Q2 2015 Earnings Call

Company Participants

- Gregory S. Panagos
- Linda G. Sullivan
- Susan N. Story
- Walter J. Lynch

Other Participants

- Barry Klein, Macquarie Funds Group
- Brian J. Chin, Bank of America Merrill Lynch
- Dan L. Eggers, Credit Suisse Securities (USA) LLC (Broker)
- David A. Paz, Wolfe Research LLC
- Jonathan G. Reeder, Wells Fargo Securities LLC
- Michael J. Lapides, Goldman Sachs & Co.
- Ryan Michael Connors, Boenning & Scattergood, Inc. (Broker)
- Spencer E. Joyce, J.J.B. Hilliard, W.L. Lyons LLC

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to American Water's Second Quarter 2015 Earnings Conference Call. As a reminder, this call is being recorded and is also being webcast with an accompanying slide presentation through the company's Investor Relations website.

Following the earnings conference call, an audio archive of the call will be available through August 13, 2015, by dialing 412-317-0088 for U.S. and international callers. The access code for replay is 10068691. The online archive of the webcast will be available through September 8, 2015, by accessing the Investor Relations page of the company's website located at www.amwater.com.

During today's presentation, all participants will be in listen-only mode. After today's presentation, there will be an opportunity to ask questions.

I would now like to introduce your host for today's call, Greg Panagos, Vice President of Investor Relations. Mr. Panagos, you may begin.

Gregory S. Panagos {BIO 17562275 <GO>}

Thank you, Gary. Good morning, everyone, and thank you for joining us for today's call. As Gary said, my name is Greg Panagos. And I'm the new Vice President of Investor Relations for American Water. Before I read you our forward-looking statement, I just like to say I'm happy to be here and excited about the opportunity with American Water.

While I haven't had the chance to meet most of you yet, I look forward to working with all of you. We'll keep the call to about an hour. And at the end of our prepared remarks, we'll open it up for your questions. Before we begin, I'd like to remind everyone that, during the course of this conference call, both in our prepared remarks and in answer to your questions, we may make statements related to future performance.

Our statements represent our most reasonable estimates. However, since these statements deal with future events, they are subject to numerous risks, uncertainties and other factors that may cause the actual performance of American Water to be materially different from the performance indicated or implied by such statements. Such risk factors are set forth in the company's SEC filings.

I encourage you to read our 10-Q on file with the SEC for a more detailed analysis of our financials. Also, reconciliation tables for non-GAAP financial information discussed on this conference call can be found in the appendix of the slide deck located at the Investor Relations page of the company website. We'll be happy to answer any questions or provide further clarification, if needed, during our question-and-answer session. All statements in this call related to earnings per share refer to diluted earnings per share from continuing operations.

And now, I'd like to turn the call over to American Water's President and CEO, Susan Story.

Susan N. Story {BIO 3335156 <GO>}

Thanks, Greg. Good morning, everyone, and thanks for joining us. With me today are Linda Sullivan, our CFO, who will go over the second quarter financial results; and Walter Lynch, our COO and President of Regulated Operations, who will give us key updates on our Regulated business.

I would also like to officially welcome Greg Panagos to our team as Vice President of Investor Relations. Greg has more than 20 years of corporate finance and investor relations experience, including several years in the energy industry. He has served in a number of senior investor relations and communication role, including Barrick Gold Corporation, Transocean, Noble Energy and Pennzoil. His knowledge and experience are a great fit for American Water. And we're happy to have him join our team.

And now, to the quarter. Once again, our employees delivered solid operational and financial results. We continue to execute our strategies through ongoing investment into our infrastructure, a sharp focus on operational efficiency, and growth in our Regulated and Market-Based customers.

Turning to slide five, we reported earnings per share of $0.68 for the second quarter. Excluding the impact from the Freedom Industries chemical spill in 2014, this is about an 8% increase compared to second quarter 2014 and a 9% increase year-to-date through June. Based on our performance through the second quarter and also including our known July weather impacts, which Walter and Linda will discuss shortly, we are reaffirming our 2015 earnings guidance to be in the range of $2.55 to $2.65 per share.

On slide six, you see that we continue to deliver on our strategies in both Regulated and Market-Based segments for the quarter and year-to-date. The capital investments we make in our Regulated segment continue to be the foundation of our consistent growth. So far, in 2015, we've made about $474 million in infrastructure investments to ensure safe, clean and reliable water services for our customers. We plan to invest $1.2 billion to $1.3 billion in capital in 2015, with over $1 billion of that to improve our water and wastewater systems. About $200 million is allocated to Regulated acquisitions and strategic investments.

Through the second quarter, we invested $41 million in acquisitions, which does not include the Keystone Clearwater acquisition, which closed on July the 9. Since our last quarterly call, we've completed the purchase of water and wastewater systems in Haddonfield, New Jersey; in Russiaville, Indiana; and in both Arnold and Redfield, Missouri, officially adding 19,000 customers to our Regulated segment.

We also have 17 pending acquisitions, which, once approved and closed, will give us the opportunity to serve an additional 14,000 customers in several of our states. The largest of these acquisitions is the Environmental Disposal Corporation, which serves 5,300 wastewater customers in Northern New Jersey. This acquisition is a great example of executing on our long-term strategy to focus on wastewater acquisitions in areas where we already serve water.

Our Market-Based segment had a strong second quarter. Homeowner services entered into an exclusive contract with the city of Rialto, California to offer service line protection programs to homeowners. We were also recently notified by Wilmington, Delaware of its intent to award an exclusive contract to offer our programs to its residential customers, pending city council approval. If approved, we expect both of these programs to launch by year-end.

As you know, our long-term growth triangle includes a Market-Based shale component, which we have shown could contribute from 0% to 2% of our long-term earnings growth. Since our last call, we announced and closed on the acquisition of Keystone Clearwater Solutions. Keystone is a water services provider to oil and gas companies in the Appalachian Basin, which includes the Marcellus and the Utica.

Keystone's leadership, which we have left intact, has over 30 years of experience in addressing water solutions for Appalachia's oil and gas market. The team of 350 employees has a strong reputation for meeting their customers' needs with a priority on safety and protecting the environment. These values are consistent with American Water's values and they matter deeply to us.

And, critically important, Keystone's offerings are aligned with American Water's core competencies: supplying, transmitting, pumping and storing water, and developing the infrastructure that goes along with those services. Despite the fact that Keystone is a relatively small part of our overall business portfolio, we know it faces somewhat different risks than American Water's traditional lines of business.

As a result, we've set up a legal structure to ring-fence Keystone. For example, we've established it under a holding company separate from our existing Regulated segment and separate from our Market-Based, American Water Enterprises entity. As a reminder, American Water Enterprises is the subsidiary that includes our military, contract and homeowner services lines of businesses.

We expect the shale market will continue to grow for many years given the critical role it plays in the energy security and economic prosperity of the U.S. In addition, we believe Keystone's turnkey business model is repeatable in other areas of this industry creating opportunities for expansion in this sector.

It's important to note that over the past few years, our Non-Regulated segment has averaged around 11% of our revenues and 9% of our earnings. We are not going to fundamentally change the risk profile of the company going forward. And our long-term plan is that our Non-Regulated segment, in total, will not contribute more than 15% to 20% of earnings over the next five years.

Additionally, the upper part of that range will occur only if a meaningful part of the earnings are lower risk, regulated-like such as our military services business. Looking forward, we remain confident in our ability to deliver on our long-term earnings per share growth of 7% to 10% through 2019, anchored from our 2013 earnings.

Walter will now give an update on our Regulated segment.

Walter J. Lynch {BIO 6064780 <GO>}

Thanks, Susan. Good morning, everyone. As Susan mentioned, our Regulated business has delivered positive results year-to-date. And I'm especially proud of our progress in our O&M efficiency ratio, which I'll talk about in a moment.

Let me start by providing you with an update on California on slide eight. California continues to experience the worst drought in the last 100 years. Based on an overall 25% state-mandated reduction, our California American Water customers have been asked to reduce water usage anywhere from 8% to 32%, depending on their level of water use in 2013. All but one of our districts are exceeding those reduction goals.

California American Water has launched ambitious conservation outreach programs to reduce water use. This includes mail, radio, social media and door-to-door efforts on programs such as turf replacement rebates, pre-leak detection devices, and water-wise surveys. Our conservation staff is active at community events, reaching out to customers and equipping them with the tools they need to conserve water. As a reminder, California American Water has rate decoupling, so reduced sales volumes do not result in reduced earnings.

The other news in California is our water revenue adjustment mechanism or WRAM filing. As of June 30, we had an under-collected WRAM receivable balance of about $50 million, of which almost $45 million related to the Monterey District. In order to assist with the impact on our customer bills in that area and to limit future accumulation, we filed an application with the California Public Utilities Commission requesting recovery of the existing Monterey balance, along with the return, over a 20-year collection period. We also requested that the WRAM account be trued-up annually going forward. We expect the decision on the Monterey WRAM filing in mid to late 2016.

As a reminder, California American Water is approximately 8% of our total Regulated revenue. However, we put a tremendous amount of focus there because issues the state faces offer us an opportunity to fully deploy our numerous water supply and service solutions. Many of these such as our AMI customer alert pilot in Monterey could apply in many other states where we operate.

On July 31, Missouri American Water filed a request with the Missouri Public Service Commission for a general increase of about $51 million. This request includes about $25 million of new revenue and about $26 million of infrastructure surcharge revenue, known as ISRS in Missouri, which gets rolled into base rates at the end of the case.

Consistent with our growth strategy, the filing includes $436 million of new infrastructure investments since 2012 to ensure reliable service to our customers. The company's last filing was more than four years ago. And since then, the company reduced its operations and maintenance expense by about $7 million, which means we're able to invest over $40 million of capital with no impact on customer bills.

We estimate that for every $1 of O&M expense reduction allows a capital investment of about $6 with no impact on customer bills. I commend our team in Missouri for their disciplined approach to managing costs. The rate process in Missouri takes approximately 11 months to complete. So we anticipate a decision in the second quarter of 2016.

Lastly, in the second quarter, we saw wet weather in the Midwest that was offset by dry weather in the Northeast. However, we've seen above-normal rainfall through much of our footprint in July, which resulted in modestly lower sales. Linda will talk about the known financial impacts of this in a moment.

Moving to slide nine, we continue to make steady progress towards achieving our O&M efficiency ratio stretch goal of 34% or less by 2020. We achieved 35.9% for the last 12 months ended June 2015, which is a result of a disciplined approach to cost management by our employees.

These efforts, of course, are driven by our focus on the customer and our commitment to clean, safe, reliable, and affordable water services. This is fundamental to our business. When we achieve smart O&M reductions, we can invest in our water and wastewater systems, while mitigating the impact on our customers' bills.

Now, I'll turn the call over to Linda for more detail on our second quarter financial results.

Linda G. Sullivan {BIO 7300156 <GO>}

Thank you, Walter, and good morning, everyone. In the second quarter, we continued to deliver strong financial results. As shown on slide 11, revenues were up almost 4% quarter-over-quarter and up 3% year-to-date. We reported earnings per share for the second quarter of $0.68, up about 8% over adjusted earnings for the same period last year. Year-to-date earnings were $1.13 per share, up about 9% over adjusted earnings in the same period last year.

On the right side of the page, we show each business segment contribution to 2015 earnings per share. For the quarter, the Regulated segment contributed earnings of $0.68 per share or an increase of about 6%. Our Market-Based segment contributed $0.06 per share in the second quarter, an increase of about 20%. Parent interest and other, which is primarily interest expense on parent debt, was a negative $0.06 per share for the quarter, flat to the prior year.

Now, I'll go over the different components of our second quarter adjusted earnings per share growth on slide 12. 2014 adjusted earnings were $0.63 per share. The second quarter of 2015 came in $0.05 above 2014 adjusted earnings at $0.68 per share, reflecting increases in both our Regulated and Market-Based segments.

Our Regulated segment benefited from both increased revenues and lower cost of $0.03 each. The higher Regulated revenue was primarily from authorized rate increases and higher infrastructure charges. The lower operating and maintenance expense was mostly due to three factors: first, lower transportation expense as a result of lower fuel prices and leased vehicle cost; second, lower uncollectable expense as we continue to bring collections back toward historical level after implementation of our customer information system; and third, savings in employee-related costs from lower wages, salaries and severance expense.

For the Market-Based segment, earnings per share was up $0.01 due to additional construction projects under our military contracts and the addition of two new military bases in the second half of 2014. We also had contract growth and geographic expansion in our homeowner services business. Partially offsetting these improvements were higher depreciation, taxes and other costs of about $0.02 per share, mainly from growth associated with our capital investment programs at the Regulated segment.

In the appendix of this slide deck, we have included our revenue and expense bridge slides to provide more detail to the variances I just discussed. Now, let me cover regulatory highlights on slide 13. We have three ongoing general rate cases in New Jersey, West Virginia and Missouri, for a combined annualized rate request of $127 million. As Walter mentioned, these rate cases continue to reflect our disciplined approach to investing.

For rates effective since July 1 of last year through today, we received a total of $55 million in additional annualized revenues from general rate cases, step increases and infrastructure charges. These are the highlights of these cases. And we encourage you to review the footnotes in the appendix for more information. Slide 14 is a summary dashboard of our financial performance, which showed improvement across the board. During the second quarter of 2015, we made total investments of $348 million, primarily to improve infrastructure in our Regulated segment and for Regulated acquisitions.

As Susan mentioned earlier, we expect to invest $1.2 billion to $1.3 billion for the full year of 2015. For the quarter, our cash flow from operations increased approximately $14 million, primarily from earnings growth. Our adjusted return on equity increased by approximately 40 basis points over the past 12 months compared to the prior year. We also paid a $0.34 quarterly cash dividend to our shareholders in June, which represented about a 10% increase compared to last year. And on July 24, the board of directors approved a $0.34 per share dividend payable in September.

As Walter mentioned in his comments, related to the California water revenue adjustment mechanism or WRAM, we requested recovery of the Monterey WRAM balance over a 20-year period, along with a return. Based on long-standing precedent in California, we expect to collect the entire WRAM balance. However, due to extending the recovery period, we will recognize an immaterial, non-cash, timing-related adjustment to earnings in the third quarter. This adjustment has been factored into our reaffirmed 2015 earnings guidance.

We have now closed the Keystone acquisition for a purchase price of about 9 times the trailing 12-month EBITDA. Under our purchase agreement, we will have small purchase price adjustments for changes in working capital, capital investments and the results of operations through the July 9 closing date. Once we record the acquisition in the third quarter, we will provide additional details.

For segment reporting purposes, we will include the operating results of Keystone as part of our Market-Based business segment. The Market-Based segment will be comprised of American Water Enterprises and Keystone Clearwater Solutions. Keystone, as Susan noted, is a legally separate entity.

Keystone has about 20 E&P and other large corporate customers in the Appalachian region. Today, its business is relatively asset-light. Its costs are largely variable. And we believe that we'll be able to capture synergies with American Water. We expect the acquisition to be earnings neutral in 2015 and accretive to earnings per share in 2016. We will provide you additional detail on Keystone during our Analyst Day presentation on December 15.

And lastly, we mentioned earlier we experienced wet weather in July which, for the month, is estimated to unfavorably impact net income by about $4 million. We will be updating you further on the third quarter earnings call. Building on our solid financial performance year-to-date and despite the wet weather in July, we're reaffirming our 2015 earnings guidance to be in the range of $2.55 to $2.65 per share.

And, with that, I'll turn it back over to Susan.

Susan N. Story {BIO 3335156 <GO>}

Thanks, Linda. Before taking your questions, I'd like to take just a couple of minutes to highlight American Water's sustainability leadership. Our company treats and delivers over a billion gallons of water a day to our customers. And this is just a start of our environmental focus. We have some of the best people in the water industry. And they choose to work here because environmental leadership is a core value at American Water.

When you marry great minds with a passion for innovation and sustainability, you can accomplish some pretty exciting results. Let me give you just a couple of examples. Reclaiming and reusing water is an imperative in the face of water supply and infrastructure challenges for future generation. And this isn't just a California issue as some believe. In fact, 40 of 50 state water managers say they expect water shortages in some portion of their state in the next 10 years. It will take bold strategies, including public-private partnerships, to address these challenges.

This year, Illinois American Water was selected by the Metropolitan Water Reclamation District of Greater Chicago or MWRD to partner on a beneficial water reuse project. The agency is partnering with us to reclaim, treat and distribute wastewater to large water users like manufacturing plants. Through this partnership, Illinois American will build the distribution infrastructure, develop the customer base, buy water from MWRD and resell the water. Once fully operational, this water reuse project will significantly reduce freshwater withdrawals from the Great Lakes. This project has already been recognized by the American Society of Civil Engineers as a game-changer in its recent report regarding innovative infrastructure solutions.

Let me give you one other example where we're using water in smarter ways. Geothermal heat pump technology is not new, but an innovative American Water R&D pilot could transform traditional geothermal HVAC system and introduce a new application in renewable energy. American Water is piloting a geothermal innovation to heat and cool a 40,000 square foot school on Long Island, New York. Our pilot geothermal system transfers ground temperature from a water main using a heat exchanger, allowing the same system to cool during the summer and heat during the winter.

Once unable to have community events or classes during the summer months due to lack of air conditioning, this school has been fully utilized this year with the geothermal installation. This pilot project was actually highlighted at the NARUC Conference in New York City just last month. These examples are just two of our numerous sustainability efforts. We're proud to note that we have already reduced our greenhouse gas emissions by 17% since 2007, exceeding our initial target of 16% reduction by 2017, a full two years early.

Additionally, our water pump efficiency efforts to-date are expected to produce energy savings of 12 million kilowatt hours per year. These are just some of the reasons that American Water was ranked number 24 of the almost 500 companies listed in Newsweek Magazine's Top Green Companies for 2015, one of only two utilities in the top 25 and the only water utility. We're proud of this recognition because we believe being green is not just good for the environment. It's also good for the bottom line. We believe our company can not only do well, but we can also do good.

And, with that, we're happy to take any questions you may have.

Q&A

Operator

We will now being the question-and-answer session. And the first question comes from Daniel Eggers with Credit Suisse. Please go ahead.

Q - Dan L. Eggers {BIO 3764121 <GO>}

Hey. Good morning, guys.

A - Susan N. Story {BIO 3335156 <GO>}

Hi, Dan.

Q - Dan L. Eggers {BIO 3764121 <GO>}

Susan, you kind of talked a bit about Keystone. Obviously, it's an interesting opportunity. But the trailing earnings contribution that you guys showed when you bought it wasn't particularly all that large. Is that number or earnings contribution – has that changed since 2014 in some appreciable way? And then, you kind of look out over forward, what's going to drive that business with or without an improvement in drilling activity in the region?

A - Susan N. Story {BIO 3335156 <GO>}

Dan, thank you for the question. We're going – on December the 15, at our Analyst Day, we're going to be providing a deeper look forward in all parts of our growth triangle, including Keystone and the shale area.

Q - Dan L. Eggers {BIO 3764121 <GO>}

So is that southern for you're not going to answer the question?

A - Susan N. Story {BIO 3335156 <GO>}

Yes. It is.

Q - Dan L. Eggers {BIO 3764121 <GO>}

Okay. Very good. On the growth triangle, you guys said that Non-Reg is not going to get to be more than 15% to 20% of contribution from roughly 10%-ish today. Is that the correct messaging?

A - Susan N. Story {BIO 3335156 <GO>}

That's correct. And, currently, over the past three years, our earnings from the Market-Based business has been around 9%, so that puts it in context. In the past, Dan, we've talked mainly just from revenue numbers. So we've actually added more transparency and talking about earnings from that segment as opposed to just revenues.

Q - Dan L. Eggers {BIO 3764121 <GO>}

Okay. And, I guess, we didn't really get into what else is going on with the core of that business these days, but just can you give an update on government contract in the home businesses and kind of where you're seeing the opportunities right now or where the actions have been this year so far?

A - Susan N. Story {BIO 3335156 <GO>}

Sure. One thing, because we won the two military bases last year, we're starting to see the revenues, as well as some of the working capital we're putting into some of the projects on those bases. There are currently several outstanding RFPs. As we've mentioned before, when they will be awarded is we never can predict with a tremendous amount of accuracy. There's a chance maybe one can be awarded this year, maybe two to three next year that we're involved with.

But what's important on military – and I think it's important – and you asked that in your question. Military – it's not just the new bases but the continuing projects that are on the existing bases beyond just the O&M contracts that we have – the money we get paid each year for running the water and wastewater systems. So, I will tell you that we currently have on the books, I believe, another $200 million of backlog of existing projects to do on the basis that we already have. So, the Military Services, we continue to ensure that we're providing the best water and wastewater services for those military men and women who serve our country.

On the homeowner services, as we said, we had mentioned about Orlando. We have launched it this year. So, we're starting to get customers signing up in Orlando. Orlando also presents for us the first place that we have a much deeper service offering beyond just water and sewer line, but also HVAC and in-home plumbing. So, that's another opportunity there.

And, as I mentioned in my comments, we were awarded an exclusive contract that has been signed for Rialto, California which is about 55,000 potential customers. And then we won the bid for exclusive contract with Wilmington, Delaware, but the city council still needs to approve that. And we're hoping to launch both of those by the end of the year. So, in those two areas, that's what we're seeing from that Market-Based business.

Q - Dan L. Eggers {BIO 3764121 <GO>}

I guess just one last one, Susan. When you think about moving into these new cities, is there a start-up cost associated with trying to recruit customers and acquisition-wise where you have more expense on the front-end as you push into these towns to get people and then it pays off over time. Or are you guys amortizing that expense over a longer period?

A - Susan N. Story {BIO 3335156 <GO>}

Dan, we love that you listen to us when we talk to you. Yes. The answer is yes. We have the upfront marketing expenses, and because we have to let people know that we're there. And one thing that's important. We put a lot of emphasis on these exclusive partnerships. That's important because, in an exclusive partnership, our billing is typically on the city or the municipality or whatever the governmental entity or the entity is, it's on their water and/or wastewater bill. So, for us, that tends to be a higher take rate. And that's why those are so important for us as opposed to just – we do have areas where we just generally market and we provide separate billing. But the exclusive contracts are really much more effective for us financially.

Q - Dan L. Eggers {BIO 3764121 <GO>}

Got it. Thank you.

A - Susan N. Story {BIO 3335156 <GO>}

Thanks, Dan.

Operator

The next question comes from Ryan Connors with Boenning & Scattergood. Please go ahead.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Great. Thank you. A few questions this morning, if I might. First, just on the guidance. It seemed like – I noticed weather is still a $0.07 plus or minus swing point in the guidance, even here kind of mid way through the third quarter I guess. So, just wanted to get some color on that. That seemed like it was a little large in terms of a swing factor there at this point in the year. So, I just want to get some flavor on why that's such a large wildcard at this point.

A - Linda G. Sullivan {BIO 7300156 <GO>}

Ryan, the chart that we have in there shows the major variability as of February 25. So, that's the full year variability. In terms of the impact of weather that we've seen thus far in July, it's about $4 million net income. And it's due to wet weather across our system.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Okay. I see. So, it's safe to say that that gap has closed then at this point and we're largely – that gap has tightened up?

A - Linda G. Sullivan {BIO 7300156 <GO>}

That's right. And this variability chart is the one that we provided to you at the December 15 call.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Got it. Got it. Okay.

A - Susan N. Story {BIO 3335156 <GO>}

One thing, as we look at this too. The reason we put multiple items up there is, as we establish a range, we understand there is going to be variability. Some of the variability offset each other.

So, you don't take each one in isolation. But, as you remember, we started in 2013 saying, so why do we have a $0.10 range, why do we have the range we do? Here are some factors up or down, puts or takes. So, it's important to look at it all in context as a whole.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Right. Now, wanted to talk a little bit, just get some color on this WRAM application for the extension there. Now you mentioned, Walter, that the decision there is expected mid to late 2016. Seems like a pretty straightforward filing and a pretty good deal for the ratepayers. So, I'm just wondering what the key points of debate are on that filing and where the pushback is, if any, on the way that that's structured.

A - Walter J. Lynch {BIO 6064780 <GO>}

Yeah. Thanks for the question, Ryan. I think two things. One is the length of time over which we're going to be able to recover it. And the other is the return that we're asking for. It will take time to work through that. And that's why we say it will take to mid-2016 to get the decision.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Okay. And it's my understanding that the application seeks to establish the WRAM balance as a – itself as a Regulatory asset. Is that correct? And if so, can you kind of give us a very brief CliffsNotes version of how that works?

A - Linda G. Sullivan {BIO 7300156 <GO>}

Yes. It is essentially setting it up as an accounts receivable from the customer, which would be a regulatory asset.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Okay. Okay. And then, Susan, you mentioned that at the NARUC Summer Meetings some of your sustainability initiatives were highlighted. And that's great. Could you also kind of give us any takeaways from those meetings in terms of what's around the corner, just looking ahead at the big regulatory developments? Any big topics there about what might be next in terms of policy developments or regulatory evolution in the water space?

A - Susan N. Story {BIO 3335156 <GO>}

Sure. Well, I'll start and I know Walter may have a couple things since he was at the meetings also. One of the things that we're very excited about that was launched at the Summer NARUC Meeting is a step forward in terms of, not just water-energy nexus, but the look at – in most state utility commissions, they look separately at electric, gas and water. One of the things that President Edgar rolled out was an effort at NARUC to start looking at where all utilities could come together on common items such as, for example, critical infrastructure, cyber security, looking at how we could work together, looking at the fact that things like the mechanisms for infrastructure replacement.

There are a lot of issues at state utility commissions that really cross the boundaries of electricity, gas and water. And so, there is an effort to create this project or this task force at NARUC to look at what those are and where commission can work with utilities in a state to find the areas that we can find some common ground and some common efforts. An example for us in California is the Monterey pilot, the AMI pilot, that Walter mentioned.

What that is, is that we actually partnered with Pacific Gas & Electric and we're using some of their backbone to put the water meters there, so that we can send alert to those customers. They have a very steep tiered pricing structure for water in Monterey. So, we can actually send as part of the customers on the pilot signals when they're about to enter a new tier of pricing or they set a budget and we can send them messages when they're getting close to the budget.

That's just one example. Also, we're very involved and, actually, in American Water, we adopt the electric utility industries' NIST standards for cyber security. We're very involved with the Department of Homeland Security and DoD on those things. So, there's a lot of efforts like that and we're very excited at NARUC where we're looking at cross-utility type projects that can benefit all of us.

A - Walter J. Lynch {BIO 6064780 <GO>}

I think Susan did a great job recapping the meeting. I mean, the four areas, again, as she mentioned: water-energy nexus and opportunities for us to work with the electric and gases, cyber security in the same way, regulatory mechanisms that are going to be continued to incentivize us to invest and upgrade our water and wastewater systems, and then where can we partner with electrics and gases to drive better customer service. Those are the key themes that I saw coming out of NARUC.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Great. Well, as usual, that's very comprehensive and helpful. Thanks for your time.

A - Susan N. Story {BIO 3335156 <GO>}

Thanks, Ryan.

Operator

The next question comes from Michael Lapides with Goldman Sachs. Please go ahead.

Q - Michael J. Lapides {BIO 6317499 <GO>}

Hey, Susan, Linda. Michael subbing in for Mike Dandurand today.

A - Susan N. Story {BIO 3335156 <GO>}

Hi, Michael.

Q - Michael J. Lapides {BIO 6317499 <GO>}

Hey, guys. One question on the Clearwater acquisition – Keystone Clearwater acquisition. Keeping in a separate legal structure, how do you think about the optionality that creates if this business continues to grow in terms of potential revisions to the corporate structure? In terms of whether this is a business that – and I don't know if legally it could. Is this a business that could eventually wind up in an MLP structure? And if you don't mind into answering that first and then I may do one follow-up.

A - Susan N. Story {BIO 3335156 <GO>}

Okay. Sure. We did look at that. And I will tell you that just a little more color around the legal structure. So, there is a separate holding company that – Water Solutions Holdings that actually is the holding company for Keystone Clearwater. And that holding company is 95% owned by American Industrial Water which is also a separate LLC and 5% from Sand Hills Management, which is the founding members, which includes the current CEO and President and COO. So we're glad they not only are staying to run the business, they continue to have an equity ownership. So, that's how it's structured legally.

We did actually, Michael, get – we took a look at MLPs. A few things, just to let you know that we are constantly monitoring it. The EBITDA last year of Keystone Clearwater was around $15 million. Even some of the smaller MLPs are between $50 million and $70 million EBITDA. So, scale-wise, it's just not quite large enough. Number two, we've just purchased Keystone. You have to have a predictability of the cash distributions. We're continually looking at that as we get into looking at this business. And, of course, the big thing, you've got to have really pretty clear visibility into the future growth potential. Kind of people talk about the save the bees issue. So in terms of the future, we're always open to all options that make sense to our shareholder interest. And we're looking at those variety of things. At this point, it doesn't make sense to do an MLP.

Q - Michael J. Lapides {BIO 6317499 <GO>}

Got it. One follow-up actually on the core Regulated business and really an M&A question. You all have been excellent over the years in terms of doing kind of small bolt-on acquisitions. What's your thought process around or what's the market dynamic and opportunity set around kind of more larger-scale M&A? I mean, there are not ton – it's obviously a far more fragmented business than the electric and gas, but just kind of curious when you look at the landscape of publicly-traded or kind of larger or private or municipal owned ones.

A - Susan N. Story {BIO 3335156 <GO>}

Well, I will start and then I want Walter to fill in because he and his team have done a lot of work on this. In terms of looking at other IOUs, you're always looking at the marketplace, but the fact is it's a pretty well-valued space out there. But we're always looking at all options. Where I think our sweet spot is though, something that Walter and his team had put a priority on. So, Walter, do you want to talk about kind of the focus going forward on the Regulated piece?

A - Walter J. Lynch {BIO 6064780 <GO>}

Yeah. We still pursue the smaller acquisitions, but our focus is really on the 5,000 to 25,000 customer systems. And we see a number of opportunities. I've been in this business many years, two decades. And this is the best environment for acquisition that I've seen, I think, because municipalities are looking for options. And we, as the largest water and wastewater company in United States, have tremendous expertise that we can share with these municipalities. So, the opportunities are huge. There are also with some of the fiscal issues that they're facing. It's a tough environment for some of these municipalities.

I think the other thing is we work very closely with the legislators to provide enabling legislation that allows us to pay a fair market value and really reduce the bureaucracy in some of these acquisitions. So, that's our focus. We have great people out in our states that are focused primarily on growing the business from the state leadership teams to the growth teams. And, I think, we've been doing a very good job and more to come.

Q - Michael J. Lapides {BIO 6317499 <GO>}

Got it. Thanks you all. I appreciate you taking my questions.

A - Susan N. Story {BIO 3335156 <GO>}

Thanks.

Operator

The next question comes from Spencer Joyce with Hilliard, Lyons. Please go ahead.

Q - Spencer E. Joyce {BIO 17611965 <GO>}

Good morning. Nice quarter. Thanks for taking my question.

A - Susan N. Story {BIO 3335156 <GO>}

Thank you, Spencer.

Q - Spencer E. Joyce {BIO 17611965 <GO>}

Yeah. Just one real quick one here from me and I want to jump back to Keystone. Correct me if I misheard, but I believe the purchase may have been qualified as asset-light earlier in the call. And when we think about water service, I mean, trucks, pipes, tanks, asset-light is not what comes to my mind. And then to kind of follow-up, if it really were an asset-light business, why would you all have looked at an MLP structure? Can you speak to any of those points?

A - Linda G. Sullivan {BIO 7300156 <GO>}

Absolutely, Spencer. Let me start and then I'll ask Susan if she has anything to add. In terms of the asset-light, you're right. The things that are owned by Keystone are really the pumps, the pipes, the valves, and temporary storage tanks. We also see vehicles as part of the asset as well. And so, the current model includes both permanent pipelines, as well as temporary pipelines that are owned by Keystone.

So, that's one element of it today. The assets are – their – the business is very asset-light. The audited financials were about $36 million in assets at the end of December. So, that gives you a feel for the size of it. As Susan mentioned on the MLP structure – I mean this is one of the things that we look at, is what are the future growth potential and can you continuously have a transparent pipeline for growth in the business. And that's one of the key elements to look at from an MLP structure.

A - Susan N. Story {BIO 3335156 <GO>}

And, Spencer, to add to that, when we talk about asset-light, we do it in terms of our business overall, which we're so capital-intensive in utilities. In some spaces, that may not seem as capital-light. For us, it does. However, one of the things we are looking at is the potential. Remember that as part of – with Rex as a 60% owner, there were capital constraints. One of the things we are looking at strategically is the possibility or potential of actually deploying more capital to build longer term pipelines as opposed to having the E&Ps fund them. What if we now have the capital? Keystone has the capital to actually fund some of those constructions and entertain things like take-or-pay contracts or those type things.

So, the good news is you've got Keystone, which is an outstanding company. And I will tell you, just to add to this. I spent a day with those folks out there before we closed and after we announced the acquisition. And, culturally, they are – it's been such an easy transition. They are from Pennsylvania. They grew up there. The CEO actually has a background in water, environmental remediation compliance. It's just an outstanding group of people, but they've had a certain suite of services that now, with the purchase by American Water, we make and broaden some of those suite of services, which could include more capital.

Q - Spencer E. Joyce {BIO 17611965 <GO>}

Okay. Perfect. That was helpful. Just to kind of recap here. So, when we think kind of asset-light in air quotes, we're maybe drawing a comparison versus the utility which would be perhaps more capital-intensive. And then, also from the standpoint of the business, maybe a little bit lighter on assets versus what it could be given some of the constraints that Rex had previously.

A - Susan N. Story {BIO 3335156 <GO>}

You know what, I could not have said it better myself.

Q - Spencer E. Joyce {BIO 17611965 <GO>}

Great. Well, I was listening too.

A - Susan N. Story {BIO 3335156 <GO>}

Thank you, Spencer.

Q - Spencer E. Joyce {BIO 17611965 <GO>}

All right. You all take care.

A - Susan N. Story {BIO 3335156 <GO>}

You too.

Operator

The next question comes from Jonathan Reeder with Wells Fargo. Please go ahead.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Hey. Good morning, everybody. I'll start out with an easy point of clarity question. The $4 million net income headwind from weather that you mentioned, does that include July's impact as well? I must have missed that.

A - Susan N. Story {BIO 3335156 <GO>}

That is the impact in July. And it's across all of our regions.

A - Linda G. Sullivan {BIO 7300156 <GO>}

Yeah. Jonathan, one thing we try to do. Typically, we don't talk about the month outside the quarter. But because we were able to get the information we wanted to go ahead and share that. That was not from the second quarter.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Okay. So, for the – I guess, the first half of the year, what was the weather impact?

A - Linda G. Sullivan {BIO 7300156 <GO>}

In the first half of the year, we had an increase in demand – or in the second quarter, we had an increase in demand of about $2.7 million. Over half of that was associated with an increase in our commercial customers. And then the remainder of it was weather-related. And what we saw was, on the residential side, we had hotter or drier weather in the Northeast. And given our geographic diversity, that was offset somewhat by the wet weather that was in the Central Region.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Okay. So, pretty much if we go through July, I mean, you're kind of breakeven or so from a weather impact and everything. Nothing too major.

A - Linda G. Sullivan {BIO 7300156 <GO>}

So, we are negative all the way through July from a weather standpoint because we had that $4 million approximate net income impact in the month of July.

A - Susan N. Story {BIO 3335156 <GO>}

But, yes – but January through June, you could say it was breakeven.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Yeah. Okay. And then -

A - Walter J. Lynch {BIO 6064780 <GO>}

One could even offset the other. Right.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Yeah. Okay. Then the military bases that you mentioned you might get awards for this year – they might announce, are these just the ones that you're involved with or is that kind of encompassing the whole RFP space?

A - Susan N. Story {BIO 3335156 <GO>}

We're only tracking the ones we're involved with, Jonathan. And we only – the ones that we're involved with typically are medium to larger size. We don't get involved with the smaller ones, so there could be.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Okay. And then do you expect a pick-up in the pace of RFP awards going forward? Or maybe you can talk about how many are open right now that you're actively bidding on?

A - Susan N. Story {BIO 3335156 <GO>}

There are numerous ones that are open. Pretty much – probably high single-digits that are open. They're in varying stages. We have best guesses. And they're pretty spread out over the next two years or three years. But you never know. It depends on what's going on in Washington, what they're going through. I will tell you that we have this year seen more interest from the Air Force. In the past, the Army has been the service that has been most interested. And we still are seeing some RFPs from the Army. But we're really seeing a lot of interest in the Air Force.

A - Linda G. Sullivan {BIO 7300156 <GO>}

And, Jonathan, what we have disclosed previously is that we are active in several RFPs today, with a gross revenue value of $1.5 billion to the extent that we would be successful in all of them.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

You said $1.5 billion gross revenue and that's for the 50 years?

A - Linda G. Sullivan {BIO 7300156 <GO>}

Correct.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Okay. And then, Walter, I didn't know if you could give any kind of update on the New Jersey and West Virginia rate cases. How they're kind of progressing and maybe how you would handicap the prospects for reaching settlements?

A - Walter J. Lynch {BIO 6064780 <GO>}

Let me start by saying they're both progressing on schedule. So, typically, New Jersey is nine months to 12 months to get a rate order; we filed in early January. That's going according to plan. In West Virginia, there's an 11-month rate case process. And, again, it's moving according to schedule, so nothing to be concerned about for both of those.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Okay. How about on West Virginia? I mean, it's been a bit of a challenge your past few cases there. You obviously had the challenges last year that weren't necessarily your fault, but you needed to respond to them. How is the outlook there? It was a pretty large ask, in part because you haven't gotten what you've needed in the past. But what's kind of been the response in West Virginia?

A - Walter J. Lynch {BIO 6064780 <GO>}

Well, our team is doing a great job working through the rate case process and talking about the value that we provide to our customers. And we're confident that we're going to continue to make that case. And we're hopeful to get a fair outcome.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Okay. And then what would be the timing on the outcome? 11 months would put us into – is it early 2016?

A - Walter J. Lynch {BIO 6064780 <GO>}

Yeah. So, around April 1 of 2016.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Okay. All right. Great. Thanks so much.

Operator

The next question comes from Brian Chin with Bank of America Merrill Lynch. Please go ahead.

Q - Brian J. Chin {BIO 20276978 <GO>}

Hi. Good morning.

A - Susan N. Story {BIO 3335156 <GO>}

Hi, Brian.

Q - Brian J. Chin {BIO 20276978 <GO>}

Just piggybacking on the last question. I know it's really early on here, but for the Missouri rate case, just thoughts on possibility of a settlement there. That'd be great.

A - Susan N. Story {BIO 3335156 <GO>}

So we have just filed the rate case in Missouri on July 31. And so we are going to be working through the process as we normally do in this case.

A - Walter J. Lynch {BIO 6064780 <GO>}

Yeah. And, typically, in Missouri, it takes 11 months. And we're working through that process and it's right on schedule, even though we just filed.

Q - Brian J. Chin {BIO 20276978 <GO>}

Can you remind me, again, historically, have you guys gotten settlements in Missouri or not?

A - Walter J. Lynch {BIO 6064780 <GO>}

Yes, we have.

Q - Brian J. Chin {BIO 20276978 <GO>}

Great. And roughly at what point in the process does most of the legwork on that settlement and an agreement typically get reached?

A - Susan N. Story {BIO 3335156 <GO>}

It really depends rate case by rate case, company by company. It's really hard to predict. But you go through the process and it can happen as we work together.

Q - Brian J. Chin {BIO 20276978 <GO>}

Okay. And then one last question from me because most of my other questions were asked and answered. Any update on sort of the corporate headquarters move? I would love to get an update there.

A - Susan N. Story {BIO 3335156 <GO>}

So, we're in the beginning stages of that. The latest information is that we have received approval of the tax credits in New Jersey, which, if we determine that we would move to the Camden location, we would be able to effectuate those tax credits. We are currently in the process of looking for a location. And so we are working through that. And to the extent that we can find a location in the Camden area, we are very excited about being part of the revitalization in that city.

Q - Brian J. Chin {BIO 20276978 <GO>}

And is there a sense of timing as to when you guys will make a decision on what you want to do there?

A - Susan N. Story {BIO 3335156 <GO>}

The credits are for a three-year period where the clock started in June. And then we have the opportunity to have an extension of six months automatically and a request of an additional six months that would be met with approval requirement, so a three-year to four-year period.

Q - Brian J. Chin {BIO 20276978 <GO>}

Great. Thank you very much.

A - Susan N. Story {BIO 3335156 <GO>}

Thanks, Brian.

Operator

The next question comes from Barry Klein with Macquarie. Please go ahead.

Q - Barry Klein {BIO 16859708 <GO>}

Hey, guys. Thanks for taking my question. This might be a little bit in-depth. But in the pyramid that you always put on to the slides in the presentation, it looks like you added a new area entitled Other. And I was just wondering if you could please explain what is meant for that portion of the pyramid.

A - Susan N. Story {BIO 3335156 <GO>}

Okay. Well, Barry, that's a great question. We have actually included Other in the past couple of years. But we have not – you're correct. We have not talked about it a lot. We put that in there because one of the things – one of the advantages we have at American Water with our size and scale, we have our own R&D group and we have 20 scientists. And most of their work is dedicated to finding better ways to do our business, bring efficiencies, water quality. We work a lot with EPA. We work with foundations actually all over the world, including Israel, different parts of Europe on new technologies in the water industry.

What happens when we do that? While the focus is making our business more efficient, we also at times have opportunities with partnering up with start-up companies where part of our deployment and testing we're able to get small interest in some of these businesses. So, not a big thing but it's called our – and we have an innovation development process. We actually came up with a process called NPXpress that is used in wastewater plants that reduces energy of aeration by 50% and carbon additions by up to 100%. And we actually did an international license agreement with Abengoa on that, which last year maybe was $0.5 million, not a lot of money.

So, this other is almost this holding category for lots of smaller things like that that may or may not be something down the road. There's no – in the long-term triangle, we don't assign any weight to it in terms of how much of the growth it's going to provide, but we put it up there because there could be some things like that that come up. And, again, this is not big investments into things for the purpose of creating new business. It's investment into opportunities that help our base business be better, but potentially could result in some income.

Q - Barry Klein {BIO 16859708 <GO>}

Okay. Thanks. That was helpful.

Operator

The next question comes from David Paz with Wolfe Research. Please go ahead.

Q - David A. Paz {BIO 16573191 <GO>}

Hey. Good morning.

A - Susan N. Story {BIO 3335156 <GO>}

Hey, David.

Q - David A. Paz {BIO 16573191 <GO>}

Just on the Regulated acquisition strategy. I know there have been some companies saying they want to expand their water business and they're seeking to buy small water companies. Have you seen competition pick up or noticeably pick up for your Regulated acquisitions?

A - Walter J. Lynch {BIO 6064780 <GO>}

We operate in 16 states, so we have varying levels of competition in each of the states where we operate. But, by far, we're the biggest and we have the biggest footprint. It gives us an opportunity to expand out, get to know different municipal leaders. And so, I think, we have a competitive advantage there.

I think the other huge competitive advantage we have is that we've worked on legislation that allows us to buy wastewater systems and share those costs with our water customers. And, for example, in New Jersey, we have 650,000 customers. So when we buy a system, we can spread the cost across that huge customer base and minimize the impact on those customers that we just acquired. So, we use that to our advantage. We use that to advantage of our customers and providing great customer service for them.

Q - David A. Paz {BIO 16573191 <GO>}

Got you. Okay. Thank you.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

A - Susan N. Story {BIO 3335156 <GO>}

Well, thank you so much, Gary, and thanks for everybody for joining us today. We had a good quarter. And I just want to remind you that all of this happens because of the 6,700 employees that we have out there every day. We talk about the fact. We talk about the numbers. But these are our employees out there serving one customer at a time every day.

And I tell you we're very fortunate in our industry to have some of the best people anywhere, making sure that we're able to be up here today talking about the numbers that we're able to accomplish. So, I want to give a shout out to them and thank them for all of their hard work. And thank you for all of your questions and for supporting our company.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.