

Q1 2019 Earnings Call

Company Participants

- Edward Vallejo, Vice President of Investor Relations
- Linda G. Sullivan, Executive Vice President and Chief Financial Officer
- Susan N. Story, President and Chief Executive Officer

Other Participants

- Angie Storozynski, Analyst, Macquarie Capital (USA), Inc.
- Jonathan Reeder, Analyst, Wells Fargo Securities LLC
- Richard A. Verdi, Analyst, Coker & Palmer Investment Securities, Inc.

Presentation

Operator

Good morning and welcome to American Water's First Quarter 2019 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 May 9, 2019. 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 10130570. The online webcast will be available at American Water's Investor Relations homepage at <http://ir.amwater.com>.

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>}

Thanks, Brendon. And good morning, everyone, and thank you for joining us for today's call. We'll keep the call to about an hour and at the end of our prepared remarks, we will be opening the call for your questions.

During the course of 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 other 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, each as filed with the SEC.

Reconciliations for all non-GAAP financial information discussed in this conference call 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 of our website. All statements in this call related to earnings and earnings per share refer to diluted earnings and earnings per share.

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

Susan N. Story {BIO 3335156 <GO>}

Thanks, Ed. Good morning everyone and thanks for joining us. Before I discuss our first quarter earnings results, I'd like to talk about Linda Sullivan's retirement. While we made the announcement yesterday, she will remain as CFO until July 1 and will stay with us until August 1, to ensure a smooth transition. This is especially bittersweet for me as Linda and I have been a team and she began her tenure as CFO in early May of 2014, when I moved from the CFO position to CEO. But her family is growing, in addition to her two beautiful grandsons, who met in presentation at our Investor Day last December. Her son and daughter-in-law in California are expecting her first granddaughter in June.

We're happy for Linda and in a few minutes, you will tell you more about our plans. Her accomplishments are to to list, but I would highlight that from 2014 through 2018, our EPS has grown at an 8% CAGER, our annual dividends have increased at a 10.1% CAGER and our stock price has risen from \$46.22 on May 1, 2014 to \$107.10 then yesterday's closing. I'm reminded of an executive team meeting in 2014, when we ask each person for his or her top aspirational goals for American Water, literally Linda said quote for our stock to go over \$100 per share.

Linda, we did it. Linda also oversaw the raising of \$4.4 billion of financing capital over the past five years. She rebuilt our tax and risk management functions with industry leading talent and she's led significant improvements in our supply chain processes. She also designed and developed the financial strategy and planning organization and she has recently said at digital finance within her organization, one of the first in the utility industry. She has also been very involved in our corporate wide growth customer and people initiatives and she helped us recruit her successor, Susan Hardwick whom she has known for several years.

Many of you also know, Susan who serve more than six years as CFO of Vectren, she has 35 years of deep Finance and regulated utility experience. She most recently led the execution of the \$8.5 billion Vectren sale to CenterPoint Energy. Susan is strongly committed to customers, constructive regulatory relationships and building better communities. She prioritizes employee development and the building of collaborative and successful teams. She has a strong record of living in leading the values we have at American Water and is a tremendous fit for our company. She will join our company on June 3, as Executive Vice President of Finance until she takes the CFO reigns from Linda on July 1.

She's actually here in the room with us today. Linda, would you like to say a few words?

Linda G. Sullivan {BIO 7300156 <GO>}

Yes. And thank you Susan for your very kind words and your inspirational leadership. I have learned more from you in the last five years than in my entire career and I thank you immensely.

My husband and I took the road less traveled when we moved from California to New Jersey five years ago, and being part of the American Water team turned out to be the best career decision of my life, and I would not trade this experience for anything in the world.

And to our analysts and investors, I want you to know that one of my favorite things to do is to meet with you and discuss the American Water story and listen to your insights and views. You are truly the grand teachers and thought leaders of our industry. It has been an absolute pleasure learning from all of you.

So now, after 30 years in the utility industry, this decision to retire is the hardest career decision I have made, and at the same time the easiest personal decision for me and my family. It's hard because I love everything about American Water, the leadership team, my colleagues, my team, the board, and our collective ability to do what we say we're going to do. I believe American Water is the best-run utility in the nation and with our announcement today, bringing Susan Hardwick onboard, I am confident it will continue to be just that.

Personally this is an easy decision for me. My coast-to-coast family is rapidly expanding with two grandsons and a granddaughter due in June, and I am fortunate in this stage of life to be able to follow that strong pull of my heart. And it's really hard to explain the way grandchildren make you feel, but there is a song lyric and it's by Andy Grammer that sums it up pretty well. It says, "I think I finally found my hallelujah." So I also love the work I do on several boards and I'm eager to spend more time pursuing that passion. Plus my bucket list is approaching the size of a novel, and my husband Tom and I look forward to living those dreams.

I would like to thank the leadership team and Board for being so understanding and gracious about my decision and working with me through a strong succession plan. I am thrilled to have Susan Hardwick join the team. She will bring tremendous value to American Water.

Susan N. Story {BIO 3335156 <GO>}

Thanks, Linda. As always, Linda will cover our financial results in just a few minutes. Unfortunately, our COO, Walter Lynch is in Arkansas due to the passing of his father-in-law, Alex Street. Many of you know that Walter is a West Point graduate and an Army veteran, and Mr. Street also served our country in the Army. At 80 years old, he was still a practicing attorney after more than 50 years. We applaud his life's commitment to his family and the values we hold dear at American Water; integrity, service, and unwavering commitment to his community and country.

So now, moving on to our first quarter results. The employees of American Water delivered solid performance and further strengthened our low-risk and predictable growth story. Our first quarter 2019 adjusted earnings per share were up 3.4% compared to the first quarter of 2018.

As a reminder, we had an extraordinary first quarter of 2018 with a 13.5% EPS increase from the previous year, primarily due to the impact of finalizing both the Pennsylvania and the Missouri general rate cases in 2018, which Linda will discuss in more detail. While American Water does not give quarterly guidance, our first quarter results were a \$0.01 ahead of plan for the quarter.

Given our performance year-to-date, we are affirming our 2019 adjusted EPS guidance of \$3.54 to \$3.64 per share as well as affirming guidance to the top half of our 7% to 10% EPS compound annual growth rate through 2023. Also, consistent with our previous dividend guidance, on April the 17th, our board of directors increased our quarterly cash dividend payment from \$0.455 to \$0.50 per share, a 9.9% increase. The company has increased its dividend every year since our IPO in April of 2008 with consistent annual increases of around 10% per year since 2013.

The foundation for our earnings growth continues to be the capital investment we make in our regulated operations so that we can provide clean, safe, and reliable service. We invested \$337 million total this quarter, with the majority for infrastructure improvements in our Regulated Businesses.

We minimize the customer bill impacts of these investments through a continued focus on controlling O&M costs. These cost savings are driven by optimizing capital spend through value engineering and volume procurement, constructive regulatory mechanisms, and deploying technology developed with input from both our employees and our customers. I'll talk more on the next slide about our continuing progress on regulated acquisitions and their contributions to our long term growth story.

Earnings were up year-over-year in our Market-Based Businesses. This was due primarily to growth in customer contracts from Homeowner Services. Of note, we have a very successful new partnership with Philadelphia where we have added more than 100,000 contracts since we launched the partnership in October of 2018.

That type of growth would not be possible without our exceptional customer service and our combined Homeowner Services has an A+ rating from the Better Business Bureau. Our Military Services Group added the Wright-Patterson Air Force Base contract in 2018, and we began full operations at Fort Leonard Wood Army Base yesterday, May the 1st. We still expect to see decisions by the Department of Defense on up to three military base awards for which we are competing this year.

Turning to slide 8, let's talk more about growth across our regulated footprint. We have closed on five acquisitions in four different states so far in 2019. Three of these were water systems in Kentucky, Indiana, and Missouri, and two were wastewater acquisitions in Kentucky and Pennsylvania. These closed acquisitions resulted in 4,700 new customer connections, and they join more than 3,000 customer connections we added through organic growth in the first quarter.

We also look forward to adding another 61,500 customer connections through signed agreements in nine states, most of which we expect to close in 2019. This includes our most recent agreement to acquire East Pasadena Water Company in California, adding 2,900 new

connections. Just as a reminder, typically a customer connection or meter represents on average 2.5 to 3 people based on a specific state.

At American Water, we believe that all people should have clean and safe water at affordable prices, regardless of where they live or their socioeconomic status. These new agreements reflect our commitment to provide water and wastewater solutions to communities across the United States.

Moving to slide 9. 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 we make these critical investments to maintain reliable service, we must also ensure affordability for our customers. We do this by putting a laser focus on both O&M efficiency as well as capital investment efficiency. This is why our 31.5% O&M efficiency goal by 2023 is so important. As a reminder, this ratio represents how many cents of O&M we spend for every dollar of revenue. Meaning we want more dollars to go to investment so we can make our system safer, stronger, and more reliable.

Our employees live in the communities we serve, and they're committed to serving their neighbors and families with the best quality water and water services at affordable prices. Let me give you just one example of how we're driving further efficiencies. We're finding that due to a growing national shortage of trucking personnel, the prices of materials and equipment are rising and scheduling has become more challenging. So we developed a supply chain strategy to continue to diversify and optimize our suppliers and their willingness to locate closer distribution points so their state's operations are more cost effective. When we roll these savings into other cost efficiencies we get by leveraging our large size and purchasing power, we will save approximately \$33 million a year just on the purchase of meters, hydrants, valves, and pipes.

Slide 10 summarizes many of the points I just covered. Again, we're affirming our 2019 EPS guidance range of \$3.54 to \$3.64, as well as affirming guidance to the top half of our 7% to 10% EPS compound annual growth rate through 2023. We're off to a good start this year, and we look forward to continuing to deliver stable and predictable results.

And with that I'll turn it over to Linda for her comments.

Linda G. Sullivan {BIO 7300156 <GO>}

Thank you, Susan. I'll start on slide 12 we had a solid first quarter of 2019, especially compared to a very strong first quarter 2018. GAAP earnings were \$0.62 per share, an increase of \$0.03 compared to the first quarter last year. Included in GAAP earnings was a favorable adjustment of \$4 million or \$0.01 per share to reflect a reduction in the settlement liability related to the Freedom Industries chemical spill. This reduction is based on our latest determination of the final claims costs. In total, our share of the original \$126 million Freedom Industries related settlement has been reduced to \$19 million through insurance recoveries and lower claims. Excluding this benefit, first quarter earnings were up 3.4%, which came in \$0.01 above our plan on strong Market-Based earnings offset partially by timing items in the Regulated business and parent.

Other highlights include achieving a consolidated adjusted return on equity of 10% for the 12-month period ended first quarter 2019, executing on our capital investment strategy by investing \$337 million during the quarter and adding \$36 million in annualized new authorized revenue since the beginning of this year.

Turning to slide 13. Let me provide more detail on our first quarter adjusted earnings results. I'll start from the left hand side of this page. As you can see, we had a very strong first quarter of 2018, up 13.5% over first quarter 2017 on settlement of both the Pennsylvania and Missouri general rate cases last year. First quarter 2019 increased 3.4% on a quarter-over-quarter basis, which reflects some timing impacts that I will discuss in more detail as I cover each business.

Let me start with our Regulated Businesses, which were up \$0.01 per share. Revenue was up \$0.08 in total and included increases from authorized rate cases, infrastructure mechanisms, and acquisitions. These increases were partially offset by lower demand and a \$0.02 benefit in the first quarter of last year as our Missouri general rate case did not begin to adjust customer rates for the lower federal income tax rate until May 28, 2018. Lastly, I should note, we did not see any material impact from weather during the first quarter of 2019.

Next we had higher O&M expense of a \$0.01 per share from something we are very proud of. Through finalization of our union-negotiated national benefits agreement last year, we now include our 17 national unions in our annual performance plans. This puts our 7,100 employees on the same annual performance plan where the annual payout is based on company performance tied to the goals you see in our proxy statement. So from our CEO to the frontline our goals are aligned. We believe this investment in our employees will further enable us to meet our OEM efficiency goals allowing us to reduce the customer bill impact of our critically needed infrastructure investments. Depreciation and interest expense were each up \$0.03 per share to support investment growth.

Our Market-Based businesses had a strong quarter, up \$0.04 or 57%, with Homeowner Services up \$0.03 from the acquisition of Pivotal and new customer additions. Military Services was up a \$0.01 from the addition of Wright-Patterson Air Force Base and an increase in capital work at Vandenberg. Lastly, the parent decreased \$0.03 from three separate items, each a \$0.01 per share. First, we had higher interest expense to support growth, next we had a tax adjustment that was favorable in 2018, and we also had a \$0.01 of expense timing.

Turning to slide 14. I will provide an update on our regulatory proceedings. We settled two rate cases in the first quarter of 2019 in West Virginia and Maryland and implemented our third year rate increase under our four-year plan in New York effective April 1st. In West Virginia, we received approval of an annualized revenue increase of \$19 million, an ROE of 9.75%, and an increased equity ratio 48.4%.

The case was driven by \$200 million of infrastructure investment since our last rate case in 2016. Additionally, the distribution system improvement charge was reset to provide for additional investment. This surcharge will be offset by the amortization of deferred tax savings under the Tax Cuts and Jobs Act.

In Maryland, we received approval of an annualized revenue increase of over a \$1 million, an estimated ROE of 9.9%, and an equity ratio of 48.7%. The case was driven by \$18 million of investment since 2015. During that time, the company constructed a new 90 million gallon reservoir and intake near Bel Air, Maryland. This new reservoir is now in service and provides a long-term safe and reliable water supply and economic opportunity in that region.

We also have three pending rate cases in Indiana, Virginia, and Kentucky, and filed our preliminary application for our California general rate case. In Indiana, we reached an agreement with the major parties on our rate case. If approved, the new rates will reflect a revenue increase of 7.5 -- \$17.5 million over two steps, an ROE of 9.8% and an equity ratio of 53.4%. The settlement shows that at the end of the 2020 future test year, Indiana American Water will have invested over \$500 million in infrastructure upgrades since its last rate case in 2015. Regarding the Tax Cuts and Jobs Act, Indiana American already reduced its customer rates by 4.4% on August 1st, 2018, and the agreement includes credit -- includes credits for the period before August 1st to be spread to customers over 12 months starting in May 2020. A final order is expected by mid-2019.

Moving to Virginia. We implemented interim water and wastewater rates on May 1st. The general rate case requested an overall increase of \$5 million, driven by approximately \$98 million in infrastructure upgrade since April of 2017. The final rate order could take several months.

In Kentucky, our general rate case requested nearly \$20 million in additional annualized revenues and was driven by more than \$100 million in capital investment since the last rate case in 2016. And yesterday California American Water filed a preliminary application for its 2021 through 2023 general rate case that includes a first year revenue increase of \$23.9 million followed by annual step increases that would support \$200 million of infrastructure projects. California is also awaiting a decision on its step increase for 2019.

Turning to slide 15. Today we are affirming our 2019 adjusted guide -- earnings guidance range of \$3.54 to \$3.64 per share. This excludes the \$0.01 favorable impact from the reduction of the liability associated with our Freedom Industries related settlement, which is included in our 2019 GAAP earnings guidance range.

Included in our annual guidance range are several variables with the most significant potential variable being the impact of weather. And as a reminder, we consider plus or minus \$0.06 of weather to be normal weather variability included in our earnings guidance range, with the largest weather impact typically occurring in the summer month or third quarter of each year. On a long-term basis, we are affirming our 2019 to 2023 long term EPS guidance in the top half of our 7% to 10% compound annual growth range, anchored off 2017 adjusted earnings.

Turning to slide 16. Let me discuss our balance sheet. As we look at our cash flow impact from tax reform, originally we expected lower cash flow of about \$500 million from 2018 through 2022. This has improved by a \$120 million following the Pivotal acquisition. You can see that the estimated impact is largest in 2020 when we expect to become a cash taxpayer, but then declines quickly as rate base grows and becomes positive by 2022.

Also as we continue to refine our estimates, we are now forecasting becoming a cash taxpayer in the second half of 2020 versus our prior estimate at a full year in 2020. Now the actual impact will be largely dependent upon the outcome of our regulatory proceedings regarding tax reform.

Also I am pleased to report that our 2018 debt to capitalization ratio came in better-than-expected at 59% in 2018, further showing our balance sheet strength and cash flow management. Incorporating the better 2018 results into our five-year plan, we have lowered our expected long-term debt-to-cap levels by a full percentage point to a range of 61% to 62% by 2023. And I should note the debt-to-cap ratio includes both long-term and short-term debt.

In terms of credit ratings, earlier this year Moody's downgraded American Water from A3 to Baa1 with a stable outlook. Although disappointing, we expect the impact to be minimal. And as you know, in the second quarter of 2018, S&P affirmed our A credit rating with a stable outlook. In summary, we continue to have a very strong balance sheet, and we do not see the need to issue new equity with our current five-year plan under normal operating conditions.

Turning to slide 17. We are committed to continue to deliver customer and shareholder value. With our announced increase in dividends of 9.9%, our five-year compound annual growth rate in dividends is 10.1%, and we have now had consistent annual dividend increases since 2013. Looking forward, we expect to grow our dividend at the top end of our 7% to 10% EPS growth range subject to board approval, and we continue our targeted dividend payout ratio of 50% to 60% of earnings.

Our total company adjusted return on equity is holding steady at 10% for the 12 months period ended March 31st. Our weighted average authorized return on equity across our regulated footprint remains at about 9.8%, and we have consistently delivered strong total shareholder returns, far outpacing the UTY Index and S&P500 over the one, three, and five-year periods. Through this disciplined financial management, customers and shareholders may be confident that American Water will continue to deliver value.

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

Susan N. Story {BIO 3335156 <GO>}

Thanks, Linda. We never forget at American Water that at the end of every water pipe there's a family depending on the safety of the water they give their children, that at every fire hydrant lives depend on the water being there at the right pressure, that at every wastewater plant we are a shield between our customers and disease.

We're very proud to announce our most recent award from the Water Research Foundation to continue research on Legionella. While Legionella is primarily an issue in customer-owned plumbing and not even on our side of the meter, we think it's critical that we further educate and protect our customers from contaminants that could impact their water quality. As a reminder, we've had an R&D group at American Water since 1981, and our newest research grant is one of over 100 we've received on topics ranging from emerging contaminants to water recycling and reuse to groundbreaking water technologies.

We know that employees, customers, and investors are seeking to align themselves with and invest in companies that are actively committed to the betterment of society, our planet, and our communities. We believe that successful financial performance follows doing these things as part of our purpose-driven values culture.

I was fortunate to be asked to participate on a panel at a recent S&P Global ESG Evaluation launch. The key topics at the launch were ESG risk quantification, developing more standardized ESG measures, and improving timeliness of reporting. S&P as well as Moody's have indicated that ESG measures will be an important input into evaluation of risks to overall financial performance capability of companies and their subsequent credit ratings. We're committed to bringing even more transparency in giving you the ESG information that you want, but the wide-ranging and non-standardized measurements today create inconsistency in reporting and comparisons.

Timeliness of data is a big issue as many of the rankings and ratings we've seen recently are based on data from as far back as 2016 and don't reflect progress that many companies have made over the past few years. We've engaged a leading ESG consulting firm, and they've recently completed a materiality assessment for us. This effort included detailed interviews with and data research from investors, credit rating analysts, regulators, customers, elected officials, environmental and ESG activists, and our own board members and employees. We will use that input to provide more complete and timely information that is most important to the stakeholders we serve, and we look forward to your continuing feedback.

In closing, I mentioned earlier about the professional accomplishments of Linda Sullivan over the past five years, but I would be remiss if I didn't end on something even more important, her personal influence and impacts on the heart and soul of who we are as a company. Linda has the highest integrity. She's smart, quick, and strategic, and she's always asking how can we get better. She cares deeply about our employees, our customers, our communities, and our shareholders. She has been a CFO that I depend on every day to do the fundamentals the very best and to look beyond the horizon to what's next. She treats every single person with respect and dignity. I can honestly say that I have learned something from her every day. She is my colleague, my hero, and my friend, and I will miss her tremendously.

For those of you who know her well, you understand this last slide. Linda loves three things very much: her family, American Water, and Corvettes. So many of you will see Linda, Susan, and me with Ed and Ralph over the next two months on investor visits. And while Linda is not retiring until August 1st, this will be her last earnings call.

And in a nod [ph] of things to come, I will share with you another first for American Water. We are one of only three S&P 500 companies with a female CEO and CFO team, and on July 1st we will have the distinction as the only company where both women even have the same first name, just another way we're trying to make things easy for you.

So with that, we're happy to take your questions.

Questions And Answers

Operator

We will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Angie Storozynski with Macquarie. Please go ahead.

Q - Angie Storozynski {BIO 15115714 <GO>}

Thank you. Linda, congratulations. I'm really happy for you, and we will live vicariously through your travels.

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

Thank you so much, Angie.

Q - Angie Storozynski {BIO 15115714 <GO>}

Thank you. So I wanted to ask about California about the recent acquisitions. I mean I was a little bit surprised. I always thought that most of the municipal M&A is going to come from the Northeast. Some of those are not muni M&A. But could you talk a little bit more about this?

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

Sure, Angie, and thank you for the question. So this is what we call, as you know, a tuck-in. And in California, there is significant interest from the Public Utility Commission to help distressed systems throughout the state. We saw that at the cost of capital hearings and some of the discussions that resulted in the increase in our cost of capital.

Our plan that we guide to is basically assuming that all of our acquisitions are these smaller tuck-ins, and you will have larger systems, of course, as you said, and if you look at our history of acquisitions, more have been in the Northeast and the Midwest. This was an opportunistic acquisition. We're pleased to have these folks onboard. It's a roll into service area where we already are, and again we have in the past several months seen for us anyway constructive outcomes at the California PUC, including the approval of the Monterey desalination facility as part of the water supply project, as well as the last general rate case outcome.

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

And Angie if I can add to that, in our cost of capital decision, as Susan mentioned, we did have a lot of conversations about investments in California. And it's really important to note that although our ROE decreased to 9.2% in that proceeding, our equity ratio increased from 53% to 55.4%.

Q - Angie Storozynski {BIO 15115714 <GO>}

Great, thank you. And just one last question about New Jersey. Is there any progress on the implementation of this New Jersey Quality [ph] Accountability Act, meaning as far as it relates to municipal M&A?

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

That's a great question, Angie. So many of that the first step in implementation was that water providers in the state of New Jersey were going to have to certify to certain parts of those regulations. That is happening, though, as the regulations are currently still being developed by the DEP in New Jersey to be rolled out further. So we were the first to certify. For us, it was more business as usual. So we are just now starting to see some of the certifications coming in. It's our understanding that there may be one or two I think a university that may be looking at consolidating those type of certifications and looking where different systems stand in the state. So it's in the early stages. The regulations are still being promulgated, and we look forward to a continuing rollout over the next probably six to 12 months.

Q - Angie Storozynski {BIO 15115714 <GO>}

Fantastic. Thank you, ladies. And Linda, congratulations.

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

Thank you, Angie.

Operator

Our next question comes from Richard Verdi with Coker & Palmer. Please go ahead.

Q - Richard A. Verdi {BIO 15139674 <GO>}

Hi, good morning, everyone. Thank you for taking my call. And before I ask my question, I just wanted to say, Linda, I wish you all the best in your retirement. Congratulations and that I really appreciate all the time that you gave me from when I would pester you for -- to do conference calls with investor with me or to go on a road to visit investors. So I appreciated all that time and I wanted to say that to make sure you knew that, and I wish you all the best in your retirement. Congratulations on a well-deserved retirement, too, I'm sure.

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

Rich, thank you so much, and it was my pleasure to have those discussions with you.

Q - Richard A. Verdi {BIO 15139674 <GO>}

Thank you. Thank you very much. So just kind of -- I'm pretty clear on everything for the quarter. Just kind of I guess more of a high-level question. Last month we saw the New Jersey Department of Environmental Protection announce that it had planned to set standards for the PFOS contamination and they're much more strict than the EPA's guidelines. And it appears other states are going to implement similar standards as well. So I was just kind of hoping maybe you could discuss a little bit about how that could impact the company on the regulated side in terms of the acquisition front. And then on in terms of what it could mean to cost to the company since it'll -- it's going to need to deal with the stricter standards as well? And then on

top of that, how it could also impact the company in terms of the military business, because a driver of this contamination is caused by the fire extinguisher firm -- foam used on these military bases every day when they're running their drills. And so I would think that that would be something with this -- with this PFOS contamination could be an impetus to see more of those military bases pursue O&M contracts with the likes of American Water. So just wondering if you could give us some high-level color on how this PFOS contamination could impact the company.

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

Rich, thank you for this. This is probably one of the largest emerging issues that will need to be addressed across the country, both from states that are doing their own limits on PFOS as well as EPA actually yesterday came out -- what most people don't understand, while the EPA has a recommended maximum contaminant level, there really isn't a regulation. It is not actually a regulated chemical. What it is, is they're recommending not to have over certain limits, but they don't have the force of regulation behind it. The EPA came out yesterday, I read, and basically said they are going to do it. They're looking at the level that they were using for maximum contaminant levels that weren't regulated of 70 parts per trillion. New Jersey, as you mentioned, has come in with a much lower, I believe 13 parts per trillion.

To your point about the company, I mentioned it's interesting you ask this question because I mentioned in my final remarks about the role of our R&D group. We've been doing research on these perfluorinated chemicals for decades. And in fact -- and I'll talk about Military first, then I'll come back to the Regulated business. We have actually already been working on a couple or three of our military bases to actually treat PFOS. We have mobile units where we can actually do on-site decontamination and, for example, at Picatinny Arsenal in New Jersey, we've done tremendous work already with a couple of wells there that we serve.

We believe from a military installation standpoint, it's actually a competitive advantage for us. We have treated to levels that are at or below what the New Jersey requirements are. We know how to do that. So this is a serious situation. And if you want to get a nice four or five page primer for those out there who want to know the National Institutes of Environmental Health Services has a wonderful three or four page primer because some people use PFOS, PFOA, they're all part of a group of PFCs called perfluorinated chemicals, and they're all manmade materials, and the issue comes in is that they are, as you said, firefighting foam, Teflon, it comes from even Stainmaster, things that repel grease and water, and it's been used for decades. And so what has happened is as it gets into the water source or the environment that it just stays and it's consumed by humans. It just doesn't get released from the body for years and years, and that's where the concern is coming.

So this is a very serious issue. We applaud all of the different states as well as the EPA for making this a priority. We actually see this as a very good thing. We are very supportive of all of the actions being taken on the PFCs in our different states, and we really want to be part of being a solutions provider for those and see it as a strength given all the research and actual deployment we've done on how to decontaminate these out of water supplies.

Q - Richard A. Verdi {BIO 15139674 <GO>}

That's excellent color. Thank you very much, Susan. I appreciate the time, guys. And again, Linda, I'm going to miss you. Congratulations. Thank you, guys.

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

Thank you.

Operator

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

Q - Jonathan Reeder {BIO 18909775 <GO>}

Hey, good morning, y'all. Wanted to echo everyone else's remarks. Linda, congrats on the retirement decision. I know you're going to continue to have fun through the rest of your life as you have been while at American Water Works. And I think I understand how that's an easy personal decision for you to make. Then last one I thought when Susan was saying for the first time in American Water Works history and had just been talking about Corvettes, I thought she was going to say there was a new Corvette waiting for you in the parking lot. Maybe they don't like you that much, I don't know.

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

I was hoping that too, Jonathan. But it could still happen.

Q - Jonathan Reeder {BIO 18909775 <GO>}

(inaudible), yeah. So anyway, Susan, just wanted to ask you, in light of the recent rate case outcome, how do you think about West Virginia in terms of being a core state for you, I know in some previous rate cases there, they were challenging outcomes plus kind of the way the Freedom event was treated seemed less than kind of equitable to you guys. So just wondering how do you view West Virginia today.

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

So West Virginia, first of all, for those who've never been there, it's a beautiful state and we have been in West Virginia since the 1880s. And the last two rate case outcomes we've had, including a settlement. I mean this was a settlement reached with all parties, were very constructive, because in West Virginia there's a realization, maybe as much as any other state, about the importance of clean water and safe water, and it's not just an issue for American Water. The public providers of water there and wastewater services see the same thing. So we have some wonderful employees in West Virginia. We have some outstanding customers in West Virginia, and we're very excited that there is a growing realization from all of the parties, the stakeholders as well as the Regulatory Commission, about the importance of investment for the future to ensure that that state can continue to grow economically and have a safe water, wastewater, and fire protection system for its citizens.

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

And Jonathan, I'll add to that as well. As you know, West Virginia now has a DSIC mechanism as well for continuing investment in the state. And as part of our settlement of the -- of the rate case, they authorized a 9.75% ROE, which is the same that we had in the last case, but they also increased the equity ratio from 45.84% to 48.4%, so really showing the need for attracting capital to the state.

Q - Jonathan Reeder {BIO 18909775 <GO>}

All right, yeah, good stuff. Glad, things are improving there for sure. Linda, did you quantify what the weather impact the headwind was in Q1 '19 then. I mean I know it's usually not overly sensitive, but ...

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

Yeah, we did not have any, really at all, weather impact in the first quarter.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay. I thought I heard you say that that was a bit of a headwind. Sorry about that. And then I also kind of missed what you said was driving the expected 1% improvement from your prior forecast in the 2023 debt to total cap ratio going to 61% to 62%. What were the drivers there?

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

So it was really kind of refining our estimates. Our actual came in much better than we thought for 2018, and we also have had a very, very strong focus on cash flow management.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay, okay. All right. Well, thank you very much and enjoy the future; I know you will.

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

Thanks, Jonathan. And that's the last question, and we 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 also want to be open and transparent in all of our discussions and dealing with all of you so that you can have confidence in your decisions around our company and investments in our stock.

If we have not been able to address your question or you have additional questions, please call Ed and Ralph, and they will be happy to help. You may also see in the next -- in the next few weeks or months the newest member of our Investor Relations team, Abbie Barksdale [ph] who is our new investor relations ESG manager. I'd like to remind everyone that our Annual Shareholders Meeting will take place a week from tomorrow, Friday, May the 10th. Thanks again for listening.

Operator

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

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