2,562	2,389	2,070	2,115	1,871	1,782	1,616	1,620	1,535	1,439
Total operating expenses	36,792	\$ 34,644	\$ 29,708	\$ 27,766	\$ 26,422	\$ 24,586	\$ 21,340	\$ 20,687	\$ 19,799	\$ 17,933
Operating income	\$ 11,795	\$ 10,641	\$ 9,874	\$ 8,529	\$ 8,175	\$ 7,401	\$ 6,211	\$ 6,090	\$ 5,667	\$ 4,407
Other income, net	613	515	471	277	380	457	295	188	215	158
Total income before interest charges	\$ 12,408	\$ 11,156	\$ 10,345	\$ 8,806	\$ 8,555	\$ 7,858	\$ 6,506	\$ 6,278	\$ 5,882	\$ 4,565
Interest charges	\$ 6,337	\$ 6,121	\$ 5,943	\$ 4,889	\$ 4,388	\$ 4,537	\$ 4,055	\$ 3,298	\$ 3,162	\$ 2,580
Net income	\$ 6,071	\$ 5,035	\$ 4,402	\$ 3,917	\$ 4,167	\$ 3,321	\$ 2,451	\$ 2,980	\$ 2,720	\$ 1,985
Dividends on preferred stock	—	—	2	71	42	51	61	71	82	93
Net income applicable to common stock	\$ 6,071	\$ 5,035	\$ 4,400	\$ 3,846	\$ 4,125	\$ 3,270	\$ 2,390	\$ 2,909	\$ 2,638	\$ 1,892
Net income per share of common stock:										
Basic	\$ 1.00	\$ 0.84*	\$ 0.75*	\$ 0.66*	\$ 0.78*	\$ 0.71*	\$ 0.53*	\$ 0.66*	\$ 0.65*	\$ 0.48*
Diluted	\$ 0.97	\$ 0.81*	\$ 0.72*	\$ 0.64*	\$ 0.76*	\$ 0.70*	\$ 0.52*	\$ 0.65*	\$ 0.65*	\$ 0.47*
Avg. shares of common stock outstanding										
Basic	6,055	5,984*	5,904*	5,820*	5,301*	4,559*	4,517*	4,413*	4,041*	3,965*
Diluted	6,235	6,182*	6,099*	5,990*	5,418*	4,662*	4,599*	4,491*	4,086*	3,995*
Cash dividends per share of common stock	\$ 0.61	\$ 0.58*	\$ 0.55*	\$ 0.53*	\$ 0.51*	\$ 0.49*	\$ 0.49*	\$ 0.47*	\$ 0.43*	\$ 0.41*
* Restated for stock split effective May 12, 2006										
BALANCE SHEET DATA										
Utility plant, at original cost										
less accumulated depreciation	\$ 253,182	\$ 227,566	\$ 212,152	\$ 187,893	\$ 167,338	\$ 152,356	\$ 134,038	\$ 122,481	\$ 109,780	\$ 97,694
Total assets	\$ 269,360	\$ 243,854	\$ 227,380	\$ 216,324	\$ 183,072	\$ 163,534	\$ 144,407	\$ 132,482	\$ 119,376	\$ 107,867
Notes payable	\$ 7,906	\$ 1,786	\$ 9,213	\$ 12,499	\$ 3,163	\$ 16,118	\$ 2,000	\$ 7,617	\$ 7,704	\$ 1,164
Long-term obligations and redeemable										
preferred stock, including current portions	\$ 92,383	\$ 92,680	\$ 83,438	\$ 80,846	\$ 64,591	\$ 50,998	\$ 52,236	\$ 36,165	\$ 32,696	\$ 32,861
Stockholders' equity	\$ 61,800	\$ 57,813	\$ 54,943	\$ 52,691	\$ 51,176	\$ 34,445	\$ 32,829	\$ 32,356	\$ 27,933	\$ 26,587
Total capitalization	\$ 153,873	\$ 150,192	\$ 137,299	\$ 133,249	\$ 115,246	\$ 84,015	\$ 83,846	\$ 67,285	\$ 60,486	\$ 59,290
OPERATING DATA										
Average water sales per customer	\$ 600	\$ 575	\$ 535	\$ 505	\$ 495	\$ 474	\$ 417	\$ 420	\$ 419	\$ 376
Water pumped (millions of gallons)	7,608	7,468	7,166	7,199	7,198	7,321	6,886	6,758	6,739	6,637
Number of metered customers	73,814	72,383	70,993	69,687	68,049	66,173	64,902	62,621	60,688	59,218
Miles of water main	1,050	1,001	977	938	917	888	872	842	820	797

The selected financial data set forth above has been derived from the consolidated financial statements of the Company and the related notes thereto. The statement of operations data for the years ended December 31, 2006 and 2005 and the balance sheet data as of December 31, 2006 and 2005 are derived from the consolidated financial statements of the Company, included elsewhere herein, which have been audited by BDO Seidman, LLP, independent registered public accountants. The statement of operations data for the years ended December 31, 2004, 2003, 2002, 2001,

1999, 1998, and 1997 and the balance sheet data as of December 31, 2004, 2003, 2002, 2001, 1999, 1998, and 1997 are derived from the consolidated financial statements of the Company, which have been audited by another auditor but whose report is not contained herein. The selected financial data should be read in conjunction with the Company's consolidated financial statements and the related notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations," which are included elsewhere herein.



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