Q1 2018 Earnings Call

Company Participants

- Ed Vallejo, Vice President, Investor Relations
- Linda Sullivan, Executive Vice President and Chief Financial Officer
- Susan Story, President and Chief Executive Officer
- Walter Lynch, Executive Vice President and Chief Operating Officer

Other Participants

- Angie Storozynski, Analyst, Macquarie
- Claire Zeng, Analyst, Bank of America Merrill Lynch
- Richard Verdi, Analyst, Atwater Thornton

Presentation

Operator

Good morning, and welcome to American Water's 2018 First Quarter Earnings Conference Call. As a reminder, this call is being recorded and is also being webcast with an accompanying slide presentation through the company's Investor Relations website. Following the earnings conference call, an audio archive of the call will be available through May 10th, 2018. US callers may access the audio archive toll free by dialing 1-877-344-7529. International callers may listen by dialing 1-412-317-0088. The access code for the replay is 10119526. The webcast will be available at American Water's Investor Relations home page at ir.amwater.com.

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

Ed Vallejo {BIO 20515524 <GO>}

Thank you, Brian, and good morning, everyone. And thank you for joining us for today's call. And as usual, we will keep the call to about an hour and at the end of our prepared remarks, we will be opening the call up for your questions.

Now during the course of this conference call, both in our prepared remarks and in answers to your questions, we may make forward-looking statements that represent our expectations regarding our future performance or other future events.

Now these statements are predictions based upon our current expectations, estimates and assumptions. However, since these statements deal with future events, they are subject to numerous known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from the results indicated or implied by such statements.

Additional information regarding these risks, uncertainties and factors, as well as a more detailed analysis of our financials and other important information is provided in the earnings release and in our Form 10-Q, filed with the SEC.

Reconciliations for non-GAAP financial information discussed on this conference call, including, adjusted earnings per share, adjusted return on equity and our adjusted regulated O&M efficiency ratio can be found in our earnings release and in the appendix of the slide deck for this call. Also, a slide deck has been posted to our Investor Relations page of our website. All statements in this call related to earnings, earnings per share refer to diluted earnings and earnings per share.

And now, I would like to turn the call over to American Water's President and CEO, Susan Story.

Susan Story {BIO 3335156 <GO>}

Thanks, Ed. Good morning, everyone, and thanks for joining us. Today, our CFO, Linda Sullivan will cover our first quarter financial results; and COO, Walter Lynch, will give key updates on our operations.

The employees of American Water delivered strong results in the first quarter of 2018. Our earnings per share were up 13.5% compared to the first quarter of 2017. This includes excellent growth in both our regulated business and market-based business, and consistent with our previous guidance on April, the 20th, our Board of Directors approved a 9.6% increase in our quarterly dividend to $45.5 per share.

This marks the sixth year in a row that our dividend increase was at or above the top of our long-term EPS CAGR of 7% to 10%. We believe that long-term financial success depends on effectively executing the fundamentals of our business every day. These fundamentals include engaging our employees to fully provide excellent service to our customers, building constructive and transparent regulatory relationships, growing our business and becoming even more efficient in our operations to ensure affordability and value for our customers.

The foundation for our earnings growth continues to be the capital investment we make in our regulated operations to provide clean, safe and reliable service to our customers. We invested $343 million this quarter, with 302 million of that for our regulated infrastructure. We minimized the customer bill impact of these investments through a continued focus on controlling O&M costs, optimizing capital spend through both value engineering and volume procurement and through constructive regulatory mechanisms. Our regulated business closed several acquisitions during the quarter for a total of 3700 new customer connections.

We also added about 1500 more customers through organic growth in our footprint. We have an additional 47,000 customer connections under agreement, including the recently announced Alton Wastewater Systems. This one agreement will add 23,000 new wastewater customers in Illinois. We have served water in this great city for over 140 years, and our employees live, work and play there. So this acquisition is very special to us.

Walter will discuss this as well as our strong pipeline of potential regulated acquisitions in a few minutes. Earnings were also up in our market-based businesses. This was due in large part to an increase in results from our Homeowner Services organization, where we saw growth in customer contracts along with benefits from cost management efforts. As you are also aware, we recently announced our agreement to acquire Pivotal Home Solutions, which will nearly double our home warranty business.

Pivotal is highly complementary to our Homeowner Services Group. We have been in this business for 16 years and we're excited to welcome the great men and women of Pivotal to the American Water family upon close of the transaction, which we expect in the second quarter. With this strong start to 2018, and our continued execution of strategies, we are affirming today our 2018 guidance of $3.22 to $3.32 per share.

As we shared with you last month, given the Pivotal acquisition and the effects of tax reform, we expect our long-term growth to be in the top half of our 7% to 10% target EPS CAGR.

American Water will invest 8 billion to 8.6 billion over the next five years, excluding Pivotal, with more than 7.2 billion spend to improve our existing infrastructure. Under this plan and normal operating conditions, no new equity is needed. We see line of sight to our 32% target O&M efficiency ratio by 2022. And we affirm our earlier guidance of dividend growth at the high end of our 7% to 10% EPS CAGR, also through 2022.

Walter will now give you his update on our regulated business.

Walter Lynch {BIO 6064780 <GO>}

Thanks, Susan. Good morning, everyone. As Susan mentioned, our regulated businesses had a strong first quarter, making capital investments to ensure clean, safe and reliable water service, while continuing to improve our operating efficiencies to benefit our customers. We also had tremendous growth, driven by acquisitions.

Let me start on slide nine with an update on our Missouri rate order that we just received yesterday afternoon. As you know, we filed a Missouri Rate Case last June, requesting an increase of $64 million in annual revenue, adjusted for tax reform. The request was driven by more than $250 million in investment in our systems, since our last rate order in 2016.

On May 2nd, the Missouri Public Service Commission issued an order approving new rates, resulting in approximately $38 million in additional annual base rate revenue, which includes $5 million of previously approved ISRS revenue. Our calculated return on equity for this black box settlement is 10% with a 52.8% equity ratio. New rates are expected to take effect in late May or early June.

Turning to slide 10. Let me provide an update on our ongoing rate cases. In New Jersey, we filed a rate case last September, seeking recovery of $868 million in infrastructure upgrades, made in less than three years, since our last rate adjustment in 2015. At this point, all parties have engaged in settlement talks, and we're currently analyzing the recently filed position. While settlement discussions may resume at any point, the company is preparing for evidentiary hearings scheduled to begin in June.

Our customers have already received a rate decrease of almost 6% effective April 1st of this year, to reflect the impact of the Board of Public Utilities Tax Cuts and Jobs Act docket New Jersey. The company is an active participant in the tax docket, which is expected to be resolved in June of this year.

In West Virginia, we filed an application to adjust rates with the Public Service Commission on Monday, requesting an increase of approximately $29 million in annual revenue already adjusted for tax reform. The primary reason for the rate request is the approximately $200 million that the company, who have invested in system improvements to replace and upgrade aging infrastructure since its last rate order in 2016.

Our team in West Virginia has worked hard to keep operating expenses relatively flat for the last 10 years, by working more efficiently, improving processes, utilizing technology and leveraging economies of scale. The filing also proposes a new proactive approach to addressing lead service lines, which is part of our commitment to maintain excellent water quality, and protect customer health and safety.

Moving to the California general rate case for 2018 to 2020, the California Public Utility Commission is considering the impact of the recent tax reform, and we now expect the Commission to issue both a proposed decision and a vote on a final decision in the third quarter of this year. Rates will be retroactive to January 1st 2018.

Turning to slide 11, let's continue discussing regulatory matters in California. In March, a final decision was issued, which authorized California American Water, a return on equity of 9.2% with an equity ratio of 55.39%, up from 53%. I want to thank our California team for working in a collaborative way with all parties to get better result.

Lastly, in California, the Monterey Bay National Marine Sanctuary and the California Public Utilities Commission released a favorable final environmental impact report or EIR in March related to our desal project.

This is the final plan for the project. That means both the National Environmental Policy Act and California Environmental Quality Act Standards. It's been six years in the making, and after reviewing environmental impacts, the federal and state government believe this is the right project at the right location. The Commission will accept final comments and then consider approving the final EIR likely in the third quarter of this year.

On the legislative front, Senate Bill 362 was enacted in Indiana during the quarter. This Act part of Indiana's commitment to water is similar to the Water Quality Accountability Act enacted in New Jersey in 2017. It sets new standards and requirements for water and wastewater systems in areas, such as capital asset management, cost benefit analysis and cyber security programs. We believe this legislation, along with the legislation in New Jersey, is in the best interest of all water customers. And recently in Iowa and Maryland, fair market value legislation has been enacted, which allows communities to receive an appropriate value for their systems.

This legislation provides an independent expert appraisal system and removes roadblocks for communities to solve their water and wastewater challenges. Our State teams have done a great job working with many stakeholders to replicate meaningful legislation across our entire footprint, all to benefit customers.

Turning to slide 12. We added 3700 new customers to date and have another 47,000 customers to sign agreements. In addition to the 1500 we added through organic growth. In April, we announced an agreement to acquire Alton's Regional Wastewater System, which will add 23,000 new customers. Illinois American Water has owned, operated and maintained the water system serving Alton for the past 140 years. This is another example like Scranton, and McKeesport, where we'll deliver efficiencies by providing wastewater services, where we already provide water services.

Alton Mayor, Brant Walker said that this agreement "puts our wastewater system and its ongoing needs in professional hands with Illinois American Water, a company that's familiar with Alton and its residents. The deal will give existing city employees more training, career advancement and professional development opportunities."

And just yesterday, Pennsylvania American Water announced an agreement to acquire the wastewater assets of Sadsbury Township in Chester County, which serves approximately 1,000 customers. Here too, our company and our employees have been the long time water service provider for this community, and we're excited for the opportunity to be the future provider of wastewater service to our Sadsbury customers.

Moving to slide 13. Doing right by our customers is key to our ability to grow. This means smart investments, balance by efficient operations and capital deployment. We invested $302 million in our regulated operations this quarter. This is critical to reliable service, but it's also about affordable service. We continue to make progress towards our long-term goal of 32% by 2022, because of our employees and their commitment to our customers.

Let me give you some examples. We continue to see O&M savings associated with the enhanced functionality and integration between our work management systems and our primary asset management systems, creating editing or retiring an asset record was historically very cumbersome. Now our people can access asset records directly through a more user-friendly system called MapCall, it reduces their time spent on basic asset control functions by approximately one-third, across the business, this will translate to about 10,000 hours saved per year.

We also continue to realize savings in our telecommunications spending. For example, we're migrating from dedicated leased lines for data to cellular solutions at a fraction of the cost. In New Jersey alone, we'll save approximately $200,000 in 2018, and we plan to roll this out system-wide in the near-term.

Finally, I want to acknowledge the tremendous effort by our employees to deliver exceptional customer service and to manage costs during a brutal winter in Northeast and Midwest, which as you know, puts tremendous stress on underground infrastructure. To give you an idea of their challenge in the first quarter, our Missouri team addressed 1700 main breaks, which is triple the normal rate. And our West Virginia team handled 1,100 main breaks, which is double their normal rate.

I want to thank all of our teams for working safely in frigid and dangerous weather conditions to keep life flowing in our communities. That was a good quarter with continued growth, smart investments and engaged employees, driving efficiencies and quality results, all to benefit our customers.

With that, I'll turn the call over to Linda for more detail on our financial performance.

Linda Sullivan {BIO 7300156 <GO>}

Thank you, Walter, and good morning, everyone. I'll start on slide 15. We had a strong first quarter. Earnings were $0.59 per share, up $0.07 or 13.5% over the first quarter of last year. The regulated businesses were up $0.05 or 9.4%, the market-based businesses were up $0.03, and the parent was down a penny.

Let me walk through our results by business segment in more detail. As I mentioned, our regulated operations were up $0.05. Revenue was up $0.03 in total and included two major components, a $0.16 increase from authorized rate cases, infrastructure mechanisms and acquisitions, including the Pennsylvania rate case settlement, which became effective on January 1st of this year. Partially offsetting this increase with a $0.13 reserve, which represents the estimated amount of revenue that will benefit our regulated customers, as a result of the lower federal tax rate.

Next, we had higher production costs of $0.03 per share, mainly from purchased water price and usage increases in California. O&M expense increased $0.06 per share from regulated acquisition growth and higher main breaks resulting from the frigid weather conditions that Walter discussed.

Depreciation was higher $0.02, driven by our investment growth. Also, our income tax expense was favorable $0.13, mainly from the lower federal tax rate.

Turning to our market-based businesses. The full $0.3 increase was from our Homeowner Services Group, due to operational efficiencies from improved management of key contractor relation -- partnerships, as well as customer growth and the favorable impact of the lower federal tax rate.

Our military services group was flat compared to the prior year, as operational improvements offset the impact from lower capital upgrades in the first quarter of this year. And Keystone was slightly positive compared to the same period last year. And lastly, the parent decreased a penny, mainly from the lower tax yield on interest expense.

Turning to slide 16, let me provide an update on the impact of tax reform. From an earnings perspective, we continue to see tax reform is largely earnings neutral in 2018, with the lower tax rate benefiting our customers in our regulated businesses and the benefit in our market-based businesses being largely offset by the lower tax shield on interest at the parent. From a cash flow perspective, we have had some positive developments.

In late March, a bill was passed that clarified bonus depreciation eligibility for projects that began before September 2017. With this clarification, we expect to be able to increase estimated bonus depreciation in the range of $150 million to $300 million, which would increase expected cash flow in the range of $30 million to $65 million. This impact is expected to push the timing of when we become a federal cash taxpayer into the beginning of 2020.

Now, we continue to work through the regulatory process of tax reform with our 14 regulatory jurisdictions. In terms of status, we have adjusted rates to reflect the benefits of the lower tax rate in two states, New Jersey and Illinois, four of the remaining 12 states have agreed to address the impact in their next general rate case. We will continue to work with our regulators on the best approach to return these benefits back to our customers. And then all of our jurisdictions, we are working to defer amortization of the re-measurement of accumulated deferred income taxes until we receive further clarification.

This is the portion required to be normalized or return to customers over the remaining life of the asset. And to date, a few of our jurisdictions have agreed to this deferral. So overall, we are trending positive on cash flow from our original estimated tax reform impact. In addition, we expect to have a positive impact to operating cash flow from the Pivotal acquisition, which once closed is expected to increase overall cash flow from our market-based businesses by 30%. The excellent progress we have made so far this year is due to the tremendous efforts of many employees across our company, especially our finance tax and regulatory team.

Turning to slide 17, let me provide an update on our regulatory filing. We have $110 million in annualized new revenue, effective since January 1st of this year. This includes 95 million from the Pennsylvania and Missouri rate case settlement, and 15 million from infrastructure mechanism. We have also filed requests and are awaiting final orders on three rate cases and one infrastructure surcharge for total annualized revenue of request $165 million after adjustment for the lower federal tax rate.

Turning to slide 18. Today, we are affirming our 2018 earnings guidance range of $3.22 to $3.32 per share. Although, we are off to a strong start this year, we still have 9 months of the year to go, and as you're all aware, generally, the most significant variable to earnings is weather, with the largest impact typically occurring in the summer months of the third quarter of each year.

Turning to slide 19, we are committed to continue to deliver value to our customers and shareholders, so you may have confidence in our disciplined financial approach. We have consistently delivered strong total shareholder return far outpacing the UTY index of the one, three and five-year period, and the S&P 500 to the three and five-year period. We've been a top leader in dividend growth for six consecutive years, with dividend growth at about 10%, and we expect to grow our dividend over the next five years at the top of our 7% to 10% EPS growth range subject to Board approval. And we continue our targeted dividend payout ratio of 50% to 60% of earnings.

Our adjusted return on equity improved from 9.7% to 10% for the 12-month period ended March 31st. Our weighted average authorized return on equity across our regulated footprint remains approximately 9.8%, and we continue to execute on our commitment and drive value through a continuous improvement culture, that focuses on O&M efficiency, capital efficiency and constructive regulatory outcome. Through this disciplined financial management, customers and shareholders maybe confident that American Water will continue to deliver value. With that, I'll turn it back over to Susan.

Susan Story {BIO 3335156 <GO>}

Thanks, Linda. I mentioned in my opening remarks that we believe long-term financial success is an outcome of doing everything else right, and successfully executing on the fundamentals of our business. What this means is to us is not only developing solid strategies, but also clearly communicating our basic beliefs and philosophies on running our business. What we do and how we do it?

Our strategies are in the areas of safety, customer, people, growth and technology and operational efficiency. Our values or how we accomplished these strategies, include safety, which is both the value and the strategy, trust, environmental leadership, teamwork and high performance. So why should you care about any of this? Because this is our core and what we continually evaluate our actions by, not just a bunch of words on a piece of paper.

We continually ask ourselves key questions .First, are we providing a safe environment for our employees and the public with all that we do? Are we developing our people to the fullest potential in their jobs? How are we implementing technology to improve customer service and reduce our costs? What are we doing to protect our natural resources and water supply? Are we a respected voice for clean and safe water throughout the US? Will these initiatives lead to higher trust in us by our customers, communities and regulators?

Our story is pretty simple and straightforward. We know and love the business of water and water services. We're committed to finding and delivering cost effective solutions to problems and challenges with water supply, water quality and water infrastructure for our customers and communities throughout the country. Which really believe in the importance of values and purpose in all that we do, including and achieving financial results. The world and yes even the water industry can be a chaotic place at times. Our customers and our investors have plenty of things to worry about. Our goal is not to be one of them.

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

Questions And Answers

Operator

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

Q - Angie Storozynski {BIO 15115714 <GO>}

Thank you. Two questions. One is a bigger picture question. So we've seen a lot of corporate M&A involving water utilities and a recurrence of water utility, and then pick [ph] to potentially acquire gas utilities. If you could share your thoughts about it, given that you have announced a number of municipal deals as of late. And again, what's your take on what's going on in the industry?

A - Susan Story {BIO 3335156 <GO>}

Well, first of all, good morning, Angie.

Q - Angie Storozynski {BIO 15115714 <GO>}

Good morning.

A - Susan Story {BIO 3335156 <GO>}

And thanks for listening in. It's interesting, so we don't really comment on what other companies do, but we are happy to talk about the way we look at things. We constantly survey the environment for opportunities, but at the end of the day, we are very comfortable with our growth strategy, and it's very transparent in the triangle, the 5% to 7% from infrastructure investment, and we've laid out clearly our plans for that. And as we said, we have decades of investment need, and through tax reform and our continuing O&M efficiency, we're finding ways to make that much more affordable for our customers. As you mentioned, the 1% to 2% that we put on our growth triangle is strictly our history of these regulated acquisitions, distressed municipality being a solutions provider for those entities that need help. And then our market-based business, while very limited in what we want to get involved with, we want to do really well in those businesses we know, like we've mentioned before, our Homeowner Services, Military and Keystone. So it's interesting, we watch, we're interested, but at the end of the day, as I mentioned in my concluding remarks, our core is water and wastewater services, we think that's what we're really good in. We believe there is lots of opportunities for investment and getting better with investment, and we think that this highly fragmented industry and sector with 53,000 water providers and 17,000 wastewater, and so few are actually managed from an overall coordinated standpoint with an entity as large as we are, where we can basically leverage volume procurement, and our technology, and our size, scope and scale, we think that's very attractive.

So we watch, we survey, but we're comfortable with our strategies as we have outlined -- as we've laid them out.

Q - Angie Storozynski {BIO 15115714 <GO>}

Perfect. And my second question to Linda. So given your updated views on operating cash flows, especially in light of the Pivotal acquisition. Have you been in discussions with credit agencies? And do you think that this improvement is going to be sufficient for you guys to avoid any potential credit downgrades?

A - Linda Sullivan {BIO 7300156 <GO>}

Yeah. And we are constantly working with our credit rating agencies, we have meetings set up on an annual basis, and we would expect to continue to hold those meetings. We were also in discussions with our credit rating agencies with regard to the Pivotal acquisition. And so we're continuing to work through that. As we mentioned, when tax reform was implemented that, we would expect our FFO to debt metric to drift a bit lower, as a result of tax reform.

We've been making positive improvements on the cash flow front since then, and we'll continue to look and to manage our cash flow very carefully. And we do have to remember that, that is one metric that the rating agencies look at, probably the bigger item around ratings is the risk profile of the water and wastewater industry. And that has not changed. And so -- and we sit very well within that -- that the industry here,.

Q - Angie Storozynski {BIO 15115714 <GO>}

Okay. Thank you.

A - Susan Story {BIO 3335156 <GO>}

Thank you, Angie.

Operator

Our next question comes from Richard Verdi with Atwater Thornton. Please go ahead.

Q - Richard Verdi {BIO 15139674 <GO>}

Hi. Good morning, everyone, and thank you for taking my call. And great quarter too.

A - Susan Story {BIO 3335156 <GO>}

Thanks, Rich.

Q - Richard Verdi {BIO 15139674 <GO>}

I'm quite clear on everything, but I have a question on another area outside of the quarter, and it pertains to safety culture. As you guys all know I'm pretty active with presenting on the conference circuit, and for about the past two years, I've noticed the topic of safety and protection has become an more and more prominent area discussed by other presenters at these events, and originally, it could be considered filler, but it really does appear that this is an emerging trend with some potential for positive impact. I was at the Southwest Infrastructure Water Summit earlier this week and Bill (inaudible) of American Water was discussing how the companies are at the forefront of ensuring employee safety. It was interesting, because he was delivering remarks stating that American's basically considering a bunch of different technologies, one of which is robotics.

And so I was just wondering if you could share with me what implementing these technologies could mean for employee safety? And what that could do for both the American Water financials, as well as for the customer, because thinking about depending on how that's implemented, it could be a cost and not an investment.

A - Susan Story {BIO 3335156 <GO>}

Rich, that's a great question. First of all, I will start with and we tell this to all of our -- almost 7,000 employees. Number one thing is that every employee goes home to his/her family in as good shape as they came to work with. I don't believe that any company can be a great company, if people get hurt or killed at work period. Nothing else you do, I mean, it sends a message as to what value you put on human people and in the nature of our business, I think that's a core value that we all have to have.

That's what the value, and I mentioned, it's also a strategy. Strategically, as you mentioned, some of the things we're doing on technology, we're very excited, we actually launched an internal safety app last week. What this app does, is it allows people in the field to be able to go and say -- and some of this is already functional, and the rest will be functional in a few months. I go out to a location, and it's a meter or a pump or something I'm not accustomed to, I can take a picture of it, it will code in and show me exactly what I need to do in terms of operational processes.

It will let me take a picture and send in and say this looks stranger, I need additional equipment, can someone send me equipment out. There is an investment in the technology, but the saving in terms of just fundamentally getting the job done right the first time, avoiding injuries, avoiding the costs that come with injuries. Number one is the right thing to do to focus on employee, and by the way, safety for the general public. When you're water company, if safety is not number one, not just for employees, but also for the public in terms of the services you provide, and how you provide it, then I think that company is not going to be long-term financially successful.

So we're very excited about what we're doing. And in terms of robotics, for example, a lot of the work that our folks on the front lines have to do is very manual, very physical. We're investing in technology. For example, putting devices on trucks that will open up some of the valve, that will open up and lift some of the meters that weight 50 pounds, 60 pounds, with aging workforce as others have, finding ways to reduce those tissue, those strain [ph] sprain. So yes, it is an upfront investment, but it is in the an investment that's paying off from a people standpoint, and its also we're finding paying off from a financial standpoint.

Walter, you might want to add something?

A - Walter Lynch {BIO 6064780 <GO>}

Yes. Thank you, Susan. Safety is number one at our company, and the safety culture is just taking off at our company, because as Susan said, there's nothing more important than our employees going home at the end of the day in the same condition in which they came in. And we talk about it, but it's also important that we go out and we demonstrate it with new technology.

And one of the things we're doing, we've talked in the past about drones, we're using drones to do things that before we used to do with people climbing on water tanks to inspect water tanks. And now we're using drones to inspect water tanks. Also above ground water line, we're using drones to inspect those. So we're looking at every available technology to make sure that what we're doing is in the -- is in the interest of our employees and is that we're doing in the safest way.

Q - Richard Verdi {BIO 15139674 <GO>}

That's interesting. Thank you very much, guys. I appreciate the time. It's really interesting. And again, great quarter. I Appreciate it. Thank you.

A - Susan Story {BIO 3335156 <GO>}

Thanks, Rich.

Operator

And our last question today will be from Claire Zeng with Bank of America Merrill Lynch. Please go ahead.

Q - Claire Zeng {BIO 20347802 <GO>}

Hi. Great quarter. Thank you so much for taking the question.

A - Susan Story {BIO 3335156 <GO>}

Thanks, Claire.

Q - Claire Zeng {BIO 20347802 <GO>}

Yeah. So I wanted to do two quick housekeeping keeping items on the market-based businesses. So the first is, I think with the Pivotal transaction, you guys are coming pretty close to the 15% mark for EPS contribution from your unregulated businesses. Just wanted to get your thoughts there on, if that's how you think about, that 15% or how that -- is that metric has little more flexibility and the timing for that?

A - Linda Sullivan {BIO 7300156 <GO>}

Yes, Claire, thank you for the question. And the way that -- what we disclosed as part of the Pivotal acquisition is that, although, this acquisition really kind of nearly doubles the size of our HOS business. We expect over the next five years to continue to see the entire market-based business, representing less than 15% of our total earnings per share. And so you're absolutely right there, that's what we see. And when we step back and strategically look at the overall risk profile of the company, the 15% to 20% of our market-based businesses is where our comfort zone is, and only up to 20%, if it is something that has a regulated type risk profile.

So more regulated like in that, in that regard. And so that's where we are, that does not change our fundamental strategy at all in terms of our market-based business or the overall outlook of how large those businesses could become.

A - Susan Story {BIO 3335156 <GO>}

And Claire, this is Susan. And to add to that, when you think about how small market-based is for our total business, when we talk about doubling Homeowner Services as Linda said, it's still such a small part of our overall business, because regulated currently is about 90%, it takes a lot to really move that. So something like this really as Linda said, over the next five years, it could move as closer to the 15, but that's given that we don't do other thing. So -- and our goal is, we really prefer the 15%, which you said regulated like, that's something like Military, where you get the 50-year contract, so that you have some certainty there, that's what we consider to be regulated like. So right now, we're very comfortable with it being right at and below 15%.

Q - Claire Zeng {BIO 20347802 <GO>}

Got it. That's really helpful color. Thank you. And the second question is, since you've had a bit of time to review the Pivotal transaction. Just to be sure that you guys are still saying, it will be irritable in terms of earnings contribution, as in, it will be zero, maybe 3-6 9-12, just want to get some color on that.

A - Susan Story {BIO 3335156 <GO>}

Absolutely. So what we disclosed was that, we would be earnings neutral in 2018 after transition costs, and this is assuming that we closing the second quarter will be accretive in the first full calendar year 2019. And then that accretion would steadily grow to about $0.12 per share by 2022.

Now that said, we will do a purchase price allocation upon closing, and these businesses as you are aware are capital-light, but they do have some capital investments in operational and customer system. And we plan to integrate those systems over time, and that will likely require accelerated depreciation, as we move to integrate the system. And that's why we've built in this gradual accretion. We need to close it first, and then, we'll put together a more detailed integration plan.

Q - Claire Zeng {BIO 20347802 <GO>}

Got it. That's all from me. Thank you.

A - Susan Story {BIO 3335156 <GO>}

Thanks, Claire.

Operator

This will conclude the question-and-answer session. So with that, I'd like to turn the conference back over to Susan Story for any closing remarks.

A - Susan Story {BIO 3335156 <GO>}

Thank you, Brian. And thanks to everybody for participating in our call today. Please note again that we value you as our investor owners and as the financial analysts who research our company for the benefit of your client and their futures. We always want to be open and transparent in all of our discussions and dealings with you, so you can have confidence in your decisions around our company and the investments in our stock.

If we've not been able to address your questions or if you have additional questions, please call Ed and Ralph, and they'll be happy to help. I'd like to remind everyone that our Annual Shareholders Meeting will take place next, a week from Friday, on Friday, May, the 11th. Thanks again for listening, and have a great week.

Operator

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