Q3 2018 Earnings Call

Company Participants

- Edward Vallejo, Vice President, Investor Relations
- Linda Sullivan, Executive Vice President and Chief Financial Officer
- Susan Story, President and Chief Executive Officer
- Walter Lynch, Executive Vice President and Chief Operating Officer

Other Participants

- Angie Storozynski, Analyst, Macquarie Research
- Durgesh Chopra, Analyst, Evercore ISI
- Jonathan Reeder, Analyst, Wells Fargo

Presentation

Operator

Good morning, and welcome to American Water's Third Quarter 2018 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 November 8, 2018. US callers may access the audio archive toll free by dialing 1-877-344-7529. International callers may listen by dialing 1-412-317-0088. The access code for replay is 10125306. The audio webcast will be available on American Water's Investor Relations homepage at ir.amwater.com through December 1, 2018.

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

Edward Vallejo {BIO 16076814 <GO>}

Thank you, Karl. Good morning, everyone, and thank you for joining us for today's call. We will keep the call to about an hour and at the end of our prepared remarks we will open the call up for your questions.

Now during the course of this conference call, both in our prepared remarks and to address your questions, we may make forward-looking statements that represent our expectations regarding our future performance or other future events. Now, these statements are predictions based upon our current expectations, estimates, and assumptions. However, since these statements deal with future events, they are subject to numerous known and unknown risks, uncertainties, and other factors that may cause actual results to be materially different from the results indicated or implied by such statements. Additional information regarding these risks, uncertainties, and factors, as well as a more detailed analysis of our financials and other important information is provided in the earnings release and in our Form 10-Q as filed with the SEC.

Reconciliations for non-GAAP financial information discussed on this conference call, including adjusted earnings per share, both as historical financial information and as earnings guidance, and our adjusted regulated O&M efficiency ratio can be found in our earnings release and in the appendix of the slide deck for this call. Also, this slide deck has been posted to our Investor Relations page of our website and will remain available through December 1, 2018. All statements made during this call related to earnings and earnings per share refer to diluted earnings and earnings per share.

And, with that, I'll now turn the call over to American Water's President and CEO, Susan Story.

Susan Story {BIO 3335156 <GO>}

Thanks, Ed. Good morning, everyone, and thanks for joining us. As always, after my opening remarks, you will hear from our COO, Walter Lynch on regulated business highlights, and then our CFO, Linda Sullivan on third quarter financial results. However, Linda will join me in a few minutes as we talk a bit more about our Keystone operations before turning it over to Walter.

We're pleased to report another strong quarter of performance. Our third quarter adjusted earnings per share were up 11.1% compared to 2017 and our nine months year-to-date grew 11.5% year-over-year. The foundation for our growth continues to be the capital investment we make in regulated operations. We invested a total of $1.5 billion during the first nine months of the year with $1.1 billion for regulated infrastructure and $383 million for acquisitions, which includes our acquisition of Pivotal. We had several positive events this quarter which Walter will discuss more fully in just a few minutes.

To mention just a few, we received a BPU approved settlement in our New Jersey rate case and reached a stipulated agreement with the Consumer Advocate and PSC staff in West Virginia. We received a unanimous five to zero vote by the California Public Utilities Commission for our Monterey Peninsula Water Supply Project, which includes both water reuse capabilities and a desalination facility. We were also pleased to get clarifying legislation to exempt water and wastewater utilities from the 2018 New Jersey tax law changes. We continue to have strong regulated customer growth. To-date, we have welcomed about 16,500 new customer connections through closed acquisitions and organic growth. We have an additional 56,000 customer connections under agreement for acquisition. Walter will give you more detail shortly.

Our adjusted earnings increase of over 11% was also driven by growth in our Market-Based Businesses. We're pleased to share that our Homeowner Services' financial results to-date are above projection with both excellent operating performance and Pivotal integration expenses favorable compared to our plan. We look forward to fully integrating the business and realizing synergies in the future. Our legacy Homeowner Services Group has had several wins this year. Most recently, we announced formal partnerships with the cities of Philadelphia and Fort Wayne, Indiana. We also have received notices from San Francisco and Toledo, Ohio of their preliminary intent to award partnerships to us following final negotiations.

Additionally, we were pleased to announce last month that our Military Services Group won a 50-year, $591 million contract to serve Fort Leonard Wood Army Base in Missouri. We are very proud to grow to 14 bases where we serve quality water, fire protection, and sanitation services to the incredible men and women and their families who serve our nation and defend our liberties. And, as we have already shared, we sold the majority of our Contract Services Group to Veolia in July. We are recognizing a positive $0.06 of benefit from that sale this quarter as a non-GAAP item.

Now let's move to Keystone. As you saw in our press release late yesterday, we have taken an after-tax impairment charge of $40 million for Keystone this quarter. This is a result of our efforts to streamline the business and focus on the operations that we believe will deliver the most predictable and stable margins going forward. The original structure of Keystone consisted of three businesses; water trucking; construction services, which focus mainly on permanent water line pipeline construction for oil and gas companies; and water transfer, which involves the mobilization and operation of temporary piping and pumping systems to transfer water to storage locations and well pads.

As you know, we were able to manage the business to be neutral to earnings during the overall market downturn in 2016 and we closed last year, slightly positive in net income. This year, consistent with what we have noted in the past few earnings calls, the water services market in the Appalachian Basin has been growing and, in fact, our revenues through the second quarter, showed a steady increase three quarters in a row. However, this increase in revenues did not flow to the bottom line due to the operational challenges in the construction business. We discontinued the very small water trucking business earlier this year, and are now exiting the construction business as we have determined in the past month that it is simply too small and volatile for the management time that it was consuming.

Going forward, Keystone will be a water transfer services business, which has demonstrated continuing operational success and better margin predictability. These low capital, mobile piping and pumping systems enable water recycling and reuse in order to reduce both fresh water consumption and reduce the waste disposal needs for our customers. We are continually evaluating the performance and contributions of our Market-Based Businesses to determine which ones both leverage our core competencies and deliver appropriate risk adjusted returns. At this point in time, we believe that narrowing the focus to water transfer is the best way to determine whether Keystone should continue to be part of our portfolio for the future.

Linda will now discuss the financials around Keystone a bit further.

Linda Sullivan {BIO 7300156 <GO>}

Thanks, Susan. Regarding the Keystone impairment, we recorded a $40 million after-tax impairment charge this quarter or $0.22 per share and there were two primary drivers to the impairment. First, as Susan mentioned , although we saw higher revenue trends this year in both water transfer and construction, the operational challenges in our construction business led to several financial adjustments this quarter that overshadowed the solid margins in water transfer.

Let me talk about the financial adjustments. In the third quarter, we had a total of $2.6 million after-tax associated with the operational issues in the construction business. This included charges to discontinue work on two large projects, one of which will need a longer transition time, and a write-off of a supply chain contract. As a result, our third quarter results at Keystone are negative just over $0.01 per share. Importantly, we have also made key leadership changes at Keystone including hiring a new CFO and key operational personnel. They have been reviewing the business in detail and helped to identify and quantify these adjustments over the past few months. With these adjustments, we now expect Keystone's annual 2018 results to be negative just over $0.01 per share.

Second, as Susan mentioned, we have narrowed the business to focus solely on water transfer where we have seen revenue growth and consistently delivered margins. So, in summary, due to the operational challenges in the construction business that lowered our 2018 projected results, along with the strategic narrowing of the business scope, this triggered a review of our long-term valuation of the business, resulting in the third quarter impairment charge. In terms of overall impact on our long-term plan, as you know, Keystone is very small for us. The lower projections of the narrowed business scope do not materially impact our long-term compound annual growth rate and, in fact, we remain confident in delivering a long-term CAGR in the top half of our 7% to 10% EPS growth range. Susan?

Susan Story {BIO 3335156 <GO>}

Thanks. Linda. Moving to our long-term plan, we believe that sustainable financial success depends on effectively executing the fundamentals of our business every day and finding ways to be even better. These fundamentals include being the very best at our proven core competencies of water and wastewater treatment and delivery, delivering the best service and experience to our customers, building constructive and transparent regulatory relationships, growing our business and becoming even more efficient in our operations to ensure affordability and value for our customers.

American Water will invest $8.4 billion to $9 billion over the next five years, with more than $7.2 billion spent to improve our existing infrastructure. We see line of sight to our 32% target O&M efficiency ratio by 2022. Our regulated water and wastewater operations will continue to be our core and anchor business. Our Market-Based Businesses will continue to provide strategic value and cash for the business, and our customers must remain at the center of every decision we make in everything we do, because we know that long-term financial success is an outcome of doing everything else right.

With this strong performance and our continued execution of strategies, we are narrowing our 2018 adjusted earnings guidance to the upper portion of the range at $3.27 to $3.32 and as Linda said, we affirm our long-term EPS growth CAGR to be in the top half of our 7% to 10% range.

Walter will now give his update on our Regulated Businesses.

Walter Lynch {BIO 6064780 <GO>}

Thanks, Susan, and good morning, everyone. Our Regulated Businesses had a strong third quarter making capital investments to ensure clean, safe, and reliable water services, continuing to improve our operating efficiencies to benefit our customers and growing our business through acquisitions.

Let me start on Slide 9 with our New Jersey rate case. Our rate case settlement was approved by the Board of Public Utilities earlier this week. This case was driven by more than $868 million in infrastructure investment since the company's last rate increase in 2015. The settlement provides $40 million in increased annualized revenue with the acquisition adjustment portion being deferred to a separate proceeding. I'd also like to point out that the previous return on equity level of 9.75% has changed to 9.6%. More importantly, it is more than offset by the positive shift in equity from 52% to 54%. In addition, the Board of Public Utilities approved the roll in of an additional $35 million in distribution system improvement charge.

Due to the Tax Cuts and Jobs Act and this approved order, most customers can expect to see a one-time credit in their bills beginning in November. In our West Virginia rate case, we reached a joint stipulation settlement with the Public Service Commission staff and Consumer Advocates Division. Subject to final approval, the settlement includes a $23 million increase in revenues and 9.75% return on equity and adjust for two years of declining consumption. The settlement will also add several types of capital investments to the company's infrastructure surcharge program, which allows for more timely recovery of capital investments outside of rate cases. It also allows for the company's excess deferred tax amortization to be used to offset future program surcharge to the benefit of our customers. The current infrastructure surcharge will remain until new rates go into effect in February 2019. I should note, this case was driven by $200 million in investment, while operating expenses were kept flat. Details of the stipulated settlement are available in the West Virginia Public Service Commission's website.

Moving to California, we expect both our proposed and final decision on our general rate case for 2018 to 2020 during the fourth quarter. The ROE level was determined in a separate proceeding during the second quarter. If approved, we expect that this case will support approximately $230 million of capital investments in our system. In June, Maryland American Water filed a petition with the Public Service Commission seeking recovery of approximately $18 million in capital investments since our last rate adjustment in 2015. The main component of this case is a new reservoir and intake that will help secure the water supply for our customers and Bel Air and parts of Hartford County and foster the economic development and viability of the area. We're expecting a ruling on the settlement before year-end, following the Public Service Commission's public comment period which concludes today.

In September, we filed our general rate case in Indiana seeking authorization to increase annual water service revenues by $38.9 million, stepped over two years. This case is driven by more than $542 million of water infrastructure investment since our last rate case filing in 2014. A final ruling from the Indiana Utility Regulatory Commission is expected by mid-year of 2019.

On Slide 10, you can see that we've had significant regulatory activity this year with $155 million in annualized new revenues. We are awaiting final orders in three states as well as one settlement awaiting regulatory approval for a total annualized revenue request of $67 million. Again, all of these cases are driven by significant capital investment to ensure reliable service.

Turning to slide 11, our smart investments must be balanced by efficient operations and capital deployment. In the first nine months, we invested $1.1 billion in our regulated operations. This investment remains critical to ensure reliable service, but, for us, it's also about affordable service. We continue to make progress towards our long-term O&M efficiency goal of 32% by 2022. To put this effort into perspective, our adjusted O&M expenses are only slightly higher today than they were in 2012. Since that time, we've invested more than $7.2 billion in our infrastructure and added more than 150,000 customers, while our adjusted O&M expense compound annual growth rate is just 0.4%. This clearly demonstrates our singular commitment to controlling costs on behalf of our customers and keeping their bills affordable.

Moving to Slide 12, last month in a rare bipartisan win, Democrats and Republicans in the House and the Senate came together to overwhelmingly pass a bill that supports critical upgrades to America's Water Infrastructure. The result of this law includes policies intended to improve water and wastewater system management and authorization for states to require that non-compliant systems explore consolidation options. It also provides equal access to low interest financing for private water providers, an important benefit for our customers as they also pay taxes.

In Pennsylvania, Act 58 was signed into law and provides the Public Utility Commission, the authority, to approve alternate rates and rate mechanisms. The Commission issued a tentative implementation order and is currently seeking comments on its interpretation and proposed implementation of the Act. Also, in Pennsylvania, Act 120 was signed into law that allows DSIC recovery for the replacement of customer-side lead service lines subject to a Commission approved program. As we have communicated in the past, full service line replacement is one of the most effective ways to reduce exposure to lead.

In California, the Public Utilities Commission unanimously approved the certificate of public convenience and necessity for a water supply project in Monterrey. This action, as we discussed last quarter, gives us the authority to move forward with this critical water supply project. I want to thank our California team, local leaders, and our customers for everything they've done to make this project a reality. This project will provide a much needed water supply for the Monterey Peninsula, which will benefit our customers and communities for decades to come.

Also in California, the Governor signed three bills that benefit water and wastewater customers and their communities. One allows cities to sell wastewater systems with a majority vote, the second allows certain cities to sell their water systems without an election, and the third provides a path for the Sativa Water District to be sold to an investor-owned water company or others through an RFP process.

New York American Water reached a $5 million settlement with the New York Department of Public Service and the New York Public Service Commission as part of their self-reported issue concerning a property tax error related to a 2012 acquisition and higher bills resulting from new tier conservation rates. With support from the Governor's office, this resolution memorializes the settlement between the company and both parties, which provides rate relief and other benefits to our customers.

Finally, in New Jersey, key progress will be made this month as water utilities serving more than 500 customers must submit their cyber security documentation as required by the Water Quality Accountability Act. I'm pleased to report that New Jersey American Water is well ahead of the game by already fulfilling cyber security requirements issued by the Board of Public Utilities and by voluntarily adopting the National Institute of Standards and Technology cyber security framework. The framework, which we adopted in 2014 is consistent with the standards adopted by US electric utilities and are greater than what the Water Quality Accountability Act requires.

Turning to Slide 13, we continue to have excellent growth this quarter and, as a reminder, when I say customers, I mean customer connections. We welcomed 7,600 new customers to-date and will welcome another 56,000 customers through signed agreements in addition to the 8,900 customers we added through organic growth. Our acquisition activity spans across our entire footprint, with 20 acquisitions occurring in eight different states. Let me give you some highlights.

In August, Missouri American Water completed its acquisition of the Lawson Water and Wastewater System, adding approximately 1,000 new water and 900 new wastewater customers to its 480,000 statewide customers. In Pennsylvania, the Public Utility Commission approved the stipulated settlement that will add about 1,000 wastewater customers within the township of Sadsbury, which is already in our water footprint. And, in New Jersey, we have an agreement to acquire the Roxbury Water Company, which will add nearly 4,000 new water customers in Morris County. These agreements represent our continued focus on providing regional solutions to communities with water and wastewater challenges. So, again, a great quarter delivered by our regulated state teams, all to benefit our customers.

With that, I'll turn the call over to Linda.

Linda Sullivan {BIO 7300156 <GO>}

Thank you, Walter, and good morning, everyone. Let me start with our third quarter 2018 results on Slide 15. GAAP earnings were $1.04 per share, a decrease of $0.09 compared to the same period last year. We had non-GAAP adjustments in both periods, so let me start with those.

In the third quarter 2018, we adjusted GAAP earnings for the $0.06 gain from the sale of the majority of the contracts in our Contract Services Group, and the $0.22 charge from the Keystone impairment, both discussed at the beginning of this call. Also, in the third quarter of last year, we adjusted GAAP earnings for the benefit from the Freedom Industries insurance settlement and early debt extinguishment costs at the parent. Excluding these items, adjusted earnings were $1.20 per share, an increase of $0.12 or 11.1% over the same period last year with the Regulated segment up $0.06, the Market-Based Businesses up $0.05 and the parent favorable $0.01. On a year-to-date GAAP basis, earnings were $2.53 per share, up 5.9% and our adjusted earnings were $2.61 per share, up 11.5% over adjusted earnings in the same period last year.

Let me walk through our adjusted quarterly results by each business. Turning to Slide 16, adjusted earnings were strong in the third quarter of 2018. I'll start with the Regulated Operations that were up $0.06 in total. Net revenue was up $0.06, including a $0.23 increase from additional authorized revenue to support infrastructure investments, acquisitions, and organic growth. This revenue was partially offset by the $0.17 impact of the lower federal tax rate expected to benefit our regulated customers. Next, we had higher production expense of $0.02 from higher chemical costs, as well as purchased water price and usage increases in California.

Next, O&M expense increased $0.12 from quite a few smaller items. Let me cover a few of them. First, we had higher costs of about $0.02 to support regulated acquisitions and growth. Second, we had $0.02 related to the timing of expenses such as contracted services and labor-related costs that were deferred from earlier quarters. Third, we had higher property and general insurance expense of $0.02 from both the credit in the third quarter of last year and higher claims trends this year. Fourth, we had $0.04 of one-time adjustments, including $0.02 related to the New York settlement and $0.02 of accelerated recovery of regulatory assets approved in the West Virginia tax proceeding with no bottom line impact. I will discuss both of these items in more detail on the next slide.

Next, depreciation increased $0.03 due to growth from regulated acquisitions and investments. Interest and general taxes increased $0.02, mainly to support growth. Also, our income tax expense was favorable $0.19 from the lower federal tax rate. Before turning to the Market-Based Businesses, I should note that weather variability did not affect our third quarter earnings. We did experience hot dry weather in Missouri, resulting in higher revenue of about $3 million, but this was offset by wet weather in New Jersey and Pennsylvania, reducing revenue by a like amount, which demonstrates the benefit of our geographic diversity.

Turning to the Market-Based Businesses, the $0.05 increase was almost entirely due to Homeowner Services, mainly from the Pivotal acquisition. Our operating results of Pivotal through the third quarter are right in line with our expectations. However, integration expenses were lower than expected in the quarter, mainly due to timing and capitalization. Also, as I mentioned earlier, Keystone was negative $0.01 for the quarter and this impact was offset by the favorable impact from tax reform on our Market-Based Businesses. The parent company was favorable $0.01 as lower interest expense from our debt refinancing more than offset the lower tax shield on interest expense from tax reform.

Turning to Slide 17, as you know, we take a conservative and consistent approach with making non-GAAP adjustments to our earnings. We generally only adjust for large and unusual items, the smaller settlements, tax adjustments et cetera are included in our adjusted earnings and we highlight them for transparency. This year, we have had quite a few puts and takes in our adjusted earnings. So, on this slide, I would like to highlight a few items impacting the third quarter, provide an update on several items highlighted last quarter that have been resolved, and discuss several items pending in the fourth quarter.

First, in our Regulated Businesses, as Walter mentioned, we had a settlement in New York for $5 million. As shown on this slide, half of that settlement was recorded as a reduction to revenue to provide rate relief to customers and the other half was recorded in O&M expense. Also, we had additional legal costs and customer uncollectible expense of $1.5 million combined that was recorded in O&M. Next, in the West Virginia tax proceeding, we were authorized to use a portion of our tax reform savings for accelerated recovery of regulatory assets. This increased our O&M expense and our revenue about $4 million with no impact to the bottom line.

Now, last quarter, I discussed several potential headwinds that were resolved this quarter. First, in July, New Jersey passed legislation, increasing corporate business tax rates. On October 4, a correction bill passed with language clarifying that water and wastewater utilities were exempt. As a result, we do not expect this legislation to have a material earnings impact. Also, during the quarter, we worked on our purchase price allocation and related amortization of intangible assets for Pivotal. I had mentioned last quarter, we thought this could be a bit more front-end loaded than originally planned. We have now substantially completed our accounting analysis and we do not expect it to be front-end loaded as the attrition rates for Pivotal, which is the key driver for amortization, are largely aligned with our experience at HOS and with our original estimates.

Lastly, let me discuss some items pending in the fourth quarter. First, we have begun to move into our new headquarters building in Camden and we look forward to hosting all of you at our Analyst Day there on December 11. As a result of the move from four separate buildings to one new headquarters building, we may incur up to $5 million in lease termination costs. We have already incurred about 900,000 in the third quarter, and unless we are successful in obtaining subleases, the remainder could be recorded in the fourth quarter.

In Homeowner Services, we are also continuing to determine the best integration strategy for our duplicate customer and back office systems and we expect that strategy may be finalized by year-end. And in our Regulated Business, we have an expected $12 million in timing related costs that were deferred to the fourth quarter, mainly for repair and maintenance, tank painting in New Jersey, and operating and technology costs.

Turning to Slide 18, let me provide an update on tax-related matters. We continue to make good progress in our 14 regulatory jurisdictions on the best approach to return tax reform benefits back to customers. Regarding the tax rate change. We have adjusted rates in eight states to refund all or a portion of the savings to customers. In two states, we expect to offset these savings with further capital investments or accelerated recovery of regulatory assets. Proceedings remain pending in five states.

Regarding the amortization of the remeasured, accumulated deferred income taxes, five states have agreed to defer to next year and the remaining are pending. Also, West Virginia took a constructive approach in our pending rate case settlement that, if approved, would allow us to offset the future amortization of deferred taxes with infrastructure investments. And they also expanded the infrastructure mechanism, as Walter discussed.

Turning to Slide 19, based on the strength of our year-to-date results and considering the timing of O&M expenses in the fourth quarter, we are narrowing our 2018 adjusted earnings guidance to the top portion of our prior range to $3.27 to $3.32 per share. Our adjusted guidance range excludes the non-GAAP adjustments outlined on this page.

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

Susan Story {BIO 3335156 <GO>}

Thanks, Linda. All of the efforts we discussed today drive our financial performance. We continue to be a leader in total shareholder return and dividend growth. In April of this year, our

Board of Directors approved a 9.6% increase in our quarterly dividend to $0.455 per share. This marks the sixth year in a row that our dividend increase was at or above the top of our long-term EPS CAGR of 7% to 10%. And as you know, we have also guided our next five-year dividend growth CAGR to the top end of that EPS range.

Our last 12-month adjusted annualized ROE for the entire company increased to 9.9%. We are very proud of these financial accomplishments and we know that they are very important to you. But, for us, it's also about making a difference with engaged people who have a shared purpose and a heart to make the world a better place. There's a lot of focus and conversation today by investors regarding ESG principals in their broadest and most holistic sense. At the core is the question of whether a company can do well by doing good.

We at American Water believe that the answer to that question is an unqualified and resounding yes. We never forget that at the end of every water pipe there's a family depending on us to provide life's most critical need, that at every fire hydrant lives could depend on us, that every wastewater treatment plant serves as a shield against potential disease and that every community should be stronger because we are there. We are a purpose-driven company, we are people powered, and our employees live in and give back to the communities we are privileged to serve.

As we have been saying for the past several years, we put customers at the center of everything we plan and do. Every day, our 7,100 employees take pride in delivering the critical services of water, sanitation, and fire protection to about 14 million Americans in over 1,600 communities across the country. At the end of the day, we know that what we do in our customers and communities best long-term interests will also be in our investors' best long-term interest and that's what we believe it means to be a truly sustainable company.

With that, we're happy to take your questions.

Questions And Answers

Operator

(Operator Instructions) And our first question comes with Durgesh Chopra from Evercore ISI. Please go ahead with your question.

Q - Durgesh Chopra {BIO 20053859 <GO>}

Hey, good morning, team.

A - Linda Sullivan {BIO 7300156 <GO>}

Hi, Durgesh.

Q - Durgesh Chopra {BIO 20053859 <GO>}

So two questions for me. First, high level strategy question for you, Susan. So, obviously, your peer water utility announced merging with a gas utility in Pittsburgh. And I know historically you've said it and you sort of reiterated today that your plan is 1% to 2% growth coming from acquisition of small water and wastewater systems. I understand it. So I mean, I guess in light of the announcement from (inaudible) what I'm really asking you, simply put is, if there is a water -- there's a electric an gas system in your footprint, would you consider merging with a system like that? Where would that fall in your M&A strategy?

A - Susan Story {BIO 3335156 <GO>}

Thank you, Durgesh. And just the short answer is, no. We are -- at our core, we are a water and wastewater utility. Even though we have several executives who have a deep background in electric and gas, we know that, as a company, our core competencies, what we know best, what our employees know best, what is kind of second nature to us is water and wastewater and we believe that there are significant opportunities in the US, not just -- we're not interested overseas either. We believe that the United States, the market for water and wastewater is where we should focus and we believe that we will have plenty of opportunities there.

Q - Durgesh Chopra {BIO 20053859 <GO>}

Excellent. Thank you. Then just going back to the quarter real quick, Linda, the $0.04 one-time charges, the settlement and the West Virginia, the tax reform charge, I appreciate that these are one-time items, not excluded from your adjusted EPS numbers. I guess, would it be fair to say that if you were to exclude those items, you'd be guiding to the top end of the $3 -- your EPS guidance range now, which is what like $3.27, $3.32?

A - Susan Story {BIO 3335156 <GO>}

Yeah, Durgesh, we are guiding to $3.27 to $3.32, and as you know, there's a lot of puts and takes every quarter and so we are comfortable guiding to that range, which is the upper portion of our prior range.

Q - Durgesh Chopra {BIO 20053859 <GO>}

Okay, awesome. Thanks, guys. Great quarter.

A - Susan Story {BIO 3335156 <GO>}

Thank you, Durgesh.

Operator

(Operator Instructions) And our next question comes from Angie Storozynski with Macquarie. Please go ahead with your question.

Q - Angie Storozynski {BIO 15115714 <GO>}

Thank you. So I have actually two questions. So, I mean, you have had great results year-to-date, but if you look at some of the regulatory updates that you guys have provided us with, they should have been seemingly a drag against your original guidance, right? So, for instance, you had a delay in the implementation of conservation revenues in New York The New Jersey rate case, I mean, you told me how it compares versus what was embedded in guidance, but given that there is a refund of interim rates, I would argue that it was also slightly below expectations. The weather wasn't helpful. So what is the -- I know that there are lots of puts and takes, but what is -- what are the offsets to all of the things that I've just mentioned?

A - Susan Story {BIO 3335156 <GO>}

Yeah. So, Angie, let me start with the New Jersey rate case. So we were authorized $40 million. We had interim rates of $75 million that we put into place. From an accounting perspective, what we do, we will put in interim rates is we continually assess our best estimate of the outcome and that's what we record on our books. And so we do not expect any material change in the fourth quarter associated with the New Jersey rate case. The difference between what we requested in that case and what the outcome was, was primarily driven by the change in ROE. We had requested 10.8% ROE and, as you know, we have 9.6%. We also requested the 54% equity ratio. And then the other changes were associated with changes in depreciation expense and O&M expense, which is typical.

And also, Angie, in terms of -- so we had a few headwinds, but if you look and some of the things we mentioned, we had some really positive this year. Linda mentioned that year-over-year on adjusted, we were $0.06 up in Regulated, we were $0.05 up in Market-Based, almost predominantly Homeowner Services, which is doing really well. So it was -- and then the parent was up $0.01 because of we've done some significant refinancing. So I look at it as just running our business well. I mean, we're trying to look at every lever and how can we be most efficient in our operations and make every part of our business count.

So we do have the takes, but we also had several puts and those add up and to Linda's point, that's one reason that we're very conservative about what we do for non-GAAP is that, there is normal business puts and takes and sometimes they're up and sometimes they're down. And one of the benefits we have with the diversity of state and our size and our geographic footprint is they tend to offset each other, or they have at least today. So going through and we try to and hopefully what you all see is, we try to be very granular and transparent in these items in our slides and in our discussions, so you can see what offset those items that you brought up.

Q - Angie Storozynski {BIO 15115714 <GO>}

Okay, just one follow-up and that's on the Homeowner Services. So two things. You mentioned that the integration of Pivotal is actually favorable to your original plan. If you could actually provide a little bit more color here. And the additional partnerships with cities, this is more the traditional Homeowner Services, i.e., wastewater line warranty service, whatever you call it, we're not going into those additional businesses that Pivotal has delivered along with the acquisition?

A - Susan Story {BIO 3335156 <GO>}

Yeah. And I'll take the latter question and then Linda can answer the first one. You're exactly right, though, these four partnerships were actually responses to RFPs that our legacy Homeowner Services organization has been working on for several months before we ever actually bought Pivotal. So these are predominantly the water and wastewater lines, the sewer lines. You're exactly correct.

A - Linda Sullivan {BIO 7300156 <GO>}

Yeah. And on the integration, it is going very well. We had guided, as part of the acquisition, that we were tracking to be near breakeven this year with Pivotal and as a reminder, our EPS neutral comments incorporated consideration of the modest share dilution. So we are on track there. What we are seeing is that we're a bit favorable in the third quarter associated with our integration costs and that's primarily due to some timing as well as some items that we had originally thought were going to be expensed are being capitalized. And so there's a little bit of positive there as well.

Q - Angie Storozynski {BIO 15115714 <GO>}

Great. Thank you, ladies. Thanks.

A - Linda Sullivan {BIO 7300156 <GO>}

Thank you, Angie.

Operator

And the next question comes from Jonathan Reeder with Wells Fargo. Please go ahead with your question.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Hey, good morning you all. How are you doing?

A - Susan Story {BIO 3335156 <GO>}

Hey, Jonathan.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Hey. So just wanted to clarify, in the remarks, you said that I guess despite whittling down I guess Keystone to just one business, you're still potentially evaluating the sale of water transfer. Is that correct?

A - Susan Story {BIO 3335156 <GO>}

What I mentioned was that, we are -- we believe water transfer is a good ongoing business and will allow us to decide whether in the future Keystone should remain part of our portfolio of

Market-Based Businesses or not. Jonathan, whether you are going to keep a business longer term or whether you are considering other options for the business, it's always best to have that business operating very effectively and that's what our focus has been right now.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay. And then, I guess, can you just kind of describe what when Linda -- I mean, I guess, were your hands kind of tied from the accounting perspective that you had to take that writedown as opposed to maybe just exploring the entire sale of Keystone prior to taking an impairment charge that that was maybe the best and the most efficient route?

A - Linda Sullivan {BIO 7300156 <GO>}

Yeah. And, Jonathan, this is Linda. In terms of the impairment, we generally do our impairment testing in the November timeframe, but because of the operational issues and the negative earnings results in the third quarter, combined with our decision to narrow the scope of the business going forward, that triggered us to look at the long-term valuation and triggered the impairment analysis.

A - Susan Story {BIO 3335156 <GO>}

And that's regardless of what the strategic options are for the business. We would have to do that anyway.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay. And then you mentioned about Q4 expense timing. Are you pulling forward expenses from '19, getting [ph] kind of a strong year-to-date results or is this like the shift of some expenses from earlier in '18 just into the fourth quarter instead?

A - Susan Story {BIO 3335156 <GO>}

It is the shift of expenses from the first nine months of the year into the fourth quarter and we saw some of that shifts come in in the third quarter from the prior two quarters and then we have about $12 million that we expect has shifted from the beginning of the year into the fourth quarter.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay. And then lastly, Walter, can you expand on the DSIC mechanism change in West Virginia, did the cap increase or just the type of qualifying CapEx change? What exactly is it there?

A - Walter Lynch {BIO 6064780 <GO>}

Yeah. What happened in New Jersey -- or in West Virginia was they expanded what was qualified to go into the DSIC program there in West Virginia, everything else remain the same. But it is going to start over again once the rate case is effective in February of 2019.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay. And what's the cap in West Virginia, I don't recall? Do you know offhand?

A - Walter Lynch {BIO 6064780 <GO>}

Yeah. Not offhand. We will get back to you, Jonathan.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay. I mean, I did see I guess that you can't file another West Virginia case until I think it's like May 2021. So I guess suffice it to say that capital allows for kind of a roughly three-year rate case cycle in the state. Is that fair?

A - Walter Lynch {BIO 6064780 <GO>}

Yeah, that's fair.

A - Edward Vallejo {BIO 16076814 <GO>}

Hey, Jonathan, it's Ed. We'll get back to you shortly on that one, okay.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Yeah. No, big deal. I mean, Walter's answer kind of covers what I need to know there, so. I appreciate it. A good quarter and let's (inaudible) and keep swinging, right, Susan.

A - Susan Story {BIO 3335156 <GO>}

Jonathan, I'd say what, the number four right. Undefeated. Good job. I'm not going to talk about (inaudible)

Q - Jonathan Reeder {BIO 18909775 <GO>}

We will take it right back.

Operator

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

A - Susan Story {BIO 3335156 <GO>}

Thank you, Karl. Thank you all for participating in our call today. Please know that we value you as our investor owners and as the financial analysts who research our company for the benefit of your clients and their futures. We always want to be open and transparent in all of our discussions and dealings with all of you, so you can have complete confidence in your decisions around our company and investments in our stock. If we have not been able to address your question or if you have additional questions, please call Ed and Ralph and they will be happy to help.

And as a reminder, our Investor Day will be on Tuesday December 11 at our new Platinum-certified corporate office building in Camden, New Jersey. We love our new home and our community, and we look forward to seeing you all there. If you haven't registered, please do so at your earlier convenience. Thanks again for listening and we hope you have a great week.

Operator

The conference has now concluded. Thank you for attending. You may now disconnect.