Q3 2012 Earnings Call

Company Participants

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

Other Participants

- David Paz, Analyst, Bank of America Merrill Lynch
- Gerry Sweeney, Analyst, Boenning & Scattergood
- Heike Doerr, Analyst, Robert W. Baird
- Kevin Cole, Analyst, Credit Suisse
- Michael Roomberg, Analyst, Ladenburg Thalmann & Company Inc.
- Neil Mehta, Analyst, Goldman Sachs
- Tim Winter, Analyst, Gabelli & Company

Presentation

Operator

Good morning. Welcome to the American Water's Third Quarter 2012 earnings conference call. As a reminder, this call is being recorded and also being webcast with an accompanying slide presentation through the Company's website www.amwater.com. Following the earnings conference call, an audio archive of the call will be available through Thursday, November 15, 2012, by dialing 303-590-3030 for US and international callers. The access code for the replay is 456-7592. The online archive of the webcast will be available through December 10, 2012, by accessing the Investor Relations page of the Company's website located at www.amwater.com.

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

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

Ed Vallejo {BIO 20515524 <GO>}

Thank you. Good morning, everyone and welcome to American Water's Third Quarter 2012 conference call. As usual, we will keep our call to about an hour, and at the end of our prepared remarks we will have time for questions. Before we begin, I would like to remind everyone that during the course of this conference, both in our prepared remarks and answers to your questions, we may make statements related to future performance.

Our statements represent our most reasonable estimates. However, since these statements deal with future events, they are subject to numerous risks and uncertainties and other factors that may cause the actual performance of American Water to be materially different from the performance indicated or implied by such statements. Such risk factors are set forth in the Company's SEC filings which are available to the public on the Company's Investor Relations website.

With that, I'd now like to turn the call over to Jeff Sterba, our President and CEO.

Jeff Sterba {BIO 1426511 <GO>}

Thanks, Ed. I appreciate you all joining us today and I hope you're warm and [inaudible] part of the country over the last 24 hours, particularly whoever are [ph] along the coast. In fact, let me start by acknowledging the tremendous impact that Sandy had on most of the Northeast last week.

As you all know there's an unprecedented amount of damage and hardship to millions of people in large parts of our service territory where we serve about 6 million folks. On a personal note, our hearts really go out to all of those folks that have been affected, and I'm going to talk about Sandy in a little more detail in a few minutes. But particularly to our customers in the area, our investors, and our employees, we have 20 employees who lost their homes in the storm. We have many more who lost property, have damage done to their property or to their family members' property, and they're trying to deal with that as, I'm sure, some of you all are too. So our hearts go out to that, and we're certainly committed to aiding the communities and the recovery from this damaging weather.

On a brighter note, we again had very strong quarterly results driven by consistent execution of the strategy that we've laid out, how we invest capital, the drive for operational excellence through developing a culture of continues improvement, and focused growth in the markets within and outside of our existing footprint. As we've talked about before, it's all about execution.

If you go to page five, you can see the revenues are up 9% or a little over 9% for the quarter. When you couple that with how we've managed our operating costs, the last 12-month regulated operating efficiency ratio is 40.9% compared to 44.9% for the prior 12 months.

Now as you might imagine, this is impacted a bit by the abnormally hot and dry weather that we had in the summer that drove a greater increase in sales. That impact is probably about 60 basis points. So if you try to weather normalize, if you will, that operating efficiency ratio, it may be around 41.5%, still a substantive improvement from the 44.9%.

As you know, we have a goal of 40% or being below 40% by 2015. Walter and I and the rest of the team will go out on a little bit of a limb and say we're going to beat that date based on the performance that we've had so far.

Earnings per share from continuing operations is up almost 20% for the quarter and more than 30% year-to-date over the same period in 2010. Very strong cash flow from operations which, as you know, feeds our ability to spend capital and reinvest in our system, we're up about $160 million today or about a 27% increase over 2011 year-to-date [ph].

Our return on equity is at the highest level since the IPO and it's now a little -- about 8.15%. Recall that the $1 billion of debt that sits at the parent level that was left from the heart of the [ph] ownership where we got debt, they took cash, kind of it's [ph] referred to as the gift that keeps on getting [ph] that causes about a 100 basis point drag on that return.

So based on where we are after the Third Quarter and what we see for the balance of the year, we're reaffirming our earnings guidance of $2.12 to $2.22 per share for continuing operations and a $0.13 to $0.16 per share range that is due to the increased sales from the abnormally hot and dry weather of the summer.

So let me touch on a few other highlights on slide 6. On growth, we continue to prepare for the introduction of our homeowner services to the New York City market. You'll remember from last quarter that we were selected by the New York City Water Board as the official service line protection provider and that will be for about 600,000 home owners. That program will get launched in the First Quarter because they are installing a new CIS system, and we want to make sure that that new system is up and running effectively before we start a launch since that will be going [ph] on that bill.

On the shale gas, let me remind you that we're really focused on what I'll call a regionalization strategy. And it is geared around meeting the needs of the gas industry while also bringing water to areas previously not served with clean, treated water. This provides for us the near-term value from sales to the drillers and the long-term value of expanding our retail base while supporting regional economic development without taking on volumetric risk.

This quarter, we entered into two more agreements. These are with XTO Energy to construct pipeline. Each of them is roughly a mile, one is an 8-inch line, one is a 12-inch line, to supply water for shale gas drilling as well as to provide public water service to adjacent residential areas. Now this approach is similar to the contracts with Rex Energy that we told you about last quarter, and you'll continue to see more of this kind of expansion, particularly in our Southern and our Western systems, both Northwest and Southwest.

On the regulated side during the quarter and October, we completed three more tuck-ins with about 1,200 new customers. It [ph] means for the year that we've had eight tuck-ins for roughly about 8,000 people, not including the acquisitions that occurred in New York.

On the regulatory front, you all know about the Illinois rate case decision. While we were disappointed in the return on equity that was granted, frankly, the rest of the rate case addressed all of the issues that we wanted to see addressed and we're comfortable with those outcomes. We remain concerned about the return that was allowed in that state. But quite frankly, you have to look at the case as a totality and the balance of that case came out reasonably well.

You also know that we had the cost of capital decision in California. Remember that, unlike many of the other utilities, the return that was granted in that case is not subject to the adjustment that other utilities are experiencing or will be experiencing as of the first of the year. So it remains next year at the 9.99% rate with a thickened equity ratio.

While it's a small case, let me just mention one decision that came out subsequent to the end of the quarter and that's Tennessee. I want to mention it, not because of the dollar value, but because of the change in process. About a year ago or a little over year ago, we did some changes, Walter made some changes in the management of that state because there were things that we felt we could do better there. In addition, the Governor of Tennessee took an active interest in the regulatory process and made changes. The result is that within a five-month period we filed the case, reached settlement, and had the rates approved. Five months is a remarkable kind of standard for a rate case proceeding and it was settled at a 10% return.

So while it's a fairly small territory, we see it as a growth potential territory and the kind of approach that we saw and results that we saw in Tennessee give us good reason to think and recognize why we are in Tennessee and want to stay there.

For the year, we're on pace for a capital spend of approximately $925 million, again, with no new equity except for the very small drip that exists, and we're also pleased with the new credit facility that was priced at A; spread which is above our current from of credit rating.

Let me just close, before turning it over to Ellen Wolf, our CEO [ph], who is going to go in more detail on our financials, to just spend a second on Sandy.

We talk about capital investments directly benefiting our customers through improved reliability and quality, but I think what happened last week really proves that out during the hurricane and the follow-on northeaster. You think about 85 mile an-hour winds, 10 inches of rain, and a couple of feet of snow in West Virginia that impacted our service areas in New Jersey, New York, Pennsylvania, Maryland, Virginia, and West Virginia, we serve about a total of 6 million people in those areas. Through the execution of emergency plan, the use of almost 200 generators due to the massive power losses, round-the-clock staffing and really in-depth coordination with federal, state, and local agencies on both prep and recovery, of those 6 million people, we had less than 2,000 customers that lost water service for any period, we had only minimal damage sustained by our facilities, and most importantly, there were no employee injuries.

Sometimes this stuff gets take it for granted, but to me it speaks volumes about the strength and capabilities of our Company. I really couldn't be more proud of the people that helped make this happen, particularly when many of those employees are dealing with damage and destruction of their own personal property in their families.

So, again, we had a really solid quarter. Things continue to move positively forward, and I want to turn it over to Ellen for some more detail.

Ellen Wolf {BIO 1854557 <GO>}

Thank you, very much, Jeff. Welcome to those of you who are joining us on the call today. Let me also add my signs and prays to those many American Water employees and many other individuals whose actions enabled us to keep the water running throughout the hurricane and its aftermath. Thank you.

Now turning to slide 9, let me describe the underlying factors that drove our Third Quarter results. As Jeff has indicated, for the Third Quarter we continued to deliver very strong financial results with increases in revenues, net income, and earnings per share, as well as continued improvement in our O&M efficiency ratio.

For the Third Quarter ended September 30, 2012, we reported operating revenues of approximately $832 million, a $71 million or 9% increase over the revenue reported for the Third Quarter of 2011. Net income from continuing operations for the Third Quarter was approximately $154 million, or $0.87 per common share, an approximate 20% growth over the prior year. A portion of the increase in revenues is associated with higher demand primarily related to the warmer, drier weather in the second and Third Quarters of this year.

We believe the estimated impact of the weather continues to be in the range of $0.13 to $0.16 per share for the nine months ended September 30, of which $0.06 to $0.09 represents the impact during the first six months of the year.

Net cash provided by operating activities for the three months ended September 30, 2012 was around $418 million compared to $313 million for the same period in 2011, primarily driven by increases in operating revenues, changes in working capital, and lower pension contributions.

Now I'm going to discuss briefly the various components of our income from continuing operations starting from -- with revenues. But I'd like to remind you that our 10-Q for the Third Quarter is on file now with the SEC and it has a much more detailed analysis of both the revenues and expenses.

Overall revenues increased approximately $71 million with the revenues from our regulated businesses increasing approximately $68 million or around 10% from the Third Quarter of 2011. The increase in revenues was primarily driven by rate increases related to our continued investment and infrastructure and higher customer demand in our Midwest and eastern states over the prior year.

For the Third Quarter, the impact of these -- the 2012 impact of these rate increases was approximately $35 million. The increase in revenues associated with higher demand amounted to approximately $18 million for the quarter. In addition, in the Third Quarter, revenue increases from acquisitions, primarily our New York acquisition, was approximately $12 million. For our market-based businesses, revenues for the Third Quarter of 2012 remained relatively flat compared to the same period in 2011.

Turning to slide 11, as you know, our ability to invest in our infrastructure is driven by our ability to earn an appropriate rate of return on our investments. The extent to which requested rate increases will be granted by the applicable regulatory agencies will vary. Slide 11 shows rate increases that have been filed and those that are awaiting final orders as well as rate cases and infrastructure surcharges that have been recently granted.

Year-to-date we have been awarded, through General Rate Cases, approximately $118 million annualized rate increase. Additionally, we received another $15 million of annualized rate increases related to infrastructure surcharges. Today, we have filed two of the four rate cases which are scheduled to be filed in 2012, Tennessee and Virginia. As Jeff mentioned, Tennessee has been approved, and in Virginia we are awaiting a final order for the General Rate Case. A proposed combined settlement of $2.6 million is currently pending approval by the Commission. Also in July, our California cost of capital application was approved retroactive to January 1, 2012 and provided additional revenues of $4.4 million.

And finally, our New Jersey subsidiary submitted a foundational filing for a distribution system improvement charge. The filing was approved on October 23. The benefit from this filing, both for our customers and our shareholders, should begin sometime in 2013.

Turning our attention to water sales volumes, total Company sales increased approximately 8% for the three-month period ended September 30 from the prior year. This increase in water sales volume was driven, as you can see, by our residential customer class, which was up 9.7%. Both for the current year and year-to-date, the historic decline we have been experiencing in customer usage was offset by increased usage related to weather, primarily again in our eastern states and our Midwestern states. Also contributing to the increased volume sold was the additional consumption resulting from our New York acquisition.

The total Company operating expenses for 2012 Third Quarter increased by around $24.7 million or 5.2% from the 2011 Third Quarter and 2.7% for the last nine months. For our regulated business, O&M expenses increased $11.6 million or by 4% from the 2011 Third Quarter. However, it should be noted, for the year, regulated O&M expenses are relatively flat versus prior year. Overall, we manage our expenses with an eye to total cost and at times cost increases in one area that will increase in one area while decreasing in other areas.

In fact, year-to-date regulated expenses versus prior year would have decreased, if not for the increase in production and purchased water expenses related to the increase in system delivery, which we've discussed earlier. We also experienced higher depreciation expense of $7.9 million or 8.9% increase compared to the same period last year due to additional utility plant placed in service of over $700 million.

Based on our strong results for the year and attention to cost control, our regulated O&M efficiency ratio continues to improve. For the last 12 months, stripping out 2012 weather effect, the ratio stands at around 41.5%, a 230 basis point improvement over the year-end 2011 ratio.

Based on that and looking at our outlook for 2012, based on our year-to-date performance, our continued focus on expense control, and continuing to receive appropriate returns on our needed investments, as Jeff mentioned, we are reaffirming our 2012 earnings guidance to be in the range of $2.12 to $2.22 per share. This estimate assumes a normal weather pattern for the balance of the year and does not include any impact from Hurricane Sandy.

Based upon our initial review, we do believe the damages from the hurricane are not material to American Water and therefore should not have a material adverse impact on our results of operations, financial position, or cash flow. Upon completion of the evaluation of the damages and any associated business interruption losses, claims will be submitted to our insurance carriers. We anticipate that expenses which are not covered by insurance are likely recoverable through the rate making process on a state-by-state basis.

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

Jeff Sterba {BIO 1426511 <GO>}

Thanks, Ellen. We always end on slide 16 which talks about the expectations you can hold us accountable for. I'm not going to go through these in any detail because frankly they have either already been achieved as you know or significant progress has been made. There are none that I at this time have concern will not be achieved by the end of the year.

So with that Ellen, Walter Lynch, our Regulated Operations Head, and myself will be happy to stand for any questions you might have.

Questions And Answers

Operator

Thank you, sir. We will now begin the question-and-answer session. [Operator Instructions] Kevin Cole, Credit Suisse.

Q - Kevin Cole {BIO 18674088 <GO>}

Good morning, guys.

A - Ellen Wolf {BIO 1854557 <GO>}

Good morning.

A - Jeff Sterba {BIO 1426511 <GO>}

Good morning, Kevin.

Q - Kevin Cole {BIO 18674088 <GO>}

So I guess first with -- like starting with trying to get to a clean 2012 and so we need to adjust the guidance for $0.13 to $0.16 for weather and is there any other non-recurring items that we should put into our numbers when we think about the 2013 growth?

A - Ellen Wolf {BIO 1854557 <GO>}

At this point in time the only thing really is weather which is driving the high results for 2012, and yes when you look at 2013 you need to normalize for weather, and I put the word normal in quotes.

A - Jeff Sterba {BIO 1426511 <GO>}

Yes, and that's why we gave you the information on the $0.13 to $0.16.

Q - Kevin Cole {BIO 18674088 <GO>}

Okay, there is nothing on the O&M side or anything else that we need to adjust.

A - Jeff Sterba {BIO 1426511 <GO>}

No.

A - Ellen Wolf {BIO 1854557 <GO>}

No.

Q - Kevin Cole {BIO 18674088 <GO>}

Okay. And then when do you expect to give 2013 guidance?

A - Jeff Sterba {BIO 1426511 <GO>}

Well, we've given it -- last year, we gave it in mid-February, and we'll probably do it in the same time, although I must say that Ellen has a different theory about when we should give guidance. Ellen, would you care to?

A - Ellen Wolf {BIO 1854557 <GO>}

All right. Well, you're really going to have me do this today [ph].

A - Jeff Sterba {BIO 1426511 <GO>}

Yes.

A - Ellen Wolf {BIO 1854557 <GO>}

All right. So, the theory is that the Mayan calendar has the destruction of the earth in 2012, so at this point we are not sure we need 2013 guidance.

A - Jeff Sterba {BIO 1426511 <GO>}

We do have some concern about Ellen believing in the Mayan calendar and hopefully none of us are going to be the sacrificial lambs of those [ph] Mayan culture, sorry, we just had to laugh [ph].

A - Ellen Wolf {BIO 1854557 <GO>}

Okay, next question.

Q - Kevin Cole {BIO 18674088 <GO>}

And Jeff, I guess, given that you spent a lot of time on policy in Washington, I guess under an Obama Administration, do you expect any water rules to be expedited or I guess further tightened over the next four years?

A - Jeff Sterba {BIO 1426511 <GO>}

I think there clearly will be -- I think, and it really is not administrative dependent, there is going to be a continued focus on water and I think, rule 316[b] on the power plant side which is a direct impact on water is still outstanding. It won't come out in a ruling until next year. There is going to be, again, a focus on infrastructure and the need for infrastructure. There was a great article in Bloomberg just yesterday in fact I think if you didn't see it that raises this issue again and the reality is it can't be done by the federal budget. So the more that I've talked to folks up there, the more that seems to be well understood. They've got to do something on infrastructure and it can't be done by the Federal government.

So other than that I honestly -- one good thing that is going to come out and in fact it already has been out, the EPA is finally going to allow what utilities to get their -- the quality notices that we have to literally send to every customer, they are going to allow us to do that electronically. And I -- in one sense that's small, in another sense it's big. It's recognizing that this just isn't a bureaucratic process. It's about giving customers information. I don't think you're going to see major impacts on addition of new contaminants. There is a fair amount of work already being done on the emerging contaminants.

Q - Kevin Cole {BIO 18674088 <GO>}

Great. Thank you, guys.

A - Ellen Wolf {BIO 1854557 <GO>}

Thank you.

Operator

Michael Roomberg, Ladenburg Thalmann.

Q - Michael Roomberg {BIO 16581852 <GO>}

Hi. Good morning.

A - Ellen Wolf {BIO 1854557 <GO>}

Good morning, Mike.

A - Jeff Sterba {BIO 1426511 <GO>}

Good morning [ph].

Q - Michael Roomberg {BIO 16581852 <GO>}

Jeff, I just want to start off. I was particularly interested in your comments on Tennessee. Can you just kind of give us an update or an overview of what, I guess, the competitive landscape is there, who are the purveyors of water services in the state? I guess the hopes of gaining a better understanding the long-term opportunity for you guys there.

A - Jeff Sterba {BIO 1426511 <GO>}

Yes. The private water supplier is really us. All the rest of both water and wastewater is really done by municipality, some of which are really starting to struggle or their subdivisions of the state. Some of which we've got interconnections with and good relations with, Walter what would you add.

private water supplier is really us, all the rest of both water and wastewater is really done by municipalities, some of which are really starting to struggle or their sub-divisions of the state. Some of which we've got interconnections with and good relations with, Walter, what would you add?

A - Walter Lynch {BIO 6064780 <GO>}

Absolutely Jeff, that's it. We're the largest by far, there are some smaller providers there, but we're the big player within Tennessee and we do have a lot of interconnections and we're looking to expand in that area.

[inaudible] that's it.

Q - Michael Roomberg {BIO 16581852 <GO>}

Got it, got it. Okay, thank you. Just kind of some detail on the quarter, if I could. The volume was up and that was encouraging. I'm aware that mostly residential consumers are the most susceptible or kind of affected by weather, but we were encouraged to see that your commercial, your public, and your industrial consumption were all up as well for the second consecutive quarter.

I'm just wondering if you can kind of drill down into the factors that drive demand amongst those consumers and whether we can kind of choke that up to weather as well or perhaps it's tied to some other dynamic, the economy or otherwise?

A - Jeff Sterba {BIO 1426511 <GO>}

There is really two pieces. One is, customer growth and the other is consumption per customer. Frankly, we are seeing an uptick in customer growth, particularly in our commercial area, which -- it's something we really haven't seen for the last three years or so, but this year commercial customer growth has moved up well over 1% and residential customer growth is also up. So, that's a positive sign.

Ellen, on the use per customer side?

A - Ellen Wolf {BIO 1854557 <GO>}

Yes, again, on the use per customer that continues to decline although this time, it's been offset by the --

A - Jeff Sterba {BIO 1426511 <GO>}

Residential customers.

A - Ellen Wolf {BIO 1854557 <GO>}

-- residential offset.

On the commercial, industrial, and public, most of that other than customer growth, their use per customer in those three areas has stayed fairly flat. So, this is somewhat weather dependent.

A - Jeff Sterba {BIO 1426511 <GO>}

And about 48% of our sales is commercial, industrial and public, other.

A - Ellen Wolf {BIO 1854557 <GO>}

Yes, other.

Q - Michael Roomberg {BIO 16581852 <GO>}

Right.

A - Ellen Wolf {BIO 1854557 <GO>}

56% or so is from residential.

Q - Michael Roomberg {BIO 16581852 <GO>}

Got it. Now, that's very helpful color. Last question on the XTO contract and kind of just your overall strategy in the shale plays. My understanding is that's part of your regulated business. Is that correct?

A - Jeff Sterba {BIO 1426511 <GO>}

That's correct.

Q - Michael Roomberg {BIO 16581852 <GO>}

Okay. And is that part of your rate base spend or is it customer advances, how do you kind of account for that?

A - Jeff Sterba {BIO 1426511 <GO>}

Well, not going into rate base, the customer advances obviously supplied against that or it is a net through that. But yes, it goes through the regulatory process. And that's why under those transactions, frankly, we really aren't taking volumetric risk as we add those customers or add those points of interconnection. The cost roll in. They're paying retail price for water.

And as I've told you all before that doesn't mean we won't do things off on the unregulated side to serve those customers, but we think we really get a double bang when we can do it under this kind of a structure because we'll get the long-term benefit of residential growth as well as overall economic development.

I mean, that's what's going to position us to serve a big area that's growing in parts of the particularly Southwest Pennsylvania that we'll see long-term economic growth and -- in the areas that we currently don't serve.

So, for each of these, Michael, what we effectively do is we then -- we go into the Commission with a -- to get a certificate of territory expansion. And that's the other hidden -- I won't call it hidden, but that's the other locking up or long-term value that we put development.

A - Ellen Wolf {BIO 1854557 <GO>}

So, The thing to know, Michael, is that the pipe has two purposes, it supplies water to the drillers, but it also is supplying water to residents and customers that are there for the long term.

Q - Michael Roomberg {BIO 16581852 <GO>}

Got it. Thank you.

Operator

Neil Mehta, Goldman Sachs.

Q - Neil Mehta {BIO 16213187 <GO>}

Good morning.

A - Ellen Wolf {BIO 1854557 <GO>}

Good morning, Neil.

A - Jeff Sterba {BIO 1426511 <GO>}

Good morning.

Q - Neil Mehta {BIO 16213187 <GO>}

Can you refresh us on where you are with the DSIC mechanism in New Jersey? What's left from a regulatory perspective and when should we assume this impacts?

A - Jeff Sterba {BIO 1426511 <GO>}

Well, We filed the foundational filing back in July and we had it approved on October 23. So, it took roughly the 90 days that we anticipated, and right now we are investing for that foundational filing. As Ellen said, we're going to be recognizing the benefits of those sometime in 2013.

Q - Neil Mehta {BIO 16213187 <GO>}

Okay.

A - Walter Lynch {BIO 6064780 <GO>}

And, Neil, just we've said that there is about roughly how much additional investment that will be made in the next year. [multiple speakers]

A - Jeff Sterba {BIO 1426511 <GO>}

Yes, in the filing it had a three-year period of about $220 million.

Q - Neil Mehta {BIO 16213187 <GO>}

Got it. That is helpful. And then some more modeling-specific questions. How do you think about long-term tax rates? You've been tracking around 40%. Is that the right number and when is the earliest you would be paying cash taxes here?

A - Ellen Wolf {BIO 1854557 <GO>}

Right now, we'd look at our effective rate around 40% probably. We've ranged historically between 38% and 41% or 42%. Right now, we have NOLs of around $1 billion and we look at that lasting anywhere out 8 to 10 years.

A - Walter Lynch {BIO 6064780 <GO>}

The only thing I'd add on that, Neil, is who knows what gets done in the next set of years, but one of the areas where there is agreements between the parties is on corporate tax reduction, rate reduction, and that would extend out the 8 to 10 years.

A - Ellen Wolf {BIO 1854557 <GO>}

Right. That's correct.

Q - Neil Mehta {BIO 16213187 <GO>}

Got it. And then finally on pension here, how should we think about the drag of pension post 2012, both from a tax perspective and then also from an income statement perspective?

A - Ellen Wolf {BIO 1854557 <GO>}

A couple of things have happened, as you know the ERISA rules are changing as it relates to calculating that liability and therefore we'll have an impact on that cash flow for us beginning in 2013. So we are taking a look at that. If you could predict the market for the next two months, I might be able to answer that question with a little more certainty. It was doing fine for a while, but we really don't know what's going to happen in the last few months, and we do assume discount rates will continue to decline.

Q - Neil Mehta {BIO 16213187 <GO>}

Got it. Thank you, very much, Ellen, Jeff.

A - Ellen Wolf {BIO 1854557 <GO>}

Thanks.

Operator

Thank you. [Operator Instructions] Tim Winter, Gabelli & Company.

Q - Tim Winter {BIO 1518628 <GO>}

Really good quarter.

A - Ellen Wolf {BIO 1854557 <GO>}

Thanks, Tim.

A - Jeff Sterba {BIO 1426511 <GO>}

Thanks, Tim.

Q - Tim Winter {BIO 1518628 <GO>}

Ellen, I didn't really understand a comment about 2013 guidance, do you plan on giving guidance at some point for 2013?

A - Ellen Wolf {BIO 1854557 <GO>}

Sorry, Tim. We will be giving guidance in probably at the same -- in February as we have done historically.

Q - Tim Winter {BIO 1518628 <GO>}

Okay. Great. And then I was wondering if you could talk a little bit about your military base business, the non-regulated part, if you could give us -- is that business currently profitable, do you see opportunities or where are you there?

A - Jeff Sterba {BIO 1426511 <GO>}

Yes, that business is profitable. It's a very disciplined business that, frankly, creates some ideas that we are transplanting over into our regulated operations. There has been a slowdown in the issuance of RFPs over the last couple of years for base privatization, and we are seeing that dramatically turn. The number of notifications for potential privatizations has increased. There are bids outstanding at this stage, but remember these are fairly long processes. They take 16, 18, 24 months from the time that the RFP has left [ph] until the time that an award is made.

One of the things that slowed that business down was that in the law, the original law, there has been a provision that basically said there had to be a 10% savings to the federal government. The problem is that 10% from what, and so the way it had been developed was it was 10% from what they were spending. Well, they weren't doing -- they weren't spending appropriately, and so that was not a good base line.

We got that law change in December of last year and that's what has helped now move forward a new round of RFP. So, we're very bullish on that business. It will be a growth piece for us. We're the largest provider at this stage with 10 bases, but there is obviously others that are in that space and it's -- which is a good thing. It keeps us all on our toes.

Q - Tim Winter {BIO 1518628 <GO>}

Jeff, just one follow-up question on that. Those 10 bases, do you participate in like construction of projects there that --

A - Jeff Sterba {BIO 1426511 <GO>}

Oh, yes. Oh yes. And what you typically see is that when a base comes on line and there is word, you have a pretty big chunk of catch-up because there are things that just haven't done and they need to be done, and so you end up with capital dollars. So we operate the facilities, but we also manage all of the construction that's done. And so, you end up with annual awards for the construction as well as the operation and maintenance.

The amount of construction will vary year to year based on budgets and based on where those bases stand. Again, the biggest amount of construction that you'll see will be in the first three to five years of the contract because that's when you're playing catch-up and then you're going into a more steady state construction environment.

Q - Tim Winter {BIO 1518628 <GO>}

Okay. And then did we have -- I don't know, this will be my last question, did we have a earnings bottom line impact from that business for either the three or nine-month period?

A - Jeff Sterba {BIO 1426511 <GO>}

Well, it's included in our earnings from the market base businesses. We don't break them out separately between the businesses because quite frankly they're fairly small. Across the board they add up to a reasonable impact, but we don't give the individual business line detail.

Q - Tim Winter {BIO 1518628 <GO>}

Okay. Thank you.

Operator

Gerry Sweeney, Boenning & Scattergood.

Q - Gerry Sweeney {BIO 15217227 <GO>}

Good morning, everybody. Quick question on the rate cases that are pending and you expect to file, I know you can't necessarily go into specifics on states, but just taking a look at the number of pending rate cases, probably as small as we've seen in several years from American Water. Any type of thoughts on how many rate cases you plan to file on 2013 or is it going to be -- or you're shifting more towards some of the DSIC mechanism, so we can see -- may see a little bit more of a lag between rate cases in certain states? Any type of granularity on that would be great.

A - Jeff Sterba {BIO 1426511 <GO>}

Yes, Gerry let me make a few comments and Ellen or Walter may add something to it. Remember that one of our big focuses has been to move to single tariff pricing, and so as we have had success -- really what that means is that as we -- we used to have the file individual cases for certain territories and states. As we move to single tariff pricing that has collapsed those into one filing for a state. So that reduces the number of cases that may actually be filed.

The second thing is that DSIC mechanism, which is the major focus because obviously it reduces regulatory lag et cetera. So you're seeing more focus on those kinds of mechanisms, the DSIC type mechanisms. And then the rate cases may -- they may need to be less frequent, a little more time in between.

A - Ellen Wolf {BIO 1854557 <GO>}

Yes. Let me -- to further Jeff's point, in California, for example, we now do one rate filing where historically we would do about three a year. Now we do one every three years. In addition, on the infrastructure surcharge the power of that can be seen, in particular, this quarter where year-to-date we've had 118 [ph] in general rate case awards but $15 million [ph] more in DSIC. So probably about 12% or 13% of our rate increases are now coming through this DSIC mechanism.

Q - Gerry Sweeney {BIO 15217227 <GO>}

Okay. That's generally what I thought. Then one other quick question on the New York service line protection program, I apologize, I am not sure how much granularity you have on the Q. I didn't get a chance to get into it, but I think there were 600,000 customers, or potential customers I should say, how big of a market is this compared to the rest of the service line protection [multiple speakers]?

A - Jeff Sterba {BIO 1426511 <GO>}

Well, we look at it as it's basically another New Jersey.

Q - Gerry Sweeney {BIO 15217227 <GO>}

Okay.

A - Jeff Sterba {BIO 1426511 <GO>}

Because in New Jersey we have service line protection on the bill, about the same number of customers or territory if you will and fairly similar characteristics. And New Jersey is one of our very attractive markets for service line protection. We've got a lot of customers that take multiple services, water sewer, indoor applying and we are also rolling out electric and water [ph].

Q - Gerry Sweeney {BIO 15217227 <GO>}

Okay.

A - Jeff Sterba {BIO 1426511 <GO>}

Electric and gas, sorry.

Q - Gerry Sweeney {BIO 15217227 <GO>}

Got it. And then, finally one last question in terms of Sandy, North New Jersey and I think Long Island probably too hardest hit areas. Obviously, I haven't necessarily seen it, you only see it on the news, but I am not sure how much damage there was to maybe some of your operating areas. Any potential for the long-term damage that may reduce consumption in the 2013 or any thoughts on that or is that still just way too early?

A - Walter Lynch {BIO 6064780 <GO>}

Yes, hi, Gerry, Walter. We are not seeing any long-term issues there with the supply to our customers. I mean -- and as Jeff said during his prepared comments, our employees did a tremendous job moving generators around to make sure that we continue with our service, but we don't see any impact really long term and any water supply issues.

A - Jeff Sterba {BIO 1426511 <GO>}

The one area, Walter, may be like the Barrier Island, but that's such a small.

A - Ellen Wolf {BIO 1854557 <GO>}

Yes, on the Barrier Island, we do believe we may have lost a few customers their homes were probably wiped out, but that's a very, very small percentage of our total customer base.

Q - Gerry Sweeney {BIO 15217227 <GO>}

Okay, that was my assumption. So that's all I have, appreciate it. Great quarter.

A - Jeff Sterba {BIO 1426511 <GO>}

Thanks, Gerry.

A - Ellen Wolf {BIO 1854557 <GO>}

Thanks, Gerry.

Operator

David Paz, Bank of America Merrill Lynch.

A - Ellen Wolf {BIO 1854557 <GO>}

Good morning, Dave.

Q - David Paz {BIO 16573191 <GO>}

Good morning.

A - Jeff Sterba {BIO 1426511 <GO>}

Hi, David.

Q - David Paz {BIO 16573191 <GO>}

Hey, how are you doing? Just a question actually, just a follow-up on the previous question regarding rate cases. So, should we kind of think about the incremental revenue in 2013 being effectively from what you were awarded in 2012 and of course the DSIC [ph]?

A - Jeff Sterba {BIO 1426511 <GO>}

Well, remember, first, we'll go into detail when we give guidance in February. We've got rate cases as we've said there'll be two more filed this year and there will be some rate case activity next year, but most of them take a bit of time to get processed.

Q - David Paz {BIO 16573191 <GO>}

Right.

A - Jeff Sterba {BIO 1426511 <GO>}

So I think, as you look at that, you can kind of time out because any case that's going to be filed in April or May next year, you're not -- you're going to have minimal of any impact on 2013.

A - Ellen Wolf {BIO 1854557 <GO>}

And also to remind you we will continue to do the DSIC filings which we will have in Pennsylvania, Missouri and other states, as well as for the first time we will have that filing in New Jersey.

Q - David Paz {BIO 16573191 <GO>}

Okay. And speaking of the DSIC, how it relates to CapEx, I think in your -- maybe in your release you said for 2012 you expect $925 million of CapEx, but in 2013 still your typical [ph] $800 million to $1 billion range, is that correct?

A - Ellen Wolf {BIO 1854557 <GO>}

That's correct and we'll give more guidance on that number when we do our guidance for 2013, but it will be within that range.

Q - David Paz {BIO 16573191 <GO>}

It would be in that range. Okay. Oh, and last question just on sales, I apologize if you gave it earlier, but do you have a sense of how weather-adjusted sales were on a percentage basis, excluding the New York acquisition so if you're just looking year-over-year, particularly residential?

A - Ellen Wolf {BIO 1854557 <GO>}

Yes, the New York acquisition would not have impacted that by quite a bit. New York as a whole is in that other category when you look at somewhere below probably 3% or even less of our revenue as a Company.

A - Jeff Sterba {BIO 1426511 <GO>}

And that's all of New York.

A - Ellen Wolf {BIO 1854557 <GO>}

That's all of New York.

Q - David Paz {BIO 16573191 <GO>}

Okay, so then weather-adjusted sales in the residential [multiple speakers]?

A - Ellen Wolf {BIO 1854557 <GO>}

It's not that much. It wouldn't impact that percentage increase by very much at all.

Q - David Paz {BIO 16573191 <GO>}

Okay. But I'm sorry, so what is the actual percentage increase, weather adjusted residential level?

A - Ellen Wolf {BIO 1854557 <GO>}

We talk about it on a total and if you'll remember what we talked about was the impact on EPS is between $0.13 to $0.16.

Q - David Paz {BIO 16573191 <GO>}

Okay. And so your -- and in terms of customer usage it's still -- excluding weather, it's still about 0.5 and 1.5 [ph] annual decrease, is that fair?

A - Ellen Wolf {BIO 1854557 <GO>}

Yes, it varies by state, but that's correct, that's what the number is [ph].

Q - David Paz {BIO 16573191 <GO>}

Okay. Great. Thank you.

Operator

Heike Doerr, Robert W. Baird.

Q - Heike Doerr {BIO 15084832 <GO>}

Thanks. I wanted to go back to this topic of regulation. Jeff, when you first joined American Water you had talked about on a more macro level changing kind of the fundamental structure. I wondered if you could give us an update on how you see the receptiveness of commissions regarding some of these mechanisms like addressing declining consumption. And as you look out into 2013, 2014 are there states that you have targeted to expand things like DSIC?

A - Jeff Sterba {BIO 1426511 <GO>}

Well, I think by and large there has been receptivity and it's the different kinds of things. I mean, we've filed in virtually every proceeding and in some cases it shouldn't be in a rate case, it needs to be in a different type of proceeding to address declining use or to address mechanisms to encourage the investment of capital without a regulatory lag so that we can do the thing that's needed on the infrastructure side.

So I think by and large there are always, there is hesitancy about doing something that they haven't done before, even if it's being done somewhere else. We are seeing improvements in people thinking about future test years, a legislation pass [ph] so that's facilitated in Pennsylvania. We had good success in that in Illinois.

So I -- it's never what you want us [ph] to be, Heike, but it's -- I think most commissions are moving in the right direction, let me put it that way.

And are there certain jurisdictions that we have targeted for different things, yes. That's something that we talk to the commissioners about first. But that's a -- we certainly have a plan about the next set of things that we want to get done.

Q - Heike Doerr {BIO 15084832 <GO>}

Okay, that's helpful. And is there any way for you to quantify for us what kind of opportunity exist in the Marcellus for additional projects like the one you announced this quarter?

A - Jeff Sterba {BIO 1426511 <GO>}

What gas price? I mean, that's the problem.

Q - Heike Doerr {BIO 15084832 <GO>}

Candid to ask [ph], right?

A - Jeff Sterba {BIO 1426511 <GO>}

Yes. And I wish that we knew the answer. I mean, what we're pleased about is that we have not one, but multiple drillers that are interested in working with us on the kind of approaches that we -- these regionalization approaches, as well as ongoing discussions on more directed specific kinds of projects that will either be associated with clean-up of produced water or on the provision of significant water for drilling. It's a very difficult one to predict.

Q - Heike Doerr {BIO 15084832 <GO>}

That's all I have. Thanks.

A - Ellen Wolf {BIO 1854557 <GO>}

Thanks.

Operator

[Operator Instructions] Michael Roomberg, Ladenburg Thalmann.

Q - Michael Roomberg {BIO 16581852 <GO>}

Hi, thanks. I just wanted to touch on the Allentown contract. You guys were recently approved as bidders, and I think that they've now gone ahead and are allowing bids to be submitted. I am just wondering, first of all when -- the kind of timeline that you expect to play out [ph], obviously it's not exactly clear, I'm sure, even for you.

And then secondly, I just wanted to kind of get your thoughts a bit about what will be the key criteria that you think the city will be looking at and how you are competitively positioned to win that bid?

just wanted to touch on the Allentown contract. You guys were recently accrued these bidders and I think that they've now gone ahead and are allowing bids to be submitted. I'm just wondering, first of all when the kind of timeline that you expect [inaudible] obviously it's not exactly clear, I'm sure even for you. And then secondly, I just wanted to kind of pick your due to foster a bit about it, what will be the key criteria that you think that the City will be looking at and how you are competitively positioned to win that bid?

A - Jeff Sterba {BIO 1426511 <GO>}

Well, frankly those are great questions, Michael, for you to ask them. It's -- the schedule -- they have -- there is a form of contract, but they haven't issued the RFP, but are [ph] on the qualification stage. So until you get that, it's a little difficult to understand the schedule.

I think in their eyes it's a value question. It's what are they going to get as cash upfront for the system for someone to operate those systems. We see some opportunity to improve operations in those systems, but they're not -- they're not terrible systems.

They've done a reasonable job, they've got a capital constrain. So I think price is, well as you would expect, is going to be a significant issue, but that's about all I could say at this stage, as we're still working through our strategy, probably [ph] depending on what the criteria are that are in the RFP.

Q - Michael Roomberg {BIO 16581852 <GO>}

Right. I mean, not to belabor, I mean, do you think that other criteria, being a public company or having a certain credit quality or capitalization structure or even just your local regulated footprint will kind of be a factor?

A - Jeff Sterba {BIO 1426511 <GO>}

I have no doubt that other criteria will be taken into account. I don't think these decisions are -- they are multi-faceted because it's a long-term decision. How they will weigh those factors, we can't really judge or comment on because it's their weighting, but I do believe that they will be cognizant of the other factors, and we're trade guys [ph].

Q - Michael Roomberg {BIO 16581852 <GO>}

Right, right. Okay. I mean, From a bigger-picture perspective, does this represent a potential model, if you will, of course, if it's successful to kind of realize the long elusive dream of the water utility industry to kind of grow the privatized footprint?

A - Jeff Sterba {BIO 1426511 <GO>}

Well, Michael, it is a model, it is one of a couple that we're seeing more frequently in the market and I really think that's -- we're going to see some diversity in the models that can be applied to the municipal side. This is one that we do believe in. We think it has got some power.

I think there has been some challenges. For example, the city originally felt that the state was going to regulate the price. They've now been advised by the General Counsel that the state will not do that because the ownership of the system is still with the city. So, I think that changes a little bit of the emphasis about who will play and who has got what, just because of business strategies. So, it will vary by state to state, but I think it clearly is a model that we'll have some lags [ph].

Q - Michael Roomberg {BIO 16581852 <GO>}

Okay. Thanks, Jeff.

Operator

Thank you. And I'm showing no further questions. I'll turn the call back to Mr. Sterba for closing remarks.

A - Jeff Sterba {BIO 1426511 <GO>}

Well, I'd just thank you all again for joining us, and I know you join us in thoughts and concerns for the folks affected by the hurricane, and we look forward to seeing you. If we don't see you before Thanksgiving, have a great holiday.

Operator

Ladies and gentlemen. this concludes our conference for today. We thank you for your participation. You may now disconnect?