Q1 2022 Earnings Call

Company Participants

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

Other Participants

- Gregg Orrill, USB
- Rebecca Yuan, Goldman Sachs
- Ryan Greenwald, Bank of America
- Shar Pourreza, Guggenheim.

Presentation

Operator

Good morning and welcome to American Water's First 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 archives will be available for one year on American Investors Relations website. Now I turn it to host for today's call, Mr. Aaron Musgrave Senior Director of Investor Relations. Mr. Musgrave you may now begin.

Aaron Musgrave {BIO 22474483 <GO>}

Thank you, Nick. 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 March 31, 2022 Form 10-Q each filed yesterday with the SEC. All statements during this presentation related to earnings and earnings per share referred to diluted earnings and earnings per share. Susan Hardwick, our President, CEO, and CFO will discuss first-quarter financial results 2022 earnings and long-term guidance, and our commitment to ESG principles. Cheryl Norton, our Executive Vice President and COO will then review our regulated growth strategy, including capital investments and regulatory proceedings in the first quarter. Susan will then comment on some exciting news we shared yesterday regarding our executive management team before closing by answering your questions. With that, I'll turn the call over to American Water's President, CEO, and CFO, Susan Hardwick.

Susan Hardwick {BIO 16618718 <GO>}

Thanks, Aaron. And good morning everyone. As Aaron said, I'll comment further in just a few minutes about recent announced additions to our executive team. But I want to start by saying what a privilege it has been to serve as the company's CFO of these past three years, but I also must say I'm thrilled that this will be my last call as the CFO.

Let's turn to slide 5 and 6 and I'll start by covering our first quarter financial results and then share some business highlights to start the year. In the first quarter of 2022 earnings were $0.87 per share compared to $0.73 per share in the same period of 2021. Results for the Regulated business drove all of the increase of $0.14 per share while market-based business and other results were essentially flat as compared to the same period in 2021.

Regulated results for the quarter reflect revenue increases from several general rate proceedings completed in 2021 and early 2022, as well as from infrastructure mechanism filings. These higher revenues were partially offset by higher depreciation and increased production costs due to some inflationary pressures on chemicals and energy prices. Market-based businesses and other results were similar in the first quarter of 2022 and 2021 with a loss of $2 million or $0.01 per share in both of those periods. But in those results the $0.07 per share of earnings from HOS in 2021 was mostly offset in 2022 by the interest income, and earnings from the revenue-sharing agreements in place as a result of the sale of HOS late last year.

While we're currently reflecting the interest income and a revenue share contributions in other, they really do represent results driven by the regulated business and will even more so once the proceeds of the note receivable from the sale are received and redeployed into regulated capital investment. We will continue to report these pieces separately so that it is easy to track. Finally, our Military Services Group had similar results in both quarters and our MSG team continues to expect an announcement on the Naval Station Mayport Florida bed this summer.

In addition to the strong quarter of earnings growth, our regulated business invested $437 million in capital projects and acquisitions in the quarter. This is a great start to the year and puts us on pace to meet our $2.5 billion capital investment goal in 2022. I may sound like a broken record here, but as we've said last year when we announced our stepped-up capital spending plan, the increasing levels of investment will continue to ramp up during this year and over the next few years and it will take time to see recovery of those investments in rates. We're now in the regulatory cycle that we've talked about before with general rate cases being filed every two to three years in our larger states.

We've already announced rate case filings in New Jersey and Illinois earlier this year, which are proceeding as expected. We'll be filing a general rate case in Pennsylvania tomorrow and our next case in California next week, which follows the statutory cycle there. In aggregate, we expect to file five to six general cases in 2022 seeking to earn a return on over $4 billion of investment. Clearly, regulatory execution is critical to the success of our plans.

Let me make one more comment on our investment progress before I move on. As you will recall, the $2.5 billion total capital investment plan for 2022 includes the $235 million anticipated acquisition of the City of York's wastewater system that we're very excited about. We're also excited though about the 30 other acquisitions across several states we have under the agreement as of March 31. They demonstrate that the acquisition pipeline is quite strong.

Turning to slide 7, after a strong start to the year we are affirming our 2022 guidance range of $4.39 per share to $4.49 per share. As we shared in February our expected regulated earnings growth range in 2022 of $0.24 to $0.30 reflects new authorized rate levels in several jurisdictions. As expected, we saw much of that revenue increase related to new rates in the first quarter of 2022 including in Pennsylvania, which recorded a full quarter of the base rate increase from last year, as well as the step increase effective January 1 of this year.

We also experienced about $0.03 per share of timing favorability for operating costs in the first quarter of 2022 that we expect to reverse in later quarters. As I've mentioned previously, we will not see any material earnings in 2022 from the redeployment of the sale proceeds from HOS in New York, but the expected earnings from interest on the seller note and revenue from the utility share agreements will nearly offset the loss of the prior annual earnings contribution from HOS. Finally on slide 7, I'll just reiterate that we are confident in the long-term financial targets we set forth in November, including 7 to 9% EPS growth through 2026.

Moving on to slide 8, as we announced yesterday, our Board of Directors increased the company's quarterly cash dividend payment from 60.25 cents per share to 65.5 cents per share in nearly 9% increase. Including this year's expected increase we have grown our dividend at a compound annual growth rate of 9.6% over the last several years significantly outpacing most of our utility peers. We plan to grow the dividend at the high end of the 7% to 10% range as we know that it is important to many of our shareholders.

Before I turn the call over to Cheryl, I want to cover a few important points related to our industry leadership in ESG. Coming in May, we plan to issue our second annual inclusion diversity and equity report. This report will highlight the efforts we have undertaken and the strides we have made advancing our commitment to building an inclusive workplace. Within the report you will find our first disclosure of consolidated EEO1 data for American Water based on feedback from shareholders and ESG best practices. We made a commitment in our recently filed proxy statement to begin disclosing this data annually in 2022 and thereafter.

This action will deliver on that commitment. We are also pleased to be publishing in May the second annual instalment of our ESG data summary, which will be found on the sustainability page of our Investor Relations website. The data summary will share numerous metrics for calendar year 2021 including Scope 1 and Scope 2 emissions and progress toward our greenhouse gas emissions reduction target. As many of you know, American Water has achieved significant greenhouse gas emission reductions over the last decade. Due to the nature of our business and our emission reductions over the years, we are in a great position relative to a large majority of our utility peers.

For example, we're able to talk about our emissions footprint in hundreds of thousands of metric tons whereas most other utilities talk in terms of millions of metric tons. Last year we came closer to achieving our current goal. We began the process of evaluating new greenhouse gas emission targets. This evaluation is well underway by a large cross-functional team and is running in parallel with our annual planning process. They are focused on diligent study and analysis including the potential addition of the Scope 3 emissions and potential alignment with the Paris agreement.

The team expects to present its findings and recommendations to management and the Board later this year. I wanted to share this update with you today to demonstrate our commitment to transparency is one of the top ESG leaders in the industry. And with that let me turn the call over to Cheryl to cover in more detail our operating results and strategies for 2022, Cheryl.

Cheryl Norton {BIO 17107572 <GO>}

Thanks, Susan, and good morning everyone.

Turning to slide 11, our regulated business leaders and their teams did a great job in the first quarter executing on our increased capital plan. It took a significant effort to safely and efficiently deliver the dozens of projects that improved our systems and drove capital investment higher by nearly $100 million in the quarter compared to the same period last year. This result keeps us on pace to hit our goal of approximately $2 billion of regulated capital investment spending in 2022.

Turning to Slide 12, shown here is our summary of rate case filings and legislative updates. On the legislative front, there are three pieces of legislation that are passed so far this year, two in Indiana and one in Virginia. The Virginia Bill is an important confirmation of the use of standalone state-specific capital structure in rate-making proceedings for investor-owned utilities. The two Indiana bills provide constructive outcomes around the recovery of property taxes, as well as promoting sound safety and asset management practices by all utilities in the state. We believe our legislative efforts benefit our customers and give communities more options as they seek solutions to water and wastewater challenges and you can find in the appendix to today's presentation a summary of some of our key legislative outcomes in the states we serve. You can also see on slide 12 as Susan previously indicated, this is a very busy year for general rate cases. We filed two cases already in 2022 in New Jersey and Illinois. These two filings were driven by recovery of the extensive capital investments we've made since the last cases in those states totaling more than $2 billion combined.

In New Jersey this includes a filter rehabilitation project to improve water quality at the Raritan Millstone plant serving more than 1 million people as well as projects to improve water quality at dozens of wells, pumping stations and other critical facilities, serving customers throughout New Jersey. In Illinois, investments include the replacement, lining and installation of approximately 141 miles of aging water and wastewater pipelines as well as the roll-in of nearly 30 acquisitions since the last general rate case. And as Susan mentioned, we expect to file three to four more cases this year including the case in Pennsylvania tomorrow where we'll be seeking recovery of over $1 billion of investments.

Next week we'll also be making an initial filing related to our general rate case in California, which is in keeping with the states three-year cycle. The California case we'll seek to recover nearly $600 million of forecasted capital investments and will include several closed and pending acquisitions. In addition, we will be filing notice with the Missouri Public Service Commission tomorrow that we plan to file a case by mid year. And finally, as you know, we have three active cases from 2021 that we expect to bring to conclusion this year.

Moving to Slide 13, to date we have a total annualized revenue request of $220 million in pending cases which includes two infrastructure surcharge proceedings. Already in rates is $79 million in annualized new revenues since January of 2021. This includes $48 million from general rate cases and step increases excluding the agreed reduction in revenues for excess accumulated deferred income taxes and $31 million from infrastructure surcharges. For the remainder of the year we expect to file additional general rate cases to role in infrastructure investment and acquisitions since the last cases. As always, execution on these regulatory priorities is key to our plan for earnings growth, because we make prudent investments and have skilled and dedicated employees working on these cases we're very confident in constructive outcomes.

And as always, we remain very focused on customer affordability. Our emphasis on cost and capital efficiencies, coupled with our customer growth efforts have continued to deliver very affordable bills as a percentage of household income for most of our customers. We also continue to involve our strategies around rate design to assist our low-income customers who are challenged with affordability. These efforts in addition to our historical customer assistance programs as well as the programs we are implementing across our footprint funded by the 2021 American Rescue Plan Act. These programs have already provided millions of dollars of support to our customers and we support their continued funding.

Turning to slide 14, and the acquisition piece of our growth triangle, we were excited to announce on April 14 that the Pennsylvania Public Utility Commission approved our application to purchase the City of York's wastewater system for $235 million. Signed just one year ago York is the largest municipal acquisition in Pennsylvania American Waters history and is being executed under Pennsylvania's fair market value legislation. We're thrilled to soon be serving approximately 45,000 customers there and we expect to close the acquisition by or before mid June. Another acquisition under agreement is Egg Harbor City, New Jersey, which is the first transaction under the New Jersey Water Infrastructure Protection Act.

Importantly, we believe other municipalities will benefit by this legislation in the future as it allows communities with significant operating challenges to swiftly partner with a provider like us to address those issues. Egg Harbor City represents about 3,000 customer connections and we also expect to close on this acquisition later this year. Finally, still on the acquisition front, a smaller, but important one is the water system we are acquiring from the town of Waverly, Virginia that we expect to close in the next few months. This represents our first acquisition in Virginia under the fair market value legislation that was finalized in October of 2021. As a result the pending closing is an important milestone as we work through this process for the first time in the state.

I'll close on Slide 15, with the project coming from our Military Services Group that illustrates another example of ESG impact as a result of American Water's investment. MSG partnered with Hill Air Force Base in Utah to construct a net-zero operation center to enhance energy efficiency and reduce emissions there. The building, design focused on both reducing energy usage and also offsetting energy usage with solar panels. After project completion the building not only met all of its power supply needs, but also sent power back to the grid. This project is just one example of the many projects MSG undertakes at the 17 military installations it serves across the country that creates a financial win for both sides and an environmental win for us all. With that, I'll now turn it back over to Susan for some closing remarks, Susan.

Susan Hardwick {BIO 16618718 <GO>}

Thanks Cheryl. Turning to our final slide, slide 16 and before we begin Q&A, I want to comment further on our announcement of the hiring of the CFO. As I'm sure you saw yesterday we announced that John Griffith will be joining American Water as our Executive Vice President and Chief Financial Officer effective May 16. John comes to us from Bank of America and brings more than 25 years of industry knowledge and financial and transactional expertise. I personally know John and his capabilities. He is very talented and will bring the right skills at the right time to help American Water continue its journey of strategic execution and delivery of superior results. As John joins us, our senior executive team is now fully in place. If you recall, Jim Gallegos, our Executive Vice President and General Counsel, joined us on April 1 of this year. Jim brings nearly 20 years of Regulated General Counsel expertise and is already integrating nicely into the organization. We are thrilled to have both John and Jim on board now.

As I've said before, I am confident in the plan that we have in place to grow this business and I'm confident we have the right teams in place throughout our states, at the bases we serve and here in our corporate office to achieve our goals in 2022 and beyond. And with that, I'll turn it back over to our operator to begin Q&A and we'll be happy to take your questions.

Questions And Answers

Operator

We'll now begin the question & answer session. (Operator Instructions). First question comes from Rebecca Yuan of Goldman Sachs. Please go ahead.

Q - Rebecca Yuan {BIO 20445582 <GO>}

Hi, thanks, good morning. So first question, are there any changes to your equity issuance plans both in terms of the $1.1 billion magnitude and timing in the middle of the five-year range?

A - Susan Hardwick {BIO 16618718 <GO>}

Good morning. No, expected changes to that plan.

Q - Rebecca Yuan {BIO 20445582 <GO>}

Great. And then my second question, given the current inflationary environment are muni is more willing to sell their utilities, are you seeing any of that or potential opportunities to accelerate some tuck-ins.

A - Susan Hardwick {BIO 16618718 <GO>}

We certainly think that is going to contribute to issues that municipals will face. We haven't seen any specific opportunities pop up because of that, but we do know that those are factors that will weigh heavily on some of these communities and their analysis and assessment of their opportunity to sell to American Water and Cheryl anything to add from your perspective on that.

A - Cheryl Norton {BIO 17107572 <GO>}

No, not really. Susan, as you said we haven't seen anybody specifically come forward related to that, but we do know those pressures are very real and we're able to manage them because of our size and scope, where a lot of the municipals are going to struggle with that.

A - Susan Hardwick {BIO 16618718 <GO>}

Right.

Q - Rebecca Yuan {BIO 20445582 <GO>}

Right. Thanks so much.

A - Susan Hardwick {BIO 16618718 <GO>}

Thanks, Rebecca.

Operator

Thank you. Next question comes from Ryan Greenwald of Bank of America. Please go ahead.

Q - Ryan Greenwald {BIO 20960461 <GO>}

Hey, good morning, everyone, congratulations.

A - Susan Hardwick {BIO 16618718 <GO>}

Good morning Ryan, thank you.

Q - Ryan Greenwald {BIO 20960461 <GO>}

So I appreciate the color around the O&M timing. Can you guys just talk a bit more about how the quarter shook out relative to your expectations. Any other particular considerations that are making you guys kind of hold guidance in place after what appears to be a pretty strong quarter to start the year here.

A - Susan Hardwick {BIO 16618718 <GO>}

Well Ryan, I think relative to expectations this quarter was right on target as we said in the call, we did have a couple of timing items not terribly material, but really what drove the quarter was revenue associated with all the regulatory proceedings that we've been in the process of executing. And if you recall, the largest piece of that is the Pennsylvania rate increase that was effective January 28 of 2021. So this year of course reflects a full quarter's worth of revenues associated with that increase. And obviously that was a big driver year-over-year for the quarter. So, again the quarter for us was a very good one, but it reflected full execution on our plan and really met our expectations. And as we said, our expectations for the year remain the same. We're very confident about our ability to deliver on the plan we have laid out for 2022.

Q - Ryan Greenwald {BIO 20960461 <GO>}

Excellent. And then can you guys just provide an update on Chester from your vantage point where things are in the process, timeline, resolution, overall conviction levels to close the transaction.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. Not a whole lot to add. Not much new from our side on that, but I'll let Cheryl make a couple of comments there.

A - Cheryl Norton {BIO 17107572 <GO>}

Yeah, it's still obviously kind of held up in the courts. If you will, I think I don't anticipate seeing anything probably it's possible this year, but it's going to be months out for sure.

Q - Ryan Greenwald {BIO 20960461 <GO>}

Great. I'll leave it there. Thanks very much.

A - Susan Hardwick {BIO 16618718 <GO>}

Thanks, Ryan.

Operator

Thank you. Our next question comes from Shar Pourreza of Guggenheim. Please go ahead.

Q - Shar Pourreza

Hey guys, it's actually James for Shar. Good morning.

A - Susan Hardwick {BIO 16618718 <GO>}

Good morning.

Q - Shar Pourreza

So I guess just want to build up the prior question, it looks like the customer connections for the year are little ahead of target. Just more broadly, are you seeing increasing competition for some of these many acquisitions.

A - Susan Hardwick {BIO 16618718 <GO>}

I'd say generally, yes in certain of our jurisdictions. We have seen certainly more competition here in the Northeast. We continue to believe that we are the preferred provider and should be. We have the scale and the scope necessary to address many of the issues that these municipals face and we have the expertise that we've demonstrated in a number of transactions throughout our service territories that really proves that in fact we are the best provider in all of these situations. So certainly more competition, but we remain very confident in our ability to deliver the needed services for some of these communities that need help.

Q - Shar Pourreza

Excellent. And I guess just building on the prior one as well, just on the supply chain side as we think about O&M for the rest of the year, anything that you've seen in the first quarter that gives you caution one way or the other or anything that we should think about as we look at the rest of the year.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, it's a good question. Obviously, there is still lots of impacts being felt throughout the economy and we certainly are not immune to that although I would say we're in a better position than most. Just given our size and scale and our ability to sort of mass purchase product that we need. There are some supply chain bottlenecks I'd say around certain items that we use, but we've actually seen a bit of an improvement in the supply in some of those critical items. We've seen price increases, but we've actually seen the rate of those increases start to slow down a bit, which is a positive sign. And again just given our size and scale, we've certainly been able to manage through that so far. And we'll continue to focus on all things we can do to help mitigate those impacts and ultimately the impacts to customers.

Q - Shar Pourreza

Excellent, thanks a lot. And so, congrats on the new hires. Thanks.

A - Susan Hardwick {BIO 16618718 <GO>}

Great, thank you so much.

Operator

Thank you. (Operator Instructions) Next question will be from Gregg Orrill from USB. Please go ahead.

Q - Gregg Orrill {BIO 1532939 <GO>}

Yeah. Thank you. I was wondering if you could put into context, sort of the backlog of rate cases that you have right now relative to your sort of 7% to 9% earnings growth target, is it when you think about Pennsylvania and California and what's already outstanding. Do you think that I could take you above trend or is that kind of what we're expecting or is there even sort of momentum that's continuing to build there.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, it's a good question. I would just tell you that our current regulatory schedule or activity is really according to our plan. We have signaled I think for some time that you can expect us to be in the regulatory arena regularly and certainly in our larger states every two to three years we would expect to be in for general rate increases every two to three years. And I think that's reflective also of just the level of capital spending, as you know we have increased our spend trajectory in this last plan update we did in November. So, that just again underscores our approach to regulatory recovery and the cycle in which we will execute that. I think it's also important to note that we have very effective mechanisms in many of our jurisdictions and I think we're somewhere in the 65% range or so of our spend gets recovered through those mechanisms, would certainly helps on the regulatory lag side from an earnings perspective and helps the customer I think sort of better plan for rate increases coming their way.

So we take advantage of all of those things and use those as effectively as we can to execute on the strategy now. Long answer to your question, short answer is, it is according to the plan and we've continued to execute according to that plan.

Q - Gregg Orrill {BIO 1532939 <GO>}

Okay, thanks.

A - Susan Hardwick {BIO 16618718 <GO>}

Thank you.

Operator

That concludes our question and answer session. And also concludes the conference. Thank you for attending today's presentation. You may now disconnect.