Q3 2022 Earnings Call

Company Participants

- Aaron Musgrave, Vice President, Investor Relations
- Cheryl Norton, Executive Vice President and Chief Operating Officer
- John Griffith, Executive Vice President and Chief Financial Officer
- Susan Hardwick, President and Chief Executive Officer

Other Participants

- Angie Storozynski, Analyst, Seaport
- Durgesh Chopra, Analyst, Evercore ISI
- Gregg Orrill, Analyst, UBS
- Insoo Kim, Analyst, Goldman Sachs
- Julien Dumoulin-Smith, Analyst, Bank of America
- Richard Sunderland, Analyst, JPMorgan
- Shar Pourreza, Analyst, Guggenheim Partners
- Steve Fleishman, Analyst, Wolfe Research

Presentation

Operator

Good morning, and welcome to American Water's Third Quarter 2022 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. The audio webcast archive will be available for one year on American Water's Investor Relations website.

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

Aaron Musgrave {BIO 22474483 <GO>}

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

Let me first go over some safe harbor language. Today, we will be making forward-looking statements that represent our expectations regarding our future performance or other future events. These statements are predictions based on 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 September 30 form 10-Q each filed yesterday with the SEC.

And finally, all statements during this presentation related to earnings and earnings per share refer to diluted earnings and earnings per share. Susan Hardwick, our President, and CEO will discuss third quarter and year-to-date highlights and touch on 2023 guidance and our long-term targets. John Griffith, our Executive Vice-President, and CFO will cover our financial results in more detail, and provide an update on active general rate cases and acquisition activity. And we'll close with further details on our 2023 and longer-term outlook including the overall financing plan.

Cheryl Norton, our Executive Vice-President, and COO will then discuss our capital investment plan, rate base growth expectations, and our focus on affordability. Cheryl will then conclude with a review of some important new operating goals and disclosures that align with our focus on ESG. We'll then close by answering your questions.

With that, I'll turn the call over to American Water's President and CEO, Susan Hardwick.

Susan Hardwick {BIO 16618718 <GO>}

Thanks, Aaron, and good morning, everyone. As Aaron said we have a lot to discuss this morning in addition to third quarter results. And specifically, we also want to cover today, our outlook for 2023 and our longer-term targets. As, you know, last year at this time we shared some significant news when we sold our Homeowner Services Business to transition to a pure play regulated water and wastewater utility. And that update we announced a new five-year plan, an acceleration of capital investments, and some adjustments to our financial targets.

The updates that we'll share today are largely an affirmation of last year's plan and targets with adjustments primarily reflecting the shift out to 2027 in our five-year outlook. We will also share additional thoughts and plans around our continuing ESG journey. So let's dive in and turn to Slide number 5, where I'll start by covering some highlights of 2022 to date. In the first nine months of 2022, earnings were $3.70 per share compared to $3.40 per share In the same period of 2021. Strong organic growth and increased earnings from infrastructure investments continue to be our year-over-year drivers for the quarter and year-to-date periods.

Favorable weather also added to results in the third quarter. Though we generally like others are experiencing a higher cost environment our team continues to deliver on our financial and operating plans. This includes staying on track to achieve our total capital investment goal of $2.5 billion in 2022 and executing on significant regulatory activities, including constructive settlements in two of our outstanding general rate cases. Further, we continue to effectively manage and mitigate cost increases and have been successful in recent regulatory efforts to further lessen the impact of inflationary pressures into the future.

These regulatory solutions are very important to our ability to manage inflationary headwinds as we move into 2023. So, I'm pleased that we have successfully executed our plan so far this year in a challenging and very active period. John and Cheryl will provide additional details on financial, operating, and regulatory results later in today's call. But before I move on let me comment about how excited we were to sign an agreement a few weeks ago to serve the nearly 15,000 customers of the Butler Area Sewer Authority in western Pennsylvania. This is another great example of how partnerships with municipalities can lead to positive outcomes for customers, employees, and the community at large. Our team worked very hard to understand the community's objectives and created an opportunity that we believe benefits all stakeholders.

Turning to Slide 6. As announced yesterday we affirmed our 2022 earnings guidance. We continued on track to meet our expectations for the year as we've indicated throughout the year. And in addition, we have had the incremental contribution from weather this quarter. Also yesterday we initiated our 2023 earnings guidance in $4.72 to $4.82 per share. This near-term plan, as well as our longer-term plan, remains very strong and with our record of execution, we are confident in our ability to achieve our earnings expectations for 2023.

Later, John will talk more about the drivers of our growth in 2023, but our expected growth builds on the accelerated CapEx plan we put forth last year. As we've said many times the full effect on earnings growth from the increasing capital spending will ramp up over time. John will talk further about our updated financing plan but this plan reflects our prior discussion that the growing investment plan will result in regular access to equity capital. As we've illustrated on this slide we expect our investments in infrastructure and regulated acquisitions to drive significant earnings growth through '27 and beyond.

Finally, on Slide 7, I want to make a few comments about our purpose here at American Water and how that drives our growth strategy, our operating plans, and our Company's targets and goals. Our mission is to provide safe, clean, affordable, and reliable water and wastewater services to the communities across the country. Our services are vital to sustaining life. So, while much has said in the news about the clean-energy transition that's happening, what drives us every day is an equally important need in our country. We believe that everyone should have access to safe, clean, affordable, and reliable drinking water and wastewater services and the communities are stronger because American Water has the privilege to serve them.

It's true that we have many similarities to other utilities and we embrace the knowledge-sharing in best practices that can come with those similarities. In fact, we joined EEI as the strategic partner a few years ago because of common values around customer service, safety, and cyber security, to name just a few. And as many of you know, I've spent most of my career in the gas and electric industry so I have a deep appreciation for the utility industry as a whole. However, the water industry and American Water also have some important differences from other utilities. Our capital projects for example are much smaller on average than those in the electric and natural gas industries.

Even though, they add up to a similar and very significant investment need. Another difference is our greenhouse gas emissions footprint, which is very small compared to most other publicly traded electric and gas utilities. That said we are seeing the impacts that climate variability can that -- can have through more extreme droughts or more severe floods. We strongly believe we must do our part to reduce overall greenhouse gas emissions. We have now set ambitious greenhouse gas reduction goals Including achieving net zero by 2050. Along with our goals for system resiliency and water use and efficiency, we see our greenhouse gas reduction goals as part of our commitment to provide superior and affordable service to our customers.

We believe American Water is the leader in clean water and wastewater transition in the United States. For the communities we already serve and the communities we hope to serve in the future, the capital investment needs that are required to deliver more sustainable water and wastewater services are immense. It's up to us to find ways to balance those CapEx needs with the affordability of services for our customers, that's why we've added a customer affordability targets to our list of key drivers, you see here. As a Company, we also continue to raise the bar on our efforts to create a fair and equitable place to work.

In addition to making sure our operations aligned with the spirit of environmental justice. Two recent examples of our broad focus where the recognition through the 2022 WaterSense Excellence Award from the Environmental Protection Agency and the 2022 leading disability employer by the National Organization on disability. Cheryl will provide some examples later of the good things we're doing internally in these areas.

Finally, on this slide, you can see we are affirming our long-term earnings growth targets and most of our other long-term financial targets remain unchanged. During our planning process this fall, we decided to narrow our long-term dividend growth target to 7% to 9%, which maintains our position in the top-tier of dividend growth and a payout ratio in the industry.

Our long-term dividend growth target now fully aligned with our compelling EPS growth target of 7% to 9% and the significance of our capital investment plan and related financing. This minor adjustment rounds out our strong long-term plan and will help us achieve our other important financial targets over time.

In summary, we believe the combination of our EPS and dividend growth supported by a significant and yet low-risk capital investment plan as well as our ESG leadership premium and constructive position on affordability will continue to be rewarded by investors, based on the long-term plan and our history of executing on our strategies, we expect to continue to deliver a very competitive sustainable shareholder return for many years to come.

And with that, I'll turn it over to John to cover more detail on our 2022 financial results, our 2023 and longer-term outlook, and our financing plans. John?

John Griffith {BIO 22806522 <GO>}

Thanks, Susan, and good morning everyone.

Turning to Slide 9, let me provide a few more details on third-quarter results. Regulated results in total increased $0.16 per share compared to the prior year. We saw a $0.32 per share increase related to higher revenues from new rates, acquisitions, and organic growth. Also, the weather was favorable by an estimated $0.07 per share year-over-year, due primarily to warmer and drier conditions in 2022. O&M and other expense increased by $0.10 per share, which reflects an estimated $0.07 of inflation on chemical, power, and fuel costs and higher interest rates.

Depreciation expense also increased $0.04 per share In support of growth in the Regulated Business. And as you know 2021 third-quarter results included $0.09 per share of operating earnings from our former New York subsidiary. Finally, the Market-Based business and other results decreased in the third quarter of 2022 is the $0.09 per share of operating earnings from HOS in the third quarter of 2021 was offset by the $0.06 per share of earnings in 2022 from interest income and revenue share agreements.

Moving to Slide 10. Consolidated results increased $0.30 per share for the year-to-date period compared to the same period last year driven by many of the same factors as in the third quarter. While I won't go through all of the details of the year-to-date results in short we are pleased with our financial performance over the first nine months of the year. Our leaders across the business have adjusted to the changing economic environment in 2022. Their ability to do so has put us in a good position to achieve the full-year operating results we laid out in our initial 2022 guidance a year ago.

Let's turn to Slide 11, and cover the regulatory activity in our states. Shown here is our summary of completed rate cases in 2022 and key facts for each of the rate case filings so far this year. In the appendix, we also share some details of changes in our infrastructure charges, year-to-date. These efforts reflect Susan's comment on our team's ability to execute our regulatory strategies which is a critical success factor for continuing to grow our business. As we've said before the common thread in all of these cases is the focus on recovery of infrastructure investments made since the last round of rate cases totaling over $4 billion. And in some states the roll-in of acquisitions.

As we continue to ramp up capital investments in 2023, it will take time to see recovery of those investments in rates. We continue to expect to file general rate cases, generally every two years in our bigger states. As we have already communicated in August 2022, the New Jersey BPU approved the settlement of our rate request, authorizing a total annualized revenue increase of approximately $61 million. The new rates became effective on September 1, 2022.

Two key outcomes in this case we're the incorporation of our request to update estimates of production costs including chemicals, fuel, and power costs. And the approval of deferral accounting for pension expense beginning January 1, 2023. The success of our proactive regulatory approach to these pressures will lessen the risk to shareholders into the future.

Turning back to active cases, you can see we have general rate cases in progress in five jurisdictions. And two of these states, Pennsylvania and Virginia we have reached settlement agreements with the parties and have on file petitions for approval of the settlements.

In Pennsylvania, we filed a general rate case in late April seeking recovery of $1.1 billion of investments since the prior case. The settlement provides for a total annualized revenue increase of $150 million and incorporates updated estimates of pension and OPEB expense. Similar to New Jersey, this settlement also includes increases in production costs, including chemicals, fuel, and power costs. In the coming weeks, an administrative law judge will review the settlement filing and render a recommendation to the Pennsylvania Commission regarding approval of the settlement. After its review, the commission will issue a final order. We expect the order by January 2023 with new rates to be effective as of January 28, 2023.

Moving on to Virginia. In late September a settlement agreement supported by all parties except one was filed with the Virginia State Corporation Commission and provides for a $12 million annual revenue increase compared to our original request of $15 million. A final decision in this case is expected in the first quarter of 2023.

In Illinois, where it's been about six years since our last general rate case progress has been steady since our February filing, and last Friday a proposed order was issued by the cases, administrative law judges. We view the key terms of the proposed order is very constructive including recommended approval of our updated revenue request to capture higher production costs and expected higher pension costs. We expect a final order in the case by January at the latest.

Our cases in California and Missouri were filed in July and are progressing as expected so-far. In January of 2023, we will file an update in Missouri for costs and other elements of the case as needed with hearings then to be held in February. We expect the case to reach conclusion by the end-of-the second quarter 2023.

On the legislative front, there was one additional notable piece of legislation signed since our second-quarter call, California Senate Bill 1469, which allows the commission to consider and authorize the implementation of a decoupling-like mechanism. The legislation was signed by the governor on September 30, 2022, and will become effective on January 1, 2023. Our California subsidiary is grandfathered into the previous water revenue adjustment mechanism through the end of our current rate case or 2024 and the team is working to renew decoupling under the new mechanism and the general rate case that was filed July 1, for our next rate period beginning in 2024.

Turning to Slide 12, an acquisition piece of our growth triangle. As Susan mentioned, we were excited to announce in October our agreement to purchase the Butler Area Sewer authorities, wastewater system for $232 million. This agreement was executed under Pennsylvania's fair market value legislation which is a framework that exists across 11 of the states in which we operate. Through September we have closed on $308 million of acquisitions in 2022, which represents about 65,000 customer connections. And we are excited to have nearly $350 million of signed purchase agreements through October which sets us up for 2022 and 2023 to be strong years for growth through acquisitions. With the pipeline of over 1.3 million customer connections, we expect to continue this track record of success.

On Slide 13, we provide some considerations regarding our outlook for 2023 results and our EPS guidance range of $4.72 to $4.82 per share. First, as you would expect our growth will be driven by capital investment to serve our customers and earning a return on net investment. As we've talked about previously, 2022 is year one of our accelerated CapEx plan so it will take some time to ultimately see the ramp-up reflected in earnings. Recent regulated acquisitions that are being incorporated into active or just completed rate cases will also drive growth next year.

I'd like to add that our Military Services Group does add incrementally to our earnings growth expectation as we have continued to show on our growth triangle. 2023 results will benefit from MSG's successful addition of its first Navy contract that we announced earlier this summer. Just as critical to our strategy is our ability to recover in rates, the operating costs It takes to run the business which goes to my final point on this slide. The regulatory solutions we are pursuing such as cost deferrals and expense recovery mechanisms are closely aligned with the interest of regulators and customers in managing affordability and limiting variability of customer bills, which ultimately aligns with our investors' interests as well.

As we conclude this current round of rate cases, we expect to have in place regulatory solutions for over 75% of the inflationary costs we anticipate in the near term including pension, interest, and production costs. And as always our team remains vigilant and disciplined on cost management. Finally related to pension, I would simply remind you that our pension obligation remeasurement will be done at year-end 2022, and that will drive the determination of our 2023 pension expense.

Wrapping up the 2023 outlook on Slide 14, here we are providing some more specifics regarding the key drivers for 2023 that I just discussed. This slide demonstrates the importance of our regulatory execution and the results it drives. It also reflects the financing plans we expect to execute in 2023 that support our capital investment plan which is an additional $1 billion over the next five years as compared to last year's plan. You will notice that we have included a bar for incremental debt and equity financing, which reflects the cost of incremental debt issuance in 2023, to support our growth as well as equity to be issued in 2023 which I will address on the next slide.

Our cost of increased interest rates on 2022 debt balances is captured in the cost inflation and interest rates bar the majority of which is being recovered through the current round of rate cases as just described. We are confident in our ability to look -- to deliver on this plan for 2023.

Turning to Slide 15. I'll provide a financing plan update before closing with a look at our balance sheet and liquidity profile. Our financing plan now includes an estimated $2 billion of equity issuances from 2023 through 2027 which is an update to the, $1.1 billion of equity financing need through 2026 we have previously discussed. Consistent with our prior messaging on mid-plan timing, subject to market conditions, we are likely to raise a significant portion of the total planned equity in 2023. The increase in the anticipated total equity need is driven largely by the $1 billion of increased CapEx that extends through 2027 and this new plan along with adding some incremental balance sheet capacity.

The remaining portion of the $2 billion of planned equity not completed in 2023 is expected to be issued near the end of the five-year plan. As we've said for several quarters now we expect equity will be a regular financing tool going forward to help fund our growth and maintain a strong balance sheet.

Let me conclude by turning to Slide 16, with a reminder that we have a strong balance sheet and credit profile. I'm confident our new Five Year plan is supportive of our current credit ratings as well as our long-term financial target of less than 60% debt to total capital.

Another thing, I'll point out is our debt maturity profile at the bottom left of the slide. We believe these levels along with our planned debt issuances are very manageable. In a rising interest rate environment, it's important that the company has taken a laddered approach to long-term debt financings over the years in order to minimize interest rate risk. And as a utility that predominantly invests in long-term assets, I expect us to continue to exclusively issue fixed-rate long-term debt to protect against the risk of interest rate volatility.

On liquidity, we continue to remain confident that we will have sufficient access to capital for the foreseeable future. In fact, we just announced that we increased our commercial paper program in our revolving credit facility by $500 million each to $2.6 billion and $2.75 billion respectively. And we extended the maturity of our revolving credit facility to October 2027. We believe these actions were appropriate to support our growing business and increased capital investment plan.

With that, I'll turn it over to Cheryl, to cover our CapEx and rate base growth plan, affordability, and some new sustainability goals in more detail. Cheryl?

Cheryl Norton {BIO 17107572 <GO>}

Thanks, John, and good morning, everyone. On, Slide 18, I'll start by talking about our updated capital plan. I want to first acknowledge that our teams have done a great job executing on our accelerated capital investment plan in 2022. We're on pace to meet our overall capital plan of $2.5 billion this year which includes acquisition investments. Looking ahead to 2023, we plan to again step up our investment level. This time to roughly $2.9 billion, which will generally be our new annual threshold for the next several years.

As John just mentioned, over the next five years we expect to invest approximately $14 billion to $15 billion, an increase of about $1 billion over our previous plan. This increase is mostly driven by including the increased investment for 2027 in the Five Year window, as well as about $250 million of inflationary impacts expected in the near term. We expect this pace of spend to drive our current pipe replacement cycle plan lower and much better than the industry average. On the longer horizon, you can see that we plan to spend approximately $30 billion to $34 billion in our regulated business over the next 10 years. We see this capital plan to be largely in line with last year's plan, reflecting the higher annual run rate as well as modestly higher costs for pipe and other capital goods.

Turning to Slide 19, this graph illustrates that our continued execution on capital investments both infrastructure projects and acquisitions are succeeding, and growing the Regulated business at a long-term rate of 8% to 9%. Rate base growth of course will drive earnings growth as long as we continue to prudently invest in our systems and successfully execute the regulatory process.

Moving onto our regulatory recovery strategy on Slide 20, our theme here is around timely consistent recovery of investments and operating costs. When we achieve timely and consistent recovery it levels out bill increases to our customers, which helps promote affordability. It's beneficial to our customers that we operate in states that have constructive regulatory mechanisms. We've engaged with policymakers and regulators for well over a decade to find the best ways to invest in water and wastewater infrastructure while putting the customer first. In the states where we operate 27 new mechanisms have been added over the past 12 years. As water and wastewater industry challenges grow, we'll continue to focus on constructive regulatory and legislative outcomes. I'd also like to discuss timely recovery of our investments across our footprint with the pie chart on the right side of the page. Through capital recovery mechanisms and forward test years, we are able to reduce regulatory lag and lessen the reliance on general rate cases.

This enables us not only to earn our allowed return but also to mitigate the size of the general rate increases for our customers. We expect about 45% of capital investments over the next five years to be recoverable through infrastructure mechanisms which is the key to unlocking a more consistent annual earnings growth pattern for the long term.

Turning to Slide 21. Our focus on operating efficiency has been a part of our company's DNA for many years. As you know, we've historically used O&M efficiency as one of our benchmark metrics to measure our success at managing costs as we grow the business. This focus positioned us well to manage through much of the pressure over the last couple of years on the supply chain and even cost increases brought about by the effects of the pandemic. As we look ahead, we've been asked if we can go below the 30% efficiency threshold. While we're continuing to evaluate that question, we've continued to emphasize that revenue growth has been just as important to our success with O&M efficiency as managing costs.

So with that realization in mind, there may very well be an additional opportunity to go below the 30% threshold. However, we're analyzing whether this is the best metric by which to judge our effectiveness at managing costs and running an efficient business. Moving to Slide 22. One of the most difficult challenges we face in the water and wastewater industry is balancing customer affordability with the magnitude of the system investments that are needed. Thankfully as we sit here today, our industry and our company are in very good relative positions in terms of affordability or wallet share.

In fact, as investors and analysts study the sustainability of American Water's long-term earnings growth potential we believe our affordability proposition is an important consideration. We realize though that we must continue to evolve our strategies around rate design and programs to assist our customers who are challenged with affordability. We must also consider our focus on technology, efficiencies of scale, and a sharp focus on cost management in order to deliver on values around customer affordability.

Moving on to Slide 23. And as Susan mentioned earlier, we are excited to announce our new science-based greenhouse gas emission reduction goals. And our first disclosure of estimated scope 3 emissions. Before we dive in, I'll walk you through our greenhouse gas emissions profile in a bit more detail. As an essential service provider American Water is often compared to the broader utility sector, emissions included, which can be misleading.

As Susan noted earlier is an important distinction that our emissions footprint as a water utility is much smaller than most publicly traded gas and electric companies on both an absolute and per-customer basis. To help put it into context, American Water represents just 0.1% of the total scope 1 and scope 2 emissions produced by the top 20 largest U.S. utilities measured by market cap. As we show on the slide, our total emissions footprint is made up of 7% direct scope 1 emissions such as heating, cooling, and fleet. 44% indirect scope 2 emissions for our purchase power and 49% estimated scope 3 emissions which for us largely includes purchase goods and services, capital goods, and fuel and energy-related activities.

Framing it in a different way, more than 90% of our overall emissions footprint is generated from external sources which is another key differentiator from most other utilities. Turning to Slide 24, there's a lot to unpack here. Let me say first, at a high level we believe it is prudent for our company to focus our efforts on environmental initiatives that are in the purview of a water utility and aligned with our core mission. Our view is that greenhouse gas emission reductions fit as part of our sustainability strategy that over time will help protect customers against service disruptions from more severe weather patterns such as droughts and floods.

We believe we've set forth new compelling goals to support this strategy. First, we, expect to reduce our absolute scope 1 and scope 2 emissions 50% by 2035 from a 2020 baseline. Second, we expect to achieve net zero scope 1 and scope 2 emissions by 2050. We believe these new medium and long-term emissions goals are rooted in science and aligned with the Paris Agreement. We also believe our approach is a responsible path that considers all of our stakeholders' interests, including doing our part by setting ambitious reduction goals. Our approach here will allow us to stay on course with our customer affordability metrics as we continue to deliver clean, safe, affordable, and reliable water to our customers.

This was a foundational component of our analysis and recent discussion with our board-level SETO Committee which oversees our safety, environmental, technology, and operations efforts. It's also, important to note, that as we deliver water and wastewater solutions to more customers over time through acquisitions and organic growth our energy usage is going to increase. We will re-baseline each year to account for our growth through acquisitions of systems which is an acceptable practice under the standards of the Science Based Targets Initiative or SBTI. We did consider making a commitment to SBTI as part of our analysis this year.

However, we concluded that some of SBTI's expectations around scope 3 commission -- commitments, mostly around timing were not in the best interest of our stakeholders. We do expect though to continue to work with our suppliers and vendors to consider what can be done to reduce scope 3 emissions over time. And as I stated we are confident that our new medium and long-term scope 1 and scope 2 goals are science-based and aligned with the Paris Agreement. As you can see at the bottom of the slide, these are more than just goals. We have plans in place and capital ready to deploy to achieve these goals. Obviously with greater visibility to the path to 2035.

Since our footprint is heavily weighted by scope 2 emissions, the continued greening of the electric grid is a significant component of our reduction plan. We hope to see that transition continue by our fellow utilities and other providers. For us, though we know that it is cost prohibitive and outside of our core competencies to self-generate all or even a significant portion of our power needs. We will though continue to look to enter into clean purchase power agreements or partner on renewable investments where appropriate. Similar to our engagement with New Jersey Resources on the floating solar array at one of our treatment plants in New Jersey.

Lastly, we will continue to focus on emissions reduction activities that we can control within our operations. This includes water efficiency and operational efficiency gains in order to reduce the energy and emissions associated with the pumping of water which we disclosed previously is by far the largest driver of our purchase power needs. Capital projects will include the deployment of additional leak detection technologies and more efficient water pumps across our systems as well as converting some of our fleet vehicles and other assets to more efficient options. These are small but important pieces of our plan. And in large part, these capital investments will align perfectly with some of our existing reliability and resiliency goals.

Next, let's turn to Slide 25, and discuss some new disclosures related to our continued ESG journey. First, soon we will release summary results of our most recent pay equity study on our ID&E website DiversityatAW.com. This is our third such pay equity study. And each time we have engaged a third-party consultant to conduct an objective pay equity analysis. I'm pleased to share that you will see that we're very close to achieving pay parity across employee groups, including gender.

Our performance is a testament to American Water's commitment to fair and equal pay and how our teams have leveraged findings from these regular assessments to correct inequalities and update processes around compensation. We will also share some initial summary findings of our internal labor market analysis that began in 2021. This analysis was also led by a third-party firm and was commissioned because we believed a factual and statistical analysis of our workforce was needed to support a holistic evidence-based inclusion, diversity, and equity strategy.

Lastly, I'd like to touch on two of our new goals that were established earlier this year in our annual performance plan. The first is to increase the representation of female employees at American Water, and the second is to increase ethnic and racial diversity among American Water employees. Both of these goals complement existing safety and environmental sustainability goals that are tied to annual performance plan compensation for all employees. As mentioned earlier, these goals reflect our company's focus on social benefits that we believe will help us operate as a stronger company ultimately for the benefit of our employees and to help us better reflect the customers and communities we serve. Whether it's our ESG leadership or our consistent execution on our earnings growth goals or our leading safety culture, our team at American Water has consistently raised the bar for success in the water and wastewater industry.

We have full confidence in our ability to achieve the goals we talked about today for 2023 and beyond.

So with that, I'll stop and turn it back over to our operator to begin Q&A, and take any questions you may have.

Questions And Answers

Operator

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

Q - Angie Storozynski {BIO 15115714 <GO>}

Thank you. So, first, on '23 guidance I mean It's-- I guess it's a relief to all of us to see that your messaging to get to consensus expectations even with the increased basically equity needs that you're addressing in 2023. So, I mean is it basically that your front-end loading equity to finance CapEx that will materialize in the latter part of that Five Year plan, and as such It's not only that CapEx is backend loaded but it's also that there is some incremental dilution that sort of ways on those '23 results?

A - Susan Hardwick {BIO 16618718 <GO>}

Well, good morning, Angie. A lot in your question there, and let me maybe just comment high-level, and then I'll have John jump in and talk a little bit more around our thinking around equity and the plan there. But recall from our, I guess really the last few years as we've talked about our equity needs and our expectation around that we've been signaling sort of mid-plan and we released that guidance probably two plus years ago. So, I think this '23 timing now that we're giving a little bit more insight into is consistent with our prior messaging.

The increase in the size of the equity that we now have in this plan. I think as we've highlighted, really has to do with the increased capital over the course of the five years. And Cheryl indicated that we're kind of stepping up to roughly a $2.9 billion investment per year over that five-year period. So there is more capital coming in throughout the entire five-year focus of the plan. And then we've also added a little bit of additional equity expectation here just to create some additional balance sheet capacity as we think about that going forward. The other important thing I would comment on around your opening comment around hitting expectations for '23.

I just want to underscore again, what we said in our prepared remarks around our regulatory approach to these inflationary costs, we have been very proactive in trying to get our hands around what we thought those impacts might be and we have worked very closely with regulators to try to build-in, in these existing cases, we're working on the coverage for those costs. And I think we've said something well over 75% of those expected costs in the near-term we have built-in these cases that were ramping up now. So, I think -- I'd say again just in summary, the equity plan is pretty much on-track with what we've said historically.

And the increasing capital is driving the bulk of that need of additional equity in the plan and then our proactive approach on regulatory is absolutely part of our ability to be confident about our expectations for '23. So John, anything to add on the equity piece?

A - John Griffith {BIO 22806522 <GO>}

Good morning, Angie. I would just add that, as we think about how we delineating the equity. As we said in our prepared remarks, we'll issue or we expect to issue a significant portion of the equity in 2023. As we think about the consequences of that based on how we trade, I would characterize the dilution associated with that is relatively modest. And then also we pointed out in our remarks whatever we don't Issue in 2023, we would expect to issue in the back end of our plan.

Q - Angie Storozynski {BIO 15115714 <GO>}

Good, okay. And then changing topics a little bit and I know it's not your core competence, but you are now a cash taxpayer. So you do have cash appetite I mean tax appetite I'm sorry. So why not developed or at least own some of those renewable power plants that you currently contract under the PPAs again as tax strategy as opposed to-- like a sure growth driver?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, I think it's a good question, Angie, but I think Cheryl hit on it and you did even in your remarks there we just don't view it as our core competency. There are folks, that are sort of in that business and we believe we have the opportunity to work closely with them to develop solutions and take advantage of those renewable sources that are out there without owning them. We've got enough to do and you even acknowledge it's not really a growth driver. We've got plenty to do on just our investment side to continue the growth. So we don't need it from that standpoint. Your observation around tax. I think it's also a good one but I would tell you we think we have the right strategy here to finance this plan and manage all of the elements of the requirements in that plan with what we've laid out here.

So while we are always interested in and it's been a quite a bit of time on tax planning and tax strategy, it just does not -- It just doesn't fit our profile.

Q - Angie Storozynski {BIO 15115714 <GO>}

Okay. And last one really quickly. So you have had some big mini deals announced since the second quarter earnings call. I think we've all been concerned about some of those high profile privatizations of wastewater system sort of falling through. So, are you seeing that there is any sort of systemic change to how municipalities look at sales of their water and wastewater systems or is it just, very much -- kind of system specific?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, Angie, let me just turn it to John and have him sort of weigh in on that question.

A - John Griffith {BIO 22806522 <GO>}

Yeah, Angie. I would say I'm glad you asked the question because our answer is, no. We haven't really seen a fundamental change in the landscape for making acquisitions. So, there's certainly been some noise out there around particular deals, but really nothing has changed. There is a huge number of systems out there many of which are under invested in our ripe for potential acquisition. And when we think about the footprint that we have, and the focus that we have, we continue to very much like our relative position there and regulated acquisitions will continue to be a key focus area for us.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, and I just would add to that simply that we work very hard In cultivating these opportunities to make sure we're developing the right solution for these communities. And, I think that's a big advantage for us.

Operator

Our next question comes from Shar Pourreza with Guggenheim Partners. Please go ahead.

Q - Shar Pourreza

Hey guys, good morning.

A - Susan Hardwick {BIO 16618718 <GO>}

Good morning, Shar.

Q - Shar Pourreza

Couple quick ones here. If I recall correctly the HOS sale aid up a lot of your I think NOL carry forwards and you've been a cash taxpayer this year. Is it your expectation that you'll be subject to the minimum tax going-forward does this latest financing plan kind of embed in ongoing assumption for that?

A - Susan Hardwick {BIO 16618718 <GO>}

Well the first part of your statement is correct, yeah, the gain on the HOS transaction sort of advanced us to being a cash taxpayer. Still evaluating what the IRA means and you know the alternative minimum tax and financial income greater in $1 billion are still lots to be sorted out in terms of what the final rules are in the final interpretation of those. So we're monitoring it closely. We've obviously modeled a variety of scenarios around it and I would just say In all those scenarios this plan adequately covers any exposure we think we might have there.

Q - Shar Pourreza

Got it. Okay, perfect. And then, I think John may have touched on this a little bit but it looks like the amount of CapEx dollars allocated for regulated acquisitions the same as the prior plan. So slightly smaller overall proportion. Anything to sort of read into here is the opportunity set fairly fixed, are you getting more selective just maybe a little bit of an elaboration on John's comments, please?

A - Susan Hardwick {BIO 16618718 <GO>}

John, you want to take that?

A - John Griffith {BIO 22806522 <GO>}

Sure, Shar. I'd say the smaller proportionality is really just a function of the increase in the regulated our organic CapEx. I'd say the which has more visibility attached to it as you know than regulated acquisitions. So in no way are we kind of decreasing our thoughts around putting dollars to work on it regulated acquisitions. We continue to feel very good about that.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. I don't think we highlighted it really much on this call, but our pipeline remains in excess of $1.3 million connection opportunity. So still very very strong. There are lots of good work in that area.

Q - Shar Pourreza

Got it. And then just last one from me is just the shape of that 7% to 9%. I mean obviously you guys -- you're executing on the regulatory front, you've got a good footprint there, some dilution, but I guess what else should we assume -- I guess as we're thinking about modeling and the extension? Where you sort of within that range as we're thinking about like the near-term versus the longer-term as we just thinking about the profile of that shape?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. I think it's a good question, I'll just repeat what I've said several times now. And, I do think you can tie it back to the HOS sale, recall our discussion about a year-ago that when we sold that business and this transition to sort of full utility. The opportunity created by that sale would result in a ramp-up of the spend. So it takes us a while to get that spend fully deployed and get it fully in rates. So I'd say in the near term like you see a little bit in '22 and in our guidance for '23 which we think is quite strong there is, obviously a ramp-up still reflected there. And we've got the proceeds that will come in from the note on the HOS sale at the end of '26.

So again you think about that sort of working its way into the plan, I'd just say what we've laid out in '22 and '23 is reflective of that ramp-up. Our view continues to be this long-term growth rate of 7% to 9% we see that extending well into the future. And we just got to get through this sort of ramp-up period and you'll see that growth rate continue.

Q - Shar Pourreza

Terrific, thanks guys. We'll see in a couple weeks, appreciate it.

A - Susan Hardwick {BIO 16618718 <GO>}

All right. Thanks Shar.

Operator

Your next question comes from Insoo Kim with Goldman Sachs. Please go ahead.

Q - Insoo Kim {BIO 19660313 <GO>}

Hey thank you. First just going back to the your comments on the financing specialty equity. I appreciate your commentary on the bulk of it potentially being in '23. I guess is it possible that when you assess the various equity options that you could potentially look to price that equity in 2022 but look to draw that down in 2023 just given market volatility?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. I think market conditions certainly play into our decisions here around timing and ultimate size and the tool that we use. So that's obviously still in all of our discussions internally. John, anything you want to add to that?

A - John Griffith {BIO 22806522 <GO>}

No, that's right. And I'd say that, we're not expecting to issue in 2022 into, but obviously as Susan said everything is subject to market conditions.

Q - Insoo Kim {BIO 19660313 <GO>}

Got it. And then at 7% to 9% EPS growth rate should we assume that it's now kind of basing off of '23 guidance or should we still use whether it's '21 or '22?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, it's a good question obviously we get this question a lot and I'm confident, my answer will frustrate you. Our view is that it's a long-term growth rate. We would expect that 7% to 9% to be the guidance regardless of the period that you're looking at. Internally we actually don't really use a base year to do the math off of, our view is it's a long-term growth rate. I know in the past we have used sort of prior year actual your latest actual information to base off of but again our view would be it doesn't really matter. The long-term growth rate is really the driver.

Q - Insoo Kim {BIO 19660313 <GO>}

Got it. I thought I'd try. Then just one more I apologize. Maybe for Cheryl, I think the EPA maybe still at least this year may on track to put out some mandates related to the people PFOS and other product contaminant kind of the maximal levels. Just based on your operations and your jurisdictions, how would that given what could come out, how does that impact your CapEx or O&M strategy of that? Thanks.

A - Cheryl Norton {BIO 17107572 <GO>}

Yeah, Insoo. Great question. We do anticipate that EPA is going to release those regulations later this year and because we don't know exactly where they're going to fall, it's a little hard to kind of put a specific dollar amount on it. But we have a really good handle on what we have across our system and what the needs will be depending on what those EPA regulations come out at and we're prepared to invest the capital needed to put treatment in place right away. We have gotten we found it to be a very quick process to design and get treatment online wherever we may need to.

So we know, what we've got out there, and we kind of know what to expect depending on what EPA comes out with. So we just have to wait and see. We don't want to spend more capital than we have to but we also want to make sure that we're meeting the regulations as quickly as possible and protecting our customers.

Q - Insoo Kim {BIO 19660313 <GO>}

Got it, thank you.

A - Susan Hardwick {BIO 16618718 <GO>}

Thanks, Insoo.

Operator

Next question comes from Julian Dumoulin-Smith with Bank of America. Please go ahead.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Hey good morning, team. How are you, guys? Congratulations. Hey, thank you guys, thank you, guys. Hey, I just wanted to follow up. I know there's a lot of questions about the growth rate. Just what's the base here is the starting point here? Are we talking about pre '23 at this point or are we rolling forward to '23 for the 7% and 9% outlook if we could just start there?

A - Susan Hardwick {BIO 16618718 <GO>}

Well Julien, as I said to Insoo. We don't really look at it that way. Our view is a long-term growth rate of 7% to 9% is the answer. So our view is you can start within a year you want and you're going to get the same result.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Okay, alright. Sorry. Yeah, I just wanted to just press a little bit. All right, and then if...

A - Susan Hardwick {BIO 16618718 <GO>}

I appreciate that.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

A little bit that-- always checking here. If I can speak a little bit about the trajectory though. As you, think about the commentary and I heard you, the early response on equity dilution for '23. What does that say for '24 vis-a-vis within that range? Obviously, '23 being at the lower end of 7% to 9%. As you, think about rolling forward that dilution it seems like more so into '24, do you think that again the 7% to 9% is clinical back half weighted regardless, or whatever time period you want to use?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. I think John's comment about the impact of dilution is really the right one. Our view is that the dilution is pretty minimal from the issue that we're anticipating in '23. I think the real driver is the ramp-up of the CapEx. We were just putting these dollars all to work. We've got the proceeds coming in again from HOS in '26, I think as we continue to see that ramp-up work its way through the plan, you'll start to see towards the back end of the plan more consistent growth rates.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

All right, excellent. No, fair enough. And then just lastly just to clarify some of the earlier conversation about the cash tax rate. So what are the planning assumptions reflected in the guidance here as you think about '22, '23 et cetera, just trying to baseline ourselves here if you can?

A - Susan Hardwick {BIO 16618718 <GO>}

Well, I mean obviously we're a full cash taxpayer now. So this five-year plan reflects that. The comment earlier around what is IRA mean to us in terms of the alternative minimum tax. I mean again there is still many rules and definition still to be done around that, that I don't think any of us know exactly how it will work. But I would just reiterate what I said a minute ago we've modeled a variety of scenarios all of which fit in this plan that we've laid out here.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Excellent. Well, thank you so very much for the time. All the best. We'll speak to you soon.

A - Susan Hardwick {BIO 16618718 <GO>}

Alright. Thanks, Julien.

Operator

Our next question comes from Richard Sunderland with JP Morgan. Please go ahead.

Q - Richard Sunderland {BIO 20365913 <GO>}

Hi good morning. Thanks for the time today. Just starting on 2023 guidance the $0.25 to $0.29 cost inflation on interest rates with 75% of that covenant rates. I'm curious on the pension side, does that kind of baked-in your estimate of the current marks and so fair to think about you see market moves from here in the interest-rate backdrop as potential upside or downside versus this outlook just, curious what you've baked-in on the assumptions are?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, it's a good question. And as John said in prepared remarks obviously we'll measure at the end of the year and determine what our actual '23 expenses once we get to the end of the year. But how we've handled this from a regulatory perspective is for the most part what we have gotten achieved, and accomplished here is whatever the '23 expense ends up being that's what will get reflected in rates. So, we've lifted a little bit open-ended in the regulatory arena where we'll actually set it at the number once we know what the number is. And in other situations, we've estimated what we think the impact will be based on year-to-date performance and expected performance for the balance of the year.

Q - Richard Sunderland {BIO 20365913 <GO>}

Okay, understood. And I guess to tackle the other side on chemicals, fuel, power is that effectively reasonable assumption in terms of rolling forward to '24 as well, if the current environment persists, or is there sufficient kind of incremental regulatory activity coming down the road here to mitigate even more of that in the '24?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. I think what we have accomplished so-far in the regulatory arena obviously will be in rates until we adjust rates again. And, I think we'll have continued opportunity in the regulatory arena to address these cost impacts in other jurisdictions. And again in some cases the ability to adjust for what the actual costs are in existing cases or an existing jurisdictions. Just depends on how we address that in each specific state. I think, again, the overall conclusion here is we've got the vast majority of these costs covered and should not really be a drag on our expectations going forward.

Q - Richard Sunderland {BIO 20365913 <GO>}

Got it. That's very clear, and understood. And if I could just sneak in one more on '23. Is there any step-up that you expect on the revenue share related to the Homeowner Services transaction? I guess just curious in terms of walking year-over-year on the outside it looks like effectively steady contributions less the post-closed adjustments in '22 is that the right way to be thinking about it?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. I think it's that's probably the right way to think about it. We're continuing in the jurisdictions, our states that don't have those agreements in place we're continuing to evaluate those opportunities. And working very closely with now the HOS ownership or leadership to see if opportunities exist. So, it's a very active part of our business plan.

Q - Richard Sunderland {BIO 20365913 <GO>}

Great, thanks for the time today.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, thanks, Rich.

Operator

Our next question comes from Durgesh Chopra with Evercore ISI. Please go ahead.

Q - Durgesh Chopra {BIO 20053859 <GO>}

Hey, good morning team. Thanks, for squeezing me in here. Good morning, Susan. Just congrats by the way on the regulatory execution here year-to-date, you guys have done a phenomenal job and great outcomes. Just, on the acquisition side of things, can you update us on where you stand year-to-date? We're seeing targets I think this year, you're planning on hitting $500 million in acquisition. So could you just update us there and then I'll follow-up?

A - Susan Hardwick {BIO 16618718 <GO>}

Sure, John, you want to handle that?

A - John Griffith {BIO 22806522 <GO>}

Yeah, sure. Good morning, Durgesh. We're on track. I think we've closed about 65,000 customers today with another kind of five -- so 1,000 customers to come. I would say that on a dollar basis as we disclosed in our slides, our expected closings for the year will be in the neighborhood of $350 million which, and as you know we target about $300 million to $400 million a year, we've said over five years $1.5 billion to $2 billion on a run-rate basis.

Q - Durgesh Chopra {BIO 20053859 <GO>}

Yeah, $350 million for this year, okay. And then maybe I was just, I don't want to front run your equity process. But just anything John you can share in terms of what are you looking for in terms of valuation or price ranges for this equity? I understand a significant portion is expected to land next year. Any additional color that you can share with us there?

A - John Griffith {BIO 22806522 <GO>}

No, Durgesh, I wouldn't say we think of it in terms of specific price range obviously will be very cognizant of market conditions. But I'd say we just -- we think of it more in terms of what we've messaged in the past which is the equity from a mid-plan perspective and as we approach 2023 here that is mid-plan relative to our historical messaging.

Q - Durgesh Chopra {BIO 20053859 <GO>}

Got it. Thanks for the time guys, appreciate it.

A - Susan Hardwick {BIO 16618718 <GO>}

Thanks, Durgesh.

Operator

Our next question comes from Steve Fleishman with Wolfe Research. Please go ahead.

Q - Steve Fleishman {BIO 1512318 <GO>}

Yeah hi, good morning, thank you.

A - Susan Hardwick {BIO 16618718 <GO>}

Good morning.

Q - Steve Fleishman {BIO 1512318 <GO>}

Hi, Susan. So just on the couple questions related to the equity and balance sheet. So in the 2023 guidance, are you kind of assuming that it's kind of averaged roughly over the year or beginning of the year just kind of, how are you incorporating that into the '23 guidance?

A - Susan Hardwick {BIO 16618718 <GO>}

John, do you want to take that?

A - John Griffith {BIO 22806522 <GO>}

Sure. Yeah, I think Steve that's a fair way to characterize '23 for modeling purposes. I'd say, I think that whereas, we used a significant portion of our equity. I think you can think of that is north of $1 billion of issuance in '23 and as you know we'll have to kind of find the right windows. But I think mid-year, is a reasonable way to think about it.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay.

A - Susan Hardwick {BIO 16618718 <GO>}

Steve, let me just add quickly, Steve. I think that, as John said these market conditions, of course, will drive this but we are still looking at how best to do it. You've heard us talk in the past about It's likely going to be in sort of a single issue or a block, but we do need to evaluate all those options available to us. So that's still in the works.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay, makes sense. And then maybe just on the balance sheet could you give more color on the comment about getting adding some of this for balance sheet, cushion [ph] flexibility, and what's the thinking there today versus in the past? Is it just a-- the volatility of markets? Is it what you see in terms of kind of acquisition pipeline or regulated investment pipeline or is it tax related? Just why now for the additional balance sheet capacity not a year ago or two years ago?

A - Susan Hardwick {BIO 16618718 <GO>}

John, do you want to take that?

A - John Griffith {BIO 22806522 <GO>}

Sure. Yeah, I'd say, Steve just as we've thought about our metrics over time we're in a very strong credit position. But we do look at our ramping up of capital spend both on the organic side as well as on the acquisition side. And so we just think it's healthy for us to have some cushion there. I would say just also as we're thinking about the cadence of our equity issuance where we'll do, much of in 2023 but then waiting until the back end of our plan for another issuance as we've thought about it. There's just a natural consequence of creating some cushion for ourselves.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, Steve, I'd simply add to that. I think that we've talked a lot about the payout ratio on the dividend and obviously we narrowed the dividend range a little bit here. We just feel the need to continue to really push ourselves on the ability to advance this capital spending as Cheryl talked about the replacement cycle. We just don't want to find ourselves in a situation where we have to put some constraints on that, on the investment side. So, I think if we can create a little capacity here it just helps us have that level of certainty around our ability to continue to accelerate. These market conditions obviously are quite volatile and it just doesn't hurt in this environment to have a little bit of extra cushion there. So, I think that's really honestly the driver.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay. That's helpful. Thank you.

A - Susan Hardwick {BIO 16618718 <GO>}

Thanks, Steve.

Operator

Your next question comes from Gregg Orrill with UBS. Please go ahead.

Q - Gregg Orrill {BIO 1532939 <GO>}

Yeah, thank you.

A - Susan Hardwick {BIO 16618718 <GO>}

Morning.

Q - Gregg Orrill {BIO 1532939 <GO>}

Good morning. I was wondering, if your guidance on the operating cash flows for '23 to '27, that ramp-up versus the prior plan if there's anything sort of non-operating in there or adjustments or if that's really the growth of the business?

A - Susan Hardwick {BIO 16618718 <GO>}

It really is the growth of the business Gregg. Again we just, we feel very good about how we are how the investment is being rolled-out, cash flows from operations, and the ability to get good solid timely regulatory solutions.

A - John Griffith {BIO 22806522 <GO>}

Yeah, Greg, I'd just add to that a significant portion is just the roll forward. So if you think about what's rolling off in 2022 versus what's being added and 2027 there is a pretty because of the ramp-up, the ramp-up in CapEx through those years that differential is reasonably significant. And then in the interim years because of our ramp, we're recovering additional depreciation deferred tax contribution to cash flows but a lot of it's the roll-forward by itself.

Q - Gregg Orrill {BIO 1532939 <GO>}

Okay, thank you.

A - Susan Hardwick {BIO 16618718 <GO>}

Thanks, Gregg.

Operator

This concludes our question-and-answer session as well as our conference for today. Thank you for attending. You may now disconnect.