Q2 2020 Earnings Call

Company Participants

- Edward D. Vallejo, Vice President, Investor Relations
- Susan Hardwick, Executive Vice President and Chief Financial Officer
- Walter J. Lynch, President and Chief Executive Officer

Other Participants

- Angie Storozynski, Seaport Global
- Insoo Kim, Goldman Sachs
- Jonathan Reeder, Wells Fargo

Presentation

Operator

Good morning and welcome to American Water's Second Quarter 2020 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, 2020. U.S. callers may access the audio archives toll free by dialing 1877-344-7529. International callers may listen by dialing +1-412-317-0088. The access code for replay is 10146461.

The audio webcast archive will be available for one year on American Water's Investor Relations website at ir.amwater.com/events.

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 D. Vallejo {BIO 16076814 <GO>}

Thank you, Gary, and good morning, everyone and thank you for joining us for today's call. At the end of our prepared remarks, we will of course open the call for any of your questions.

During this conference call, both in our prepared remarks and in answers to 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 June 30, 2020, Form 10-Q, each as filed with the SEC.

Reconciliations for non-GAAP financial information related to adjusted return on equity 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, the slide deck has been posted to our Investor Relations page on our website. All statements in this call related to earnings and earnings per share refer to diluted earnings and earnings per share.

I should note that consistent with our efforts to ensure the safety and health of our team, we're again conducting this call, while practicing social distancing and from remote locations. As an example, Walter and Susan remain in separate locations. If for any reason, technical issues do arise, Walter will take over and lead us through the full presentation.

And with that, I will now turn the call over to American Water's President and CEO, Walter Lynch.

Walter J. Lynch {BIO 6064780 <GO>}

Thanks, Ed. Good morning, everyone and thanks for joining us.

We have a lot to cover today and we thought it might be helpful to first address the impacts of COVID-19 on our operations and our estimates of the financial impact so far. As we've done since the onset of this health emergency, American Water continues to provide essential water and wastewater services to our customers. And we know the critical role we play in helping our customers and communities through this pandemic.

As we relayed on our first quarter call, we remain focused in three areas. The first is the care and safety of our employees and their families. The second is the safety of our customers and the communities we serve. And the third is the execution of our preparedness plans, we can continue to provide essential services and help our communities get through the pandemic.

With recent surges of COVID-19 cases in many parts of our country, the measures we took early on remain in place while adding additional measures. These include employee health screenings prior to coming to work, social distancing, suspension of all non-emergency in-home appointments, limiting the amount and nature of contact with customers during field appointments and a required work from home policy for non-essential employees where possible.

Because the number of cases varies across our footprint, we're taking into account CDC and local and state guidance as we work on plans to return to a more normal state of operation when possible, with safety as the primary driver.

We were among the first utilities to suspend shutoffs and late fees prior to any orders being issued by states. We continue to work with customers who are experiencing financial hardships by offering customer assistance programs and access to low income programs.

Susan will cover this in greater detail, but we're working constructively with Public Service Commissions, as they look to address utility response measures, customer protections and cost recovery for regular utilities in their jurisdictions. Additionally, our liquidity and access to capital remained strong and we continue our disciplined approach to execute on our core strategies such as making needed capital investment.

Finally, American Water and the American Water Charitable Foundation continue to help the communities that we serve giving more than $400,000 in charitable contributions over the past three months, to help mitigate impacts of COVID-19 in the communities we serve.

Before I ask Susan to discuss the financial impacts of COVID-19 so far, I want to thank our employees not only for their tremendous effort throughout the pandemic, but also of what they've done all year to stay safe and provide essential service to the communities we serve.

Now, let me turn the call over to Susan.

Susan Hardwick {BIO 16618718 <GO>}

Thanks, Walter, and good morning, everyone.

Slide 6 summarizes the estimated impact of the pandemic on results through June 30, 2020. We've seen an estimated 5% increase in residential customer volumetric demand over this period that we think is directly related to the impact of COVID-19 as many of our customers have been working from home and or sheltering in place because of the pandemic.

Likewise, we have seen commercial and industrial demand weakened by about 13% and 7% respectively as our best estimate of the impact of COVID-19 over this period as many businesses have shuttered.

And I'd simply remind you that we are about 70% residential on an annual revenue basis. As Walter mentioned, we discontinued service shutoffs that would normally occurred due to non-payment and are no longer charging late fees. As a result, those revenue categories are also down. Also we have incurred some incremental operating costs to keep our employees and customers safe and have seen some increase in uncollectable accounts expense.

The total estimated impact of the lost demand, foregone revenue and increased costs is estimated at about $21 million, which equates to about $15 million after tax or $0.09 per share before considering the accounting for future recovery. We've been working with regulators across our entire service territory alongside other utilities to address how these impacts the cost of service and recovery should be addressed.

As a result of those discussions and regulatory orders received today at June 30, 2020, we have recorded a net regulatory asset of $12 million for future recovery which represents a significant portion of the total estimated impact. After considering the accounting for future recovery, the impact resulting from COVID-19 year-to-date is an estimated $0.05 per share in total.

Let's turn to Slide 7 to look at some of the specific regulatory activities. As we said, we've been in discussions on behalf of our customers with public service commissions across our service area.

Currently 10 of our 14 regulatory jurisdictions have issued orders to address the impacts of COVID-19, authorizing deferral of incremental cost and certain other financial impacts resulting from the implementation of moratorium on shutoffs and disconnections. Four states Missouri, New York, Tennessee and Kentucky have pending proceedings, where we also expect to receive authority to capture the financial impacts of COVID-19.

As a result of the orders received and expected actions by regulators as I mentioned, we've reported a $12 million for future recovery, primarily related to foregone revenues from reconnects and late fees and estimated uncollectable accounts expense.

Now as it relates to the demand for our services, American Water has a predominantly residential customer base as I mentioned just a minute ago. As noted, our residential load is higher and our commercial and industrial loads have turned it down due to business closures.

We estimate that the demand -- the net demand loss directly related to COVID-19 to be approximately $10 million through June 30. This loss revenue is being tracked in each of our utilities.

We believe that this lost demand relates directly to the pandemic and while we've conservatively not recorded a regulatory asset at the consolidated level for future recovery, we believe we have strong arguments and good opportunity to recover the lost revenue in our future COVID-19 or other filings.

This lost revenue was essentially $0.04 per share of the total $0.05 per share estimated unfavorable impact from COVID-19 in the quarter and year-to-date periods. We will work diligently to seek recovery of these lost revenues as we think that makes more sense than making arbitrary cost reductions that could have longer term impacts on service delivery.

As we think about the impact of COVID-19 on our market based businesses for military services, O&M operations currently continue as normal, subject to each instillations individual requirements. Our services are deemed essential, so we continue to deliver safe, clean and reliable water and essential wastewater services to our military base partners.

For Homeowner Services, there has been some delay in new partner relationships and some delays in the launch of new products that we attribute directly to COVID-19 and the estimated impact of those delays is about $0.01 per share year-to-date.

We believe we can maintain our customer base during this period of economic downturn because homeowners see value in these products that protect them against large unexpected expenses. And perhaps just a couple of final comments before I turn it back to Walter, we're executing our capital investment plan for the year and are looking for additional ways to assist communities needs as we go forward. And we continue to remain confident we have sufficient liquidity available for the foreseeable future with $2.3 billion available at the end of June.

And let me turn back to Walter for discussion of the remainder of the results for the quarter.

Walter J. Lynch {BIO 6064780 <GO>}

Yes. Thanks, Susan.

Let's move on to the second quarter and six month results as it's been an eventful year-to-date with several key rate cases, significant capital investments, multiple acquisitions and a sharp focus on business fundamentals. Through trying times once again, the employees of American Water delivered solid results and further strengthened our low risk profile and predictable growth story.

Our second quarter 2020, GAAP earnings per share increased 3.2% compared to the second quarter 2019. Included in GAAP results are $0.02 per share for depreciation, not recorded due to assets out for sale and an estimated $0.05 per share unfavorable impact from the COVID-19 pandemic.

We invested capital of $930 million in the first half of 2020, which is a 17% increase over the same period last year. This increase is driven by the continued investment in our systems and the communities we serve along with more favorable construction weather this year versus last.

We also continue to work hard to minimize the customer bill impacts of these investments like controlling O&M costs. We continue our disciplined approach to regulated acquisitions. We've added more than 17,700 customer connections to-date through closed acquisitions and organic growth and look forward to welcoming an additional 43,600 customer connections through pending acquisitions, most of which we expect to close in 2020.

Our market-based businesses were up a $0.01 in earnings per share, reflecting year-to-date price increases in organic growth from Homeowner Services. We're also very honored to assume operations of Joint Base San Antonio in Texas and the United States Military Academy at West Point, New York in the second quarter of 2020.

Moving to Slide 9, the foundation of our earnings growth continues to be the capital investment we make in our regulated operations to provide clean, safe and reliable water and wastewater services to our customers.

Our strategy remains consistent as we plan to invest $20 billion to $22 billion in capital over the next 10 years to ensure the quality and reliability of our services and to bring water and wastewater solutions to communities across the United States.

We're affirming our long-term EPS compound annual growth rate in the 7% to 10% range and we expect our 2020 GAAP earnings to be in the range of $3.79 to $3.89 per share. Susan will talk more about that in a few minutes. Also consistent with our previous dividend guidance on July 29th, our Board of Directors declared a quarterly cash dividend of $0.55 per share of common stock, payable on September 1, 2020.

Turning to Slide 10, let's walk through some of the regulatory highlights of the second quarter 2020. On June 30, Missouri American Water filed a rate request with the Missouri Public Service Commission. The case includes $920 million in water system improvements and $30 million in sewer system improvements from January 2018 to May 2022.

This includes the replacement of approximately 275 miles of aging water and sewer pipes as well as the upgrading of treatment plants, storage tanks, wells and pumping stations across the state. The company's request is expected to take 11 months to complete and any new rates would not become effective until mid-2021.

Pennsylvania American Water filed a general rate case in April, requesting $92 million in the first year and $46 million in the second year. Since our last case in 2017, Pennsylvania American Water will have invested $1.6 billion in infrastructure upgrades for the four-year period of 2019 through 2022 including replacing more than 427 miles of aging water and sewer pipes.

Traditionally, the Public Utility Commission's review of the filing may take up to nine months and new rates would not be effective until 2021.

New Jersey American Water filed a general rate case in December 2019, requesting an overall revenue increase of approximately $88 million excluding the revenue from DSIC. Since our last rate case, we will have invested more than $1 billion in system upgrades in New Jersey.

Virginia American Water filed a general rate case requesting an overall revenue increase of $5.6 million in November 2018. This case was driven by approximately $98 million in infrastructure upgrades since April 2017. And we expect a decision later this year.

Now, let me turn to California, where there's been quite a bit of activity. California American Water filed for new rates in July 2019. The case covers 2021 through 2023, and request an increase in authorized revenue of $46.6 million over three years.

The request seeks $197 million for infrastructure improvements planned for 2021 and 2022. Due to COVID-19, we now expect the decision on this case in the first quarter of 2021. In addition, we filed a motion for interim rates to be effective back to January 1, 2021.

Also our Monterey Peninsula Water Supply Project is now scheduled to go before the California Coastal Commission for approval in mid-September. In early July, the California Public Utility Commission released a proposed decision on a low income rate payer assistance proceeding with the comment period currently underway and possible though in August.

The decision would require California American Water to file a proposal to alter its water revenue adjustment mechanism known as RAM in its next general rate case filing in July 2022, becoming effective in January 2024. RAMs are mechanisms commonly used across utility sectors. They really have proven critical to promote conservation and infrastructure investment.

From our experience, we believe the best way to address concerns with the impacts of RAMs is to improve forecasting in the rate making process. We're hopeful issues with the proposed decision will be resolved before the decision is voted on. If the proposed decision is adopted as is, California American water would consider options when they file their next rate case in 2022, which would affect rates starting in 2024.

On the legislative front this year, I would highlight two bills that were signed by the governor of Indiana. The first one authorizes recovery for aboveground infrastructure without a full rate case and the second establishes an appraisal process for non-municipal utilities to establish fair value and a reasonable purchase price.

Additionally, Missouri passed the Water Safety and Security Act which requires most water utilities with up to 30,000 customers to establish a cybersecurity plan and a valve and hydro inspection program. This is similar to legislation exists in Indiana and New Jersey. Finally, the sale of New York American Water continues to progress and we anticipate the closing of the acquisition by Liberty Utilities in early 2021.

Moving on to Slide 11. Customers remain at the center of every decision we make today and into the future. This means smart investments balanced by efficient operations and capital deployment.

As I mentioned earlier in the first half of this year, we invested a total of $930 million with the majority in our regulated businesses, including $881 million in infrastructure investment and $40 million in regulated acquisitions.

As we make these critical investments to maintain reliable service, we must also ensure affordability for our customers. We'll continue to focus on O&M efficiency and work toward our O&M efficiency goal of 31.3% by 2024. For the 12-month period ending June 30, 2020 our O&M efficiency ratio improved to 34.3% compared to 35.2% for the 12 months period ended June 30, 2019. Our adjusted O&M expenses are just slightly higher today than they were in 2010.

Since then, we've added approximately 281,000 customer connections, while expenses only increased at a compound annual growth rate of 0.8%. We're very proud of our employees focus and commitment to controlling costs on behalf of our customers especially given the current economic challenges some of our customers are facing.

Moving on the Slide 12, we believe our commitment to putting customers first is a key to growing our regulated footprint. So far in 2020, we've closed on 13 acquisitions in six different states adding approximately 10,800 new customer connections. We've also added more than 6,900 customer connections to organic growth in the first six months.

We look forward to adding another 43,600 customer connections to currently sign agreements in nine states, most of which we expect to close in 2020. These new agreements reflect our commitment to provide water and wastewater solutions to communities across our footprint. We know that many communities are facing unprecedented challenges now. And so we're pleased we're able to help.

This includes our recent acquisition, the Village Of Shiloh wastewater system in Illinois. This is another example of acquiring the wastewater system in an area where we provide water services for decades.

According to our Village Mayor, James Rainier, the sale of wastewater system to Illinois American Water allows the village to focus on other priorities. He also went on to say, Illinois American Water is providing excellent water service to our residents for many decades. We look forward to expanding our partnership.

We're very disciplined in our approach to acquisitions, leveraging our tremendous expertise to find solutions for communities. We now have about 800,000 customer opportunities in our pipeline, as many communities are seeking solutions to increase challenges which include regulatory, financial and those posed by COVID-19 in managing water and wastewater systems.

And with that, I will now turn the call over to Susan.

Susan Hardwick {BIO 16618718 <GO>}

Thanks again, Walter.

Let me start on Slide 14 with a bit more detail on results. Second quarter 2020 consolidated GAAP earnings were $0.97 per share compared to $0.94 per share in 2019. As Walter mentioned included in GAAP earnings is $0.02 per share for depreciation not recorded due to assets held for sale accounting. And the estimated $0.05 per share unfavorable impact from the COVID-19 pandemic.

The Regulated Business segment results increased $0.10 per share or an increase of 11.5% compared to 2019 earning. The market-based business results increased $0.01 per share and the parent company decreased $0.08 per share compared to 2019. Our 2020 GAAP earnings through June 30, were $1.65 per share or a 5.8% increase over the same period last year.

And the six month period results include $0.03 related to depreciation not recorded assets held for sale and an estimated $0.05 per share unfavorable impact from the COVID-19 pandemic. Our regulated businesses increased to $0.18 per share. Our market-based businesses increased $0.02 per share, primarily from Homeowner Services and finally the parent results decreased by $0.11 per share year-over-year.

Moving to Slide 15, let me walk through the second quarter results by business. Regulated operations increased $0.14 per share before considering the $0.04 per share estimated unfavorable impact from COVID-19 on the regulated business. We saw a $0.20 per share increase from additional authorized revenue and surcharges to support infrastructure investments, acquisitions and organic growth. Walter mentioned, as a reminder, that 2019 results include $0.04 per share of unusually wet weather in the regulated business.

O&M expense increased $0.05 per share and depreciation related to ongoing operations increased $0.07 per share, both to support regulated acquisitions and other growth.

The market-based Businesses second quarter results in 2020 increased $0.02 per share compared to 2019 before considering the $0.01 estimated unfavorable impact from COVID-19 on the Market-Based businesses. The increase was driven primarily by Homeowner Services Group organic growth and contract price increases.

Also during the second quarter, we are now fully operational on Joint Base San Antonio in the United States Military Academy at West Point, New York.

The parent results decreased $0.08 per share with $0.02 per share reflecting higher interest expense to support growth in the regulated business. The remaining $0.06 per share was the $0.03 per share sale of the legacy investment that occurred in 2019, and timing of expenses and other items $0.03 per share.

And finally on Slide 15, you'll see the total of $0.05 per share estimated impact from COVID as we discussed.

Moving to Slide 16, six-month GAAP EPS increased 5.8% year over year as I mentioned and many of the drivers on the variances in the quarter noted previously also explained year-over-year results.

Moving to Slide 17, the regulated business has received $80 million in annualized new revenues in 2020. And this includes $18 million from step increases and $62 million from infrastructure surcharges. We've also filed requests and are awaiting final orders on five rate cases as Walter just walk through and two infrastructure surcharge proceedings for total annualized revenue requests to $294 million.

The continued successful execution of our regulatory strategy is a key element of our ability to consistently deliver financial results.

Moving onto Slide 18, the company expects its 2020 earnings to be in the range of $3.79 per share to $3.89 per share on a GAAP basis. Included in this guidance range is the estimated $0.06 per share for depreciation not recorded as required by the accounted for assets held for sale and the estimated $0.05 to $0.08 per share unfavorable impact from the COVID-19 pandemic.

The full year estimated impact of COVID-19 is highly dependent on the projected impact of a number of unknown factors, which include the length and severity of decreased demand for services and the nature and scope of regulatory solution. Our current thoughts are that we start to see moderation in the impact on demand in the third quarter of 2020.

This guidance range is the same range that was previously announced on an adjusted basis. But let me be clear, our 2020 expectation of result in the range of $3.79 to $3.89 per share is unchanged from prior expectations. We continue to believe this range is reflective of the expected results on a normalized basis. Normalized for the two unusual items in 2020 related to the depreciation issue and COVID-19.

We think that guidance to GAAP results, which include these two items, makes the message quite clear. And I also want to repeat what Walter said, we are affirming our long-term earnings compound annual growth rate expectation on an earnings per share basis of a range of 7% to 10%, while investing capital in the range of $8.8 billion to $9.4 billion over the next five years.

Finally, moving on to Slide 19, as we noted in the release on July 29, 2020, the company's Board of Directors declared a quarterly dividend of $0.55 per share of common stock payable on September 1, 2020. This reflects the continuation of the 10% increase in the annual dividend declared by the Board on April 29, 2020.

We continue to be a top leader in dividend growth. We have grown our dividend at a compound annual growth rate of 10.1% over the last five years and we expect to continue that growth at the high end of the 7% to 10% range. Also we continue to target a dividend payout ratio of 50% to 60% of earnings.

Our total company consolidated actual return on equity is 10.7% for the 12 months ended June 30, 2020. Regulatory execution along with strong results from our market-based businesses, allows us to consistently deliver on our earnings commitment. We believe that delivering on results combined with our strong earnings growth and superior dividend growth expectations continue to provide excellent value for our shareholders.

To summarize, the decades of capital investment need continue and drives our planned $20 billion to $22 billion of capital investment over the next 10 years. With the fragmented water and wastewater landscape in the states, and local communities continue to face added challenges from the impacts of COVID-19. We believe we can provide those states and towns water and wastewater solutions to help mitigate those impacts.

The capital light market-based businesses continue to improve customer experience and generate cash. And simply put, our business model and resulting investment thesis is built on fundamentals. And though all segments in the economy are being impacted by this health emergency, we see our business as resilient and we have built that in a way to endure this challenge.

And with that, let me turn the call back to Walter for a few additional remarks.

Walter J. Lynch {BIO 6064780 <GO>}

Yes. Thanks, Susan.

I want to end by thanking American Water's employees for everything they have accomplished in the first half of this year, especially since the beginning of our response is the pandemic in

March. With safety as our top priority, we've continued to provide essential services in every community we serve.

Through American Water and the American Water charitable foundation, we support many organizations across our footprint and make a difference for the communities we serve, including those that seek to foster a more equitable society. And as we always have, we continue to support an inclusive and a diverse culture in American Water.

All these efforts are in addition to executing of our strategies, investing in our systems, bringing water and wastewater solutions to new customers and communities and becoming fully operational at two new military bases. While there maybe significant concerns in the market given COVID-19 and a variety of other factors, I'm pleased to report that our fundamental story of American Water remains the same and our performance remains consistent because of the incredible employees, who work here.

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

Questions And Answers

Operator

(Question And Answer)

We will now begin the question-and-answer session. (Operator Instructions) The first question is from Angie Storozynski with Seaport Global. Please go ahead.

Q - Angie Storozynski {BIO 15115714 <GO>}

Thank you. So, I have a question mostly about the guidance first. So just so I'm clear, I mean on the GAPP level, there is this positive -- positive offset to your -- to the $0.05 hit from earnings, I mean, from -- I'm sorry, from COVID-related expenses. I don't have that benefit on an adjusted basis. So are you basically saying that even with that $0.05 hit, I'm still within the adjusted EPS range? Or is there some other offset to that $0.05 hit on an adjusted basis?

A - Susan Hardwick {BIO 16618718 <GO>}

Hey, Angie, good morning. Let me address that and I think you've mostly got it right. I think, what we've continued to try to say here is that the range of $3.79 to $3.89 per share is what we believe to be expected result on a normalized basis. I think, in the first quarter, we called that adjusted, because we were dealing with the depreciation issue in New York, obviously, the COVID estimates had not been fully vetted at that time.

We now have a better insight as to what those COVID estimates are, but I think fundamentally it's important to stay focused on that range of $3.79 to $3.89 which is where we believe we will end the year, and whether you think about that as adjusted or as GAAP. I think it's important to note, that's what we believe to be sort of normalized operations. And that's what we've always said. We've gone to a GAAP guidance approach here, I think just to make it easier to understand and easier to follow what our guidance is. But there is no change from our expectation around sort of normalized results that range of $3.79 to $3.89.

Q - Angie Storozynski {BIO 15115714 <GO>}

Okay, I understand. And my second question on New York. I appreciate Walter's comments that the sale transaction continues. It seems like at least based on press reports. There are some attempts to municipalize parts of this system -- of your New York system. So do you expect that the transaction gets delayed by those potential reviews? Or how should we think about it?

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

Okay. Thanks Angie, it's Walter. How are you? Let me start by saying, we're moving forward with the sale of New York American Water. The regulatory approval process is progressing, there have been some delays related to giving third parties an opportunity to submit alternative proposals to the sale, and we've taken that into account when we look at the -- what we're saying as far as the beginning of 2021.

So, we don't anticipate any other delays because it's a very tight time frame, that they've given these communities an opportunity to submit alternate proposals. One proposal has been received so far, we're reviewing that, but Liberty and American Water committed to moving forward this sale.

Q - Angie Storozynski {BIO 15115714 <GO>}

Awesome. And lastly, I mean, we keep waiting to see the interveners filings in your New Jersey rate case. I understand that they haven't been posted yet. So can you give us at least a sense, what are the key contentious points? And how the rate case is going?

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

Well. The rate case is proceeding according to our anticipated schedule. We -- the postings have not been public. So we really can't comment on those, but just to say there's really nothing out of the ordinary in these.

Q - Angie Storozynski {BIO 15115714 <GO>}

Okay. Thank you.

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

Thank you, Angie.

A - Susan Hardwick {BIO 16618718 <GO>}

Thank you, Angie.

Operator

The next question is from Insoo Kim with Goldman Sachs. Please go ahead.

Q - Insoo Kim {BIO 19660313 <GO>}

Thank you. My first question is just following-up on Angie's questions on the guidance. I under - - I think, I understand the moving pieces and longer-term, I do agree with the fact on a normalized basis that is what it is. But I guess just from an apples-to-apples comparison versus the range that you have given out on adjusted basis as of first quarter. It seems like either the COVID expense impact expectation is excluded from a on apples to apples basis or with it you're, essentially trending $0.05 to $0.08 below the original plan. You've talked about your confidence in getting a lot of that back on the disconnect cost and what not. If those things do not materialize, what type of cost measures do you have to potentially offset this? Or is this something that you're just going to hold back to deal with it in 2021?

A - Susan Hardwick {BIO 16618718 <GO>}

Walter, I can start there. You can certainly add.

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

Okay.

A - Susan Hardwick {BIO 16618718 <GO>}

I think, as we -- again, let's just talk about guidance for a second. A couple of thoughts I would give you relative to this, maybe add to Angie's response. If we were continuing to provide adjusted guidance, let's say, using that terminology, we would certainly look at these COVID costs as an item that we would adjust for. So they would be considered part of that adjusted guidance just like we had done New York. So we would be adjusting for them. And essentially saying, they shouldn't be considered as part of normalized operations. And as we thought through that, we said it just makes more sense to go straight to GAAP guidance and say these are going to be the results on the books, and they happen to be exactly the same guidance we've been providing all along on a normalized basis, again $3.79 to $3.89. So we've viewed this as literally no change in guidance. So again, that's how we think about guidance.

As it relates to sort of recovery, again, we've got orders in 10 of 14 states, and we've got proceedings in the other four, that we believe will allow us fully to seek recovery of all of the costs associated with COVID with the exception of the lost demand revenue. That is really the piece that ultimately falls through in that $0.05, the lost demand $0.04 of unregulated size of business.

So again, we're going to continue to work with regulators on recovery of the lost demand dollars, and again, we think it makes sense to work through the regulatory process on recovery before we start to again sort of arbitrarily reduce costs that again can have longer-term impacts on our ability to continue to deliver services, we think this is a an event that has occurred during this period. We're hoping that we start to see some moderation of that exposure in the third quarter as I mentioned, so we believe there's some isolation to it and we can again sort of work with regulators to seek recovery.

And cost reductions, while we continue to focus heavily on them as we've outlined here, we've made progress again on the O&M efficiency ratio and we continue to focus very heavily on cost and our cost structure in the business. We think that's where our focus should be and not on sort of arbitrary reductions that could potentially affect our ability to sort to serve it.

Q - Insoo Kim {BIO 19660313 <GO>}

Got it.

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

And the only thing I'd add to that -- I'm sorry, go ahead.

Q - Insoo Kim {BIO 19660313 <GO>}

No. My follow-up to this question was just going to be -- so when you do provide 2021 guidance, if there are any expectations of lingering COVID related impacts that will essentially be backed out to provide a more normalized GAAP guidance?

A - Susan Hardwick {BIO 16618718 <GO>}

Well. Again, I think, we'll continue to talk about any impacts we see from COVID. I mean, that's what I think we're trying to do here is simply highlight for you the significant issues that affect results. And in this particular year, it's the New York depreciation issue and it's COVID, to the extent we see lingering impacts in the '21 we'll continue to talk about the impact of COVID and make it very transparent to you what those impacts might be, and how we're addressing them, whether they be from a regulatory perspective or some other.

I'm not saying that we'll adjust for them, again, I'm a bit of a purist as it relates to reporting, I think GAAP results are the best indicator of performance and so were, we think transparency around GAAP results is the right approach and that's what we're doing here.

Q - Insoo Kim {BIO 19660313 <GO>}

Understood. And just one follow-up if I may. I think there's been top from the campaign trail about increased clean energy plans and as part of that just focus also on the water side and water quality. How do you see that impacting or benefiting AWK from a rate case? Or having to manage expense -- on an expense basis? Or is it still something that's more on a state-by-state basis that you're working on?

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

Yeah. It's really more in a state-by-state basis. We continue to talk to the folks on a federal level about the ways that private water, American Water can help resolve some of the issues and the challenges in the water and wastewater space but it's largely driven by the states.

Q - Insoo Kim {BIO 19660313 <GO>}

Understood. Thank you very much.

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

Thank you.

A - Susan Hardwick {BIO 16618718 <GO>}

Thanks Insoo.

Operator

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

Q - Jonathan Reeder {BIO 18909775 <GO>}

Hey, good morning, Susan and Walter, beat on the dead horse a little longer in terms of the guidance, but -- to your kind of saying the COVID impacts from $0.05 so far. If you're looking in your crystal ball for the second half of the year, there's the potential for an additional $0.03, is that what -- how should -- we should view that $0.05 to $0.08 full year impact to GAAP that you're talking about?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, I think, that's fair Jonathan now, as I said in the release and in our remarks today, there's obviously lots of unknowns and we will attract this just like we do. It's a changing landscape every single day. But we have an expectation that the largest portion of the impact again this $0.05, $0.04 on the regulated side is really driven by demand changes and we expect that to start to moderate. Again, we've started to see employees return to work across our territory. We've seen industrial demand start to come back up. I think commercial is probably the biggest variable to be honest with you, that you think about restaurants, and some of the smaller commercial enterprises. They were likely going to have a little bit longer recovery period. So I think, that is the biggest variable.

Our current view is that we'll you see some of that moderation here in the third quarter. So that $0.05 to $0.08 range, we've given around COVID really reflect that set of assumptions. That for the balance of the year. Again, we should be able to sort of contain it within those that range that's our current thinking.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay, and if for some reason you are successful getting regulators to support recovery of that lost revenue than that'll represent essentially that $0.05 to $0.08 of upsides to the GAAP. If I'm right.

A - Susan Hardwick {BIO 16618718 <GO>}

Right. Now again, yeah, as you think about how that process may play out though obviously we'll -- we are working with regulators currently and we'll continue to do so. We'll have to work through a process to get those dollars reflected for recovery. So it may take a bit of time where there's been quick action by regulators to-date literally across the country as you know.

Regulatory community has been very supportive of the process to identify a need for a solution here around -- particularly around disconnect and that sort of thing. The lost revenue piece is sort of another layer of challenge that we need to work through with regulators and that may take a bit of time. But yes, I mean, if we can work through that, there is potential upside there.

And as I mentioned in the script or in our prepared remarks and it may have been sort of a subtle comment, at the state level, we are -- we have recorded these loss revenues as recoverable items. We just took a conservative view at the parent and said we don't have regulatory orders in place to support it yet. So, at the consolidated level, we did not record those regulatory assets, but we certainly expect to work through with regulators and we'll see what progress we can make.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay. And then the 12 million regulatory assets that has been recorded on a cost side. Does that assume the other 4 states, I mean, I know Missouri is the only kind of significant size one in there, but does that assume that those 4 also, I guess, approve the cost recovery at least through --

A - Susan Hardwick {BIO 16618718 <GO>}

Well. We certainly have taken lots of guidance from our discussions with regulators in those states. We have had active and ongoing conversations with them from the beginning. We've certainly filed petition that would support that approach. We have lots of precedents obviously in our other 10 States as well as other states across the country.

So again, we're not trying to predict what regulators will do, necessarily, but we certainly believe we've got good support for that approach and it is reflected in the accounting that we've done to-date.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay. And then --

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

Let me emphasize --

Q - Jonathan Reeder {BIO 18909775 <GO>}

Sorry, Walter, go ahead.

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

No. Go ahead, Jonathan then I'll jump in.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Thanks a lot. Go ahead --

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

Yeah. I know. I just wanted to emphasize that. Again, we run this business for the long term and we're going to continue to focus on those cost reductions that benefit our customers, employees in the long-term. It's part of our culture. We've been doing it for many years. We're going to continue to do it. You can see the O&M efficiency continues to improve and that's really important the way we run the business. I just wanted to emphasize that for this call.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Yeah that kind of actually leads into my thoughts. So I mean, I know you guys do run a very lean shop and everything, but your comments around kind of make an arbitrary cost reductions that could impact long-term quality versus other utilities out there that seem to be, finding these costs offsets, that they say, bulk impact, service quality is that just because you already feel like you are super lean where you don't have this little hanging fruit just to kind of offset the loss sales impact and therefore, not have to go back to the weld to ask customers to pick it up. You're already running super lean and that's why you feel like any additional cuts could impact the quality?

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

Yeah. And I can only speak for our company, Jonathan, but we've been on this journey now for a dozen years focused on efficiencies. And we're going to continue to do that. But again, we're going to make the decisions in the context of what's right for our company, for our employees, for our customers and that's really what guides our decisions.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay. Thanks for the -- thanks for taking my questions.

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

Thanks.

A - Susan Hardwick {BIO 16618718 <GO>}

Thanks, Jonathan.

Operator

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

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

Well, thank you. I'm going to defer right now to Ed Vallejo, he has a few comments to make.

A - Edward D. Vallejo {BIO 16076814 <GO>}

Thanks, Walter. Well as you all know, one of the ways American Water grows is by developing our employees and that's a great thing. So now, it's with mixed feelings today that I must share with you that Ralph Jedlicka our IR Director for the last 3.5 years will be moving on to join our treasury team to continue his development as a financial executive at American Water.

And vice to versa, coming to us from the treasury team, Mike Tavani, will be joining the IR team. Mike is our CFA holder, and he's experienced in treasury at P&A and Internal Audit. You all will be meeting Mike virtually at least as we talk to you all over the next couple of weeks.

So Ralph, thank you for your dedication and your sense of humor and most importantly for your counsel and friendship. Abbey, Kelley and I know that you'll be a great addition to the treasury team. So got speed, as you continue your journey my friend. Walter?

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

Okay. Thanks. Congratulations Ralph and Mike. Okay, so thank you for joining our call today. We value your participation and the work you do on behalf of your clients. We hope our open and transparent discussions give you confidence in our company and in investment in our stock. If you have any additional questions, please call the IR team. They'll be happy to answer them.

Thanks again and be safe.

Operator

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