Q1 2012 Earnings Call

Company Participants

- Ed Vallejo, VP, IR
- Ellen Wolf, SVP and CFO
- Jeff Sterba, President and CEO
- Walter Lynch, President and COO of Regulated Operations

Other Participants

- David Paz, Analyst, Bank of America Merrill Lynch
- Heike Doerr, Analyst, Robert W. Baird
- Kevin Cole, Analyst, Credit Suisse
- Neil Mehta, Analyst, Goldman Sachs
- Spencer Joyce, Analyst, Hilliard Lyons
- Tim Feron, Analyst, Janney Montgomery Scott

Presentation

Operator

Good morning. Welcome to the American Water's First Quarter 2012 Earnings Conference Call. As a reminder, this call is being recorded and also being webcast with an accompanying slide presentation through the Company's website www.amwater.com.

Following the earnings conference call, an audio archive of the call will be available through Thursday, May 10, 2012 by dialing 303-590-3030 for U.S. and international callers. The access code for the replay is 4531958. The online archive of the webcast will be available through June 4, 2012 by accessing the Investor Relations page of the Company's website located at www.amwater.com.

At this time, all participants have been placed in to a listen-only mode. Following the management's prepared remarks, we will then open the call for questions. [Operator Instructions]

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

Ed Vallejo {BIO 20515524 <GO>}

Thank you. Good morning, everyone. Welcome to American Water's 2012 First Quarter earnings conference call. At the end of our prepared remarks, we will have time for 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 answers to your questions, we may make statements related to future performance. Our statements represent our most reasonable estimate. 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.

Now I'd like to turn the call over to American Water's, President and CEO, Jeff Sterba.

Jeff Sterba {BIO 1426511 <GO>}

Thanks Ed. Good morning, everyone. And I appreciate you joining us today. Ellen Wolf, our Chief Financial Officer will join me in our comments this morning. Also with us here are Walter Lynch, who heads our Regulated Operations; and Kellye Walker, our Chief Administrative Officer and General Counsel.

It's a pleasure to report on another quarter of success in both our financial performance and the execution of our strategic plans. On slide 5, you can see, we delivered strong First Quarter results with a quarter-over-quarter increase in earnings from continuing operations of more than 20% to approximately $49 million or $0.28 per share. This was fueled by an almost 4% growth in revenue, while total operations and maintenance expenses were held flat to the same quarter last year.

In our Regulated segment increased revenue driven by implementation of rate case decisions in a number of our states and reduced O&M costs, improved our O&M efficiency ratio by about 280 basis points quarter-over-quarter. You'll also notice that it shows a consolidated cash flow from operations decline of about 8%. This is attributable to timing changes in working capital. These financial results are due to our focus on investing resources and capital in areas where we can drive value for customers in the Company, as well as our focus on continuous process improvement that's ongoing throughout the business.

And our financial results are obviously important, what we all are here to talk about. But their sustainability, I think has a lot to do with how we serve customers and whether they think they're getting good value for the price.

Like most companies, we survey our customers to understand their overall satisfaction with us and their perception of service quality. And I thought you may be interested in how we're fairing on this front. In the most recent survey, which was done in the last 30 to 45 days, 94% of our customers responded in the satisfied categories, concerning their overall satisfaction with American Water during the past 12 months. And among customers who had specific service contract [ph] with us, almost 90% were either extremely or very satisfied. We take these measures and the confidence our customers place in us seriously, particularly as investment in facilities critical to providing service to our customers could cause us upward pressure on rates.

Our capital investments directly benefit our customers through improved reliability and we've increased our efforts to help customers understand these investments and the associated benefits that come from having reliable water service, such as fire protection, quality water and wastewater treatment and the economic vitality of the towns that they live in.

We're also levering technology to help us serve our customers better. For example, we recently upgraded our call management system, which has significantly improved call handling performance. And while substantive improvement through our customer outreach and online service capabilities, is tied to the implementation of our new CIS system next year. We have improved our web self-service applications and have seen a more than 65% increase in the number of customer-initiated web-based transactions over last year. This enables us to meet customer needs more effectively and also at lower cost.

Turning to slide 7, let me highlight just a few other key accomplishments of this quarter. As you know, we have now closed the previous announced portfolio optimization transactions, which have added about 55,000 customers in Missouri and New York and generated more than $510 million of cash, which can more effectively it would be deployed in the 16 states in which we now have regulated operations.

So far in 2012, two rate cases have been filed and cases in five states have been resolved providing an annualized revenue increase of over $62 million. The most recent decision came a couple of days ago in New Jersey, where the New Jersey BPU approved a stipulated agreement in that rate case, as well as improved the distribution system improvement charges for the state.

We also received two proposed decisions in California that are of significance. One is on the revenue requirement for our general rate case for 2012 through 2014 and the second one is the cost recovery of the San Clemente dam removal proposal. Both of these recommendations still require final commission action, which we hope will be forthcoming soon after comments have been filed by all the parties. It has to be out for comment for 30 days before the commission can take final action. We view these recommended decisions as generally constructive, but there are some points that need clarification with the Commission.

Lastly, I know there's been talk about dry weather in the media lately, we've assessed our reservoirs and other sources of supply, and at this time, are comfortable where we are with virtually full reservoirs and our supply sources. That as always, will assess our supply on a continuing basis as we go forward. With that said, let me turn the call over to Ellen to delve into our financial performance in more detail.

Ellen Wolf {BIO 1854557 <GO>}

Thank you, very much, Jeff. Good morning to those of you who are listening to our First Quarter 2012 earnings conference call. Jeff has just reviewed with you some of the key highlights for the quarter, all built around our commitment to ensure reliable service to our customers and results to our shareholders. I'm now going to take a few minutes to describe in more detail the drivers of our results for the First Quarter. As always, additional details can be found in our 10-Q, which we filed late yesterday afternoon with the SEC.

Now turning to slide 9. As Jeff indicated, we produced solid financial results for the First Quarter of 2012 with increases in revenue, net income and earnings per share, as well as continued improvement in our O&M efficiency ratio. These results were driven by our teams' commitment to strategies that focus around the value of our customers, investing needed capital and controlling costs.

For the First Quarter ended March 31, we reported operating revenues of approximately $619 million, a $22 million or 3.7% increase over the approximately $597 million reported for the First Quarter of 2011.

Income from continuing operations for the First Quarter was around $49 million or $0.28 per common share, compared with around $41 million or $0.23 per common share in 2011 with both up over 20% year-over-year. Included in income and earnings per share for continuing operations, is an after tax charge of about $1.4 million or $0.01 respectively, related to severance cost associated with our organizational realignment.

Net cash, as Jeff mentioned, provided by operating activities for the three months ended March 31, 2012 was $148 million compared to $161 million for the First Quarter 2011. This again is mainly due to changes in the timing of working capital needs.

Now, I'd like to turn the discussion to the various components of our income from continuing operations starting with revenue. Revenues from our regulated business increased by a net of $13.6 million or 2.6% from March 31, 2011 to 2012, driven by new rates awarded and various surcharges granted by the regulators related to our continued investment in infrastructure.

As of March, 31, the 2012 impact of these rate increases, most of which were granted in 2011 was approximately $20 million. These increases were partially offset by decreased revenues of around $6 million attributable to a decrease in overall demand of 1.5% in the First Quarter of 2012, compared with the First Quarter of 2011. During the same period, our market based operations revenues increased by $5.2 million or approximately 7%, primarily as a result of incremental capital project activity related to our military services contracts.

Now turning to slide 11. As you all know, our ability to invest in our infrastructure is driven by our ability to earn an appropriate rate of return on our investments. This slide shows rate cases that have been filed and are awaiting final order. As of May 2, we're awaiting final orders in four states, requesting additional annualized revenues of $101.5 million. There is a question of assurance that all or any portion thereof of any requested increases will be granted.

During the First Quarter of 2012, we filed a general rate case in Virginia, requesting additional annualized revenues of approximately $5.7 million. As a reminder, we anticipate filing a total of four rate cases in 2012.

Slide 12 shows rate cases and infrastructure charges that have been granted since the beginning of 2011. As of May 2, 2012, we've been granted additional annualized revenues from general rate cases totaling around $190 million and another $11 million in additional annualized revenues from infrastructure charges. The most recent rate case decision was just this week in New Jersey, that the Commission approved a revenue increase of $30 million to be effective immediately. The outcome of this case balanced the requirement of the customers and the shareholders by taking into account for the first part, for the first time, as part of our original filing, the decline in customer usage, as well as our own efforts to control cost since that original filing back in July of 2010.

Turning our attention to water sales volumes. Total Company sales volumes decreased quarter-over-quarter by then [ph] 1.5%. During the First Quarter, usage is generally not impacted by weather. The quarter-over-quarter decline we are seeing is in line with the five-year demand usage trend. While we can never be completely sure of the reason for the decline in usage, again at this time, it appears that for at least the residential decline of 1.7% that it's related to consecration [ph] and more efficient work [ph] related appliances.

I'd now like to take a few minutes to discuss our operating expenses. Total operating expenses including depreciation for the 2012 First Quarter increased by $5.4 million or 1.2% from the 2011 First Quarter. This increase includes a $7 million decrease in the regulated business operations and maintenance expense, offset partially by a $3.2 million increase in the market based business expenses, mainly related to the increased revenues from our military contract. The regulated O&M decrease of approximately $7 million, the mild winter we experienced this year affected expenses by [technical difficulty] lowering our chemical usage to lower water turbidity and by increasing our capitalized labor as more time was spent on replacing all type [ph] rather than fixing main breaks.

Also employee-related expenses decreased due to employee vacancies and lower ERISA based pension expense.

And finally, included in the O&M expense for the First Quarter was as I mentioned earlier, a $2.4 million pretax severance charge again associated with organizational realignment. Overall, our O&M or regulated O&M efficiency ratio improved from 48% for the quarter ended March 31, 2011 to 45.3% for the quarter ended March 31, 2012. We continue to see improvement in this ratio quarter-over-quarter, as we remain committed to cost containment and long-term margin improvements.

The results of the First Quarter as well as our rate case decisions allow us to reaffirm for you our 2012 ongoing earnings per share range of $1.90 to $2.

And with that, I'd like to turn the call back over to Jeff for closing comments, before opening it up to your questions.

Jeff Sterba {BIO 1426511 <GO>}

Thanks Ellen. Before taking questions let me just close our discussion with the slide, remember that we presented this in January for the first this year. On some of the things that we are striving to achieve in 2012, so you can track our progress. Now of course -- that is all in addition to our target of earning a $1.90 to $2 per share from continuing operations of course.

While it's still fairly early in 2012 good progress is being made on all of these fronts. And I won't go back over them because we've discussed most of them already today. We're making solid progress in getting declining use and other regulatory lag items, recognized by regulators. Our continuous process improvement efforts are really starting to take hold and we're seeing increased opportunities in both our regulated and market based segments for customer growth, all of which lead us to continue to believe in our long-term growth prospects of 7% to 10% per year.

With the approximate 3% dividend yield, I believe we've committed to investors to providing a double-digit investment return under an investment thesis that's centered on investing in our country's infrastructure.

Lastly, just a reminder that we'll be holding our Annual Meeting here in Voorhees and also online through our virtual stockholder meeting on Friday, May 11, next Friday. So we welcome your participation. And now we'd be happy to take any questions you might have.

Questions And Answers

Operator

Thank you. [Operator Instructions] Kevin Cole, Credit Suisse.

Q - Kevin Cole {BIO 18674088 <GO>}

Hi. Good morning, guys.

A - Jeff Sterba {BIO 1426511 <GO>}

Good morning.

A - Ellen Wolf {BIO 1854557 <GO>}

Good morning.

Q - Kevin Cole {BIO 18674088 <GO>}

Jeff, I guess on your last comment, so I guess how should we think about the natural regulatory lag now with both Pennsylvania and New Jersey offering DSIC [ph] like structures. As I know traditionally, we've always thought of it as, so we have like a target [inaudible] minus 100 basis points to 125 basis points from [inaudible] and then 100 basis points to 150 basis points for regulatory lag. Where do you see that migrating towards?

A - Jeff Sterba {BIO 1426511 <GO>}

Yes, I think the 150 basis points of regulatory lag is declining as we get DSICs in place and as we get declining usage built into place. Now, obviously the best approach is when you have an automatic adjustment mechanism, but in other states like was done in New Jersey, we have a future test year and then have forecasted a year forward in terms of consumption. And then, that's what's being put in. So by the time rates go into effect they're recovering costs. You go two years and you start to still have some more lag.

But -- so I think that 150 basis points is what we're trying to shrink, do we ever get it to zero. Well, probably not. But if we can squeeze it down to 50 basis points, so that's a 100 basis point pick up, plus in some of our jurisdictions, and I'll use New York as an example, we have a dead band where we're allowed to earn above our allowed return for a little bit and then we start sharing access, if there are any additional returns. So, our goal is to drive it to zero and we're not going to be satisfied till we get there. But you'll always have a little bit of correction.

And on the rental [ph] gap, obviously that presented, when I first came it was about 125 basis points, it's already shrunk down to about a 100 basis points just because it's static and our total business is growing and so that will continue to happen. But obviously until something is done with that, that it won't go to zero. It will slowly migrate down to 75 basis points and lower.

Q - Kevin Cole {BIO 18674088 <GO>}

Okay. And [inaudible]. I notice in some recent presentations you've put in a new area chart that kind of depicts your 7% to 10% EPS growth, like the sources of that. And I guess can you kind of talk about where you think we are in like when I look at the X axis because at over the short-term, it depicts like half of the EPS growth comes from ROE improvement, but I think we've achieved a good chunk of that, right?

A - Jeff Sterba {BIO 1426511 <GO>}

Yes.

Q - Kevin Cole {BIO 18674088 <GO>}

[multiple speakers] going towards the right, it leans more into new services and then acquisitions?

A - Jeff Sterba {BIO 1426511 <GO>}

Yes, we started using this frankly at the Analyst Day a year ago, a little over a year ago February of 2011. And its purpose is to just kind of -- is to conceptually present. And there is no specific timeline, because frankly, we're in different parts of that curve or different parts of each of these curves today. So for example on the ROE improvement frankly, we're making more progress than -- we're making faster progress.

Here's the way I think about it long-term, we are investing $800,000 to $1 billion of CapEx a year, call it a midpoint of $900 million. That $900 million is offset by depreciation of about $300 million, so that's a net rate base addition of about $600 million. As you add that into our existing rate base, we're driving 6% to 7% growth in earnings, just off that fundamental driver. And that does not include, for example, acquisitions, new services, the value of efficiencies that we build in, because we think about the efficiencies as really creating head room to add this capital.

So that's where we're comfortable with a 7% to 10% growth rate as it's basically given the baseline of that comes from the investment strategy. Now the key is obviously can we recover that. And that's why the focus on efficiency, because it gives us that head room. Remember though one of the kind of rules of thumb that we talked about is $1 of O&M has the same impact on rates as $6 of capital. But that $6 of capital generates $0.30 of earnings for you. So that's the way we think and work on how do we drive operational efficiency to create headroom for capital growth.

Q - Kevin Cole {BIO 18674088 <GO>}

Okay. So -- and one follow-up question for that. So with regards to the DRIP and equity needs, how big has the DRIP got and would you agree that through use of the DRIP and through the NOL, it looks like you could be equity free for a long time?

A - Ellen Wolf {BIO 1854557 <GO>}

Let me first address the DRIP and employee stock purchases. Last year they provided about $5 million worth of cash for the company, so they are not huge providers of cash and year-to-date, we've seen about $700,000 that's come in for the First Quarter. So, again, we're not seeing them as large inputs. As we've said, there won't be an equity offering, we don't foresee one in 2012 because we had around $450 million come in as it relates to Arizona and New Mexico, and another $60 million that came in as a result of our acquisition of New York and divestiture of Ohio on May 1. So we have sufficient cash to get through this year and we've not yet talked about the future years. But again, we're continuing to see our equity ratio improve and I should note that for the First Quarter, actually we moved up to 43% equity, we're at 42% as of year-end.

Q - Kevin Cole {BIO 18674088 <GO>}

Okay. Thank you, very much. Appreciate it.

Operator

Thank you. Neil Mehta, Goldman Sachs.

Q - Neil Mehta {BIO 16213187 <GO>}

Hi, guys.

A - Ellen Wolf {BIO 1854557 <GO>}

Hi.

A - Jeff Sterba {BIO 1426511 <GO>}

How are you, Neil.

Q - Neil Mehta {BIO 16213187 <GO>}

Doing well. So a couple of questions here. First is, Jeff, if you could talk about the way you're thinking about a potential dividend raise and your dividend pay out as you think about the cash that's coming in from some of these asset sales?

A - Jeff Sterba {BIO 1426511 <GO>}

Okay. Obviously, we think about dividend as a efficient use of capital decision in terms of what can we invest to continue to build the business and what's an appropriate cash return. As you know, our payout ratio has now drifted below 50% because of our strong earnings growth. And what we're seeing obviously is our dividend growth has been about 5% but our earnings growth has been substantively higher than that. That's something we're taking a hard look at as to what's that appropriate mix on a go-forward basis.

I think it used -- when the company first came public, I think we used the payout ratio were 50% to 70% of the guideline, frankly, that's fairly broad, we're obviously now even a little bit below that. So we're taking a look at what's appropriate going forward. I think you'll see from us a little more specific conversation relative to the dividend and what our policy is going forward, as we move forward through a little more time this year.

Q - Neil Mehta {BIO 16213187 <GO>}

Got it. And the second question relates to volumes here, at some point you got to think the diminishing marginal returns of efficiency and changes in customer behavior where all the easy games have been won and the volume decrease associated with it will start to fade a little bit. How are you thinking about that or do you think that 1.5% that we saw in the First Quarter is sustainable for a long period of time?

A - Ellen Wolf {BIO 1854557 <GO>}

What we're seeing is it's been sustainable for a long period time. We would expect it to continue as a lot of the areas that we serve are older areas. And so over time, there are homes continues to take out the older appliances, and put in the newer appliances. We have seen it start to flatten only in a very, very few places. And again as you talk about more water efficient devices we've now seen that move through the outdoors. So more watering devices have become more efficient as well. So I would expect that to continue for a while.

A - Jeff Sterba {BIO 1426511 <GO>}

Yes, Id' agree, Neil. The big thing that Ellen hit on and this is one of the things that I think you'll see is on the irrigation side. More people have not just gone to drip irrigation, but now they're starting to use sensors. And so I think we'll continue to see. I think it would be in-house stuff. Yes, you hit a point of diminishing [inaudible] we probably see more potential for that. And that's why we're focused on making sure that we get appropriate mechanisms in place. At some point there's a level out. Yes, I would agree with you, but I don't think it's in the next -- we personally aren't expecting it in the next three to five years let's say.

Q - Neil Mehta {BIO 16213187 <GO>}

Thank you. And then the last question is on -- a quick update on the New Jersey rate case. As when I looked at the final outcome here, the little bit of a lower hit rate than we historically see versus your ask [ph]. Can you help us understand some of the components of the delta between the request and the final outcome?

A - Jeff Sterba {BIO 1426511 <GO>}

Yes. I'll let Walter to take that.

A - Walter Lynch {BIO 6064780 <GO>}

Yes, thanks Jeff. Yes, there are two real reasons, the final revenue requirement in the rate case showed a decrease in expenses from the original filing and it was in our press release that we issued couple of days ago that there's about $10 million less expenses in the final revenue requirement than when the original filing occurred. And also we have taken a more aggressive approach in our declining usage mechanism. In the original filing, we filed for a two year look ahead to get the revenue recognition for that. And in the settlement, in the $30 million, we got about one year of that. So that really explains some of the gap.

A - Jeff Sterba {BIO 1426511 <GO>}

When you take a hard look through it, there is no capital that was disallowed on -- or costs were allowed, all of our operating costs. We got a one-year forward look on use on declining usage. So I -- and since [ph] I think making some people will look just at the -- at the $90 million [ph] and the $30 million say you only got a third [ph]. Well that's not really the appropriate comparison, because of the O&M change that which is really a savings. And you bet, we're going to pass that on to customers as well as the way that we approached the declining usage caused the size of the increase to look much larger than, for example, it hasn't in prior years.

Q - Neil Mehta {BIO 16213187 <GO>}

Okay. Thank you, very much Jeff, Ellen.

A - Ellen Wolf {BIO 1854557 <GO>}

Thanks Neil.

Operator

Thank you. Ryan Connors, Janney Montgomery Scott.

Q - Tim Feron

Hi. This is actually Tim Feron filling in for Ryan who is on the road. I just had another question on the New Jersey case, we obviously have the numbers. But I'm -- was just curious if it was -- if the whole process was more or less contentious than in the past. And do you think the fact that the DSIC was attached to the case could have had some affect on the ultimate award?

A - Jeff Sterba {BIO 1426511 <GO>}

I don't think the DSIC really had much effect on it. I think this is one of the reasons why we are being much more active in communicating with our customers on issues around value of water. New Jersey has had a series of rate increases and it's because we haven't done what needed to be done there for a while.

And so, I think that attracted a bit more attention and particularly in -- there is a couple of individuals who took the mantle up about just no rate increases. We understand that I think the notion that this was a settled case with all of the major parties continues to speak well for a stable regulatory environment in the state of New Jersey.

And it's, obviously, it's a settlement we believe we not only live with but we think is fair and reasonable. I think the media coverage because of some of the, the stir up if you will, from a couple of folks in the political world, yes, it created more attention, if you will. Well that's fine, we understand the concerns and we're going to continue to work with those folks to help them better understand why you have to invest and what that means to rate long term.

A - Ellen Wolf {BIO 1854557 <GO>}

Tim, can I also add the DSIC was actually a separate filings from the rate case and it just so happened they were on the same agenda. But until now the comments we've had are very favorable around the DSIC. So I want to separate -- don't believe the DSIC was in way driving reaction to the rate case.

Q - Tim Feron

Okay. Thanks. That's very helpful. And thanks for taking my call.

Operator

[Operator Instructions] David Paz, Bank of America.

Q - David Paz {BIO 16573191 <GO>}

Good morning.

A - Jeff Sterba {BIO 1426511 <GO>}

Good morning, David.

A - Ellen Wolf {BIO 1854557 <GO>}

Good morning, Dave.

Q - David Paz {BIO 16573191 <GO>}

Just on New Jersey, on the DSIC specifically, can you just walk me through how that will be implemented, if we look hopefully next year. And then just any expected earnings impact, but more specifically maybe capital deployment impact? Thank you.

A - Walter Lynch {BIO 6064780 <GO>}

Yes. Dave, this is Walter. I'll take that question. The Board of Public Utilities approved the DSIC program on May 1, but it's not effective until it's published in New Jersey register. We expect that to occur in early June and then American Water and New Jersey American Water will file the foundational filing shortly thereafter. BPU had 90 days to review that filing and when it is reviewed [technical difficulty] start investing and we'll invest for a six month period and then we'll make our first filing the Board of Public Utilities will then have 60 days to review that filing and approve it and then rates will go in effect at that point. We expect the impact to be sometime in the Third Quarter 2013.

Q - David Paz {BIO 16573191 <GO>}

And in terms of just how you allocate capital, should we expect higher percentage going in New Jersey versus other states versus historically?

A - Walter Lynch {BIO 6064780 <GO>}

Yes. I mean with this mechanism, it's [technical difficulty] in New Jersey. We're going to increase our investment there.

A - Jeff Sterba {BIO 1426511 <GO>}

Yes, you've seen Dave, I think a flow of capital into Pennsylvania into Missouri and now into New Jersey because that's what these mechanisms incent.

Q - David Paz {BIO 16573191 <GO>}

Great. Okay. And then on declining usage, can you say which states that you believe you have the mechanisms in place that address decline in usage?

A - Ellen Wolf {BIO 1854557 <GO>}

I'm sorry. Which states we've mechanisms in place that address the decline in usage?

Q - David Paz {BIO 16573191 <GO>}

Yes.

A - Ellen Wolf {BIO 1854557 <GO>}

Clearly, California, which had a balancing account for declining usage.

A - Jeff Sterba {BIO 1426511 <GO>}

New York.

A - Ellen Wolf {BIO 1854557 <GO>}

New York also has a similar account that takes into effect, declining usage as well as costs. And then in New Jersey, we now have a one-year forward look on it. Illinois has always been a -- it has been a future test year for us, so that has a one year look in it. Missouri, has recognized some of it as well.

A - Jeff Sterba {BIO 1426511 <GO>}

Pennsylvania.

A - Ellen Wolf {BIO 1854557 <GO>}

And Pennsylvania definitely as time through [ph] has recognized a one-year future on declining usage. And I'm sure I missed one state --

A - Jeff Sterba {BIO 1426511 <GO>}

Well, Kentucky is also --

A - Ellen Wolf {BIO 1854557 <GO>}

Iowa and Kentucky, yes.

A - Jeff Sterba {BIO 1426511 <GO>}

Kentucky is also a future test year. So that has built in now. A future test year in and of itself it does not fully meet what we believe is necessary, but if you do a future test year plus a roll forward, we're getting pretty close. And that's what happened in New Jersey.

Q - David Paz {BIO 16573191 <GO>}

Got it. Okay. And then just last to clarify, Jeff, I think you said that you filed two cases year-to-date and Ellen you said one. How -- just to clarify how many cases have been filed year-to-date?

A - Jeff Sterba {BIO 1426511 <GO>}

We have filed two, one of which has already been resolved. And so it's kind of odd, but it's a very small operation and we filed and it has already been accepted and approved. So that's why we only have one outstanding.

A - Ellen Wolf {BIO 1854557 <GO>}

We have this internal debate whether Michigan is really a filing or not since we have the ability to put in rates after we have submitted our letter notifying them.

Q - David Paz {BIO 16573191 <GO>}

Actually got it. Okay. Thank you.

Operator

Thank you. Heike Doerr, Robert W. Baird.

Q - Heike Doerr {BIO 15084832 <GO>}

Thank you. Good morning.

A - Jeff Sterba {BIO 1426511 <GO>}

Hi, Heike.

A - Ellen Wolf {BIO 1854557 <GO>}

Good morning.

Q - Heike Doerr {BIO 15084832 <GO>}

Not to believe are this New Jersey rate case, but I wondered if we could talk a little bit about the ROE, I believe you calculated it via --.

A - Jeff Sterba {BIO 1426511 <GO>}

We'd like to talk about your twins Heike.

Q - Heike Doerr {BIO 15084832 <GO>}

They are still inside, eight weeks to go.

A - Jeff Sterba {BIO 1426511 <GO>}

Hang in there.

Q - Heike Doerr {BIO 15084832 <GO>}

That's a nice way to distract from my ROE question, Jeff.

A - Jeff Sterba {BIO 1426511 <GO>}

Heike, I would never do that to you.

Q - Heike Doerr {BIO 15084832 <GO>}

Walter, you mentioned that there was $10 million that was related to O&M if we look at that 95.5 [ph] as our starting base, maybe it makes more sense to think about it as 85.5 [ph]. I know the ROE is a little bit below what the going rate has been in New Jersey. Is there anything you can comment on that?

A - Ellen Wolf {BIO 1854557 <GO>}

We believe Heike our ROE is in line with what [inaudible] and United and others have perceived as well.

Q - Heike Doerr {BIO 15084832 <GO>}

Okay. I thought that those companies had during their last rate proceedings, the most recent being completed in February, had been at a 10.3 [ph]?

A - Ellen Wolf {BIO 1854557 <GO>}

Now they are at 10.15 [ph], I think is what [inaudible].

Q - Heike Doerr {BIO 15084832 <GO>}

Okay. And as we look ahead, Ellen, I believed you mentioned, we were expecting four rate cases in 2012, does that include the Michigan and the Virginia case that's already been filed or is that four more from here on out?

A - Ellen Wolf {BIO 1854557 <GO>}

It does include the Virginia case that has been filed.

Q - Heike Doerr {BIO 15084832 <GO>}

Okay. And can you share with us what states those are?

A - Ellen Wolf {BIO 1854557 <GO>}

No. Heike it is our philosophy to believe that really the first person we show that with is the regulator and their staff.

Q - Heike Doerr {BIO 15084832 <GO>}

Okay. Thank you.

Operator

[Operator Instructions] Kevin Cole, Credit Suisse.

Q - Kevin Cole {BIO 18674088 <GO>}

Hi Jeff. Can I just ask a quick follow-up question on the dividend. As I believe you have been doing some I guess a grassroots like conversations with your investors to see what they want from a yield and a part [ph] perspective. I guess like how do that shape up and were you able to get an indication from your investors if they want to keep doing a stay and then I guess in a sub 3.5% water, I guess normal payout ratio or be elevated to more like an electric in the mid-4% range?

A - Jeff Sterba {BIO 1426511 <GO>}

You know what you're applying to in those conversations which I have found very helpful and interesting is people obviously are -- have a little different perspectives on the basis of what kind of a fund they run et cetera. But the fundamentals were predictable, stable and growing, and those are the three components that I think were common in all of the folks that we've talked to. And so that effective, that is what we'll be guiding us going forward.

When I say stable that doesn't mean that you don't change at all, but it means that it's -- that [inaudible] risk of it being -- having to be caught obviously. And the predictable really goes to the -- the more of the notion of the dividend policy as opposed to what the specific dividend is. We had good conversations with different approaches that have been used by different firms. And I think you'll see from us an approach going forward that will be predictable, stable and growing.

Q - Kevin Cole {BIO 18674088 <GO>}

I guess the -- I guess in the recent years, the dividend increases have not tracked the EPS growth?

A - Jeff Sterba {BIO 1426511 <GO>}

That's correct.

Q - Kevin Cole {BIO 18674088 <GO>}

And so should we think of there's going to be like a I guess a one-time true up in the payout or in the -- sorry?

A - Jeff Sterba {BIO 1426511 <GO>}

Kevin, as you know, the dividend decision is a subject matter for the Board and their action. I think what you'll see is something that fits those criteria of predictable, stable and growing. I'll tell you that I have a personal bias against things where you do one times, whether it's big jumps or ex dividends, those are rare times when I think those kinds of approaches are appropriate.

Q - Kevin Cole {BIO 18674088 <GO>}

Okay. That's fair. And then did you -- did you say earlier when the Board is deciding the dividend?

A - Jeff Sterba {BIO 1426511 <GO>}

Well, we meet often on and all throughout the year. So no, we have not said when a specific decision, our next declaration, I can't remember when the date is scheduled, yes.

Q - Kevin Cole {BIO 18674088 <GO>}

Okay. But your investor meeting is next week, is that right?

A - Jeff Sterba {BIO 1426511 <GO>}

Our annual meeting is next week.

Q - Kevin Cole {BIO 18674088 <GO>}

Okay. All right. Thank you, sir. Appreciated it.

A - Jeff Sterba {BIO 1426511 <GO>}

You bet. Thank you.

Operator

Spencer Joyce, Hilliard Lyons.

Q - Spencer Joyce {BIO 17611965 <GO>}

Hey, Good morning, guys. Nice quarter.

A - Ellen Wolf {BIO 1854557 <GO>}

Hi.

Q - Spencer Joyce {BIO 17611965 <GO>}

I had to hop on here, kind of like so I apologize in advance if may have already covered this, but just a couple of quick questions. The $1.90 to $2 guidance range that is continuing operations, correct?

A - Jeff Sterba {BIO 1426511 <GO>}

Correct.

Q - Spencer Joyce {BIO 17611965 <GO>}

Okay. And just the other one regards the expense side, it looks like we had a real nice quarter, bringing down some employee-related costs. I'm just wondering if you all can provide a little color on maybe how close you all are to sort of a terminal destination there, or should we expect some significant improvement in some future quarters?

A - Jeff Sterba {BIO 1426511 <GO>}

Well, we've given -- we've made public a goal of having an operating efficiency ratio of at least no greater than 40% by 2015. We're certainly on target, I think to hit that kind of a goal maybe even to be able to beat it a little bit. It's not just what our absolute level of operating costs are, because we have re-run two very different businesses, our regulated business is capital-intensive, our market-based business is operating cost intensive. So we really look at the two as separate pieces.

You also keep in mind that one of the major things we've got going on now is our business transformation project which is bringing to the table, new platform IT systems that we have not had. Over time, we expect that to be able to help reduce operating cost because we will not have to do as much as we're doing today manually. Now that doesn't happen on day one that the systems get implemented and those systems start being implemented in August of this year through about the same time probably next year in three different phases.

But it takes a little bit of time to get people comfortable to these systems and then we can use attrition and the like to help continue to reduce the employee side expenses of running the basic business. Ellen, anything you'd add?

A - Ellen Wolf {BIO 1854557 <GO>}

All right. I think that's it. And again when you look at our operating expenses, the total transformation we are going through with our systems will impact all lines of our expenses, including things like today we can't do an electronic bill, so we will be able to do that in the future. So we will expect to see less printing costs, less mailing costs. So again, we're looking at all lines that will be impacted as we put new and much more customer friendly systems in.

Q - Spencer Joyce {BIO 17611965 <GO>}

Okay. Yes, so it looks like, we do have some ongoing things here?

A - Ellen Wolf {BIO 1854557 <GO>}

Yes.

A - Jeff Sterba {BIO 1426511 <GO>}

Yes.

Q - Spencer Joyce {BIO 17611965 <GO>}

Okay. Thanks a lot. That's all I had. Nice quarter.

A - Ellen Wolf {BIO 1854557 <GO>}

Thank you.

A - Jeff Sterba {BIO 1426511 <GO>}

Thank you.

Operator

Thank you. Ladies and gentlemen. this does conclude the question-and-answer session. I'd now like to turn the call back to management for any closing remarks.

A - Jeff Sterba {BIO 1426511 <GO>}

Well, I'll just thank you for your continued interest and support of what we're doing at American Water and again invite you to participate in our Annual Meeting and we look forward to seeing you down the road.

Operator

Ladies and gentlemen. this does conclude today's conference call. Thank you for your participation. You may now disconnect.