Q3 2023 Earnings Call

Company Participants

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

Other Participants

- Aditya Gandhi, Analyst, Wolfe Research
- Gregg Orrill, Analyst, UBS
- Jonathan Reeder, Analyst, Wells Fargo
- Paul Zimbardo, Analyst, Bank of America
- Richard Sunderland, Analyst, JPMorgan
- Will Grainger, Analyst, Mizuho

Presentation

Operator

Good day and welcome to American Water's Third Quarter 2023 Earnings Conference Call. As a reminder, this call is being recorded and is also being webcast with an accompanying slide presentation through the company's Investor Relations website. The audio webcast archive will be available for one year on American Water's Investor Relations website.

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

Aaron Musgrave {BIO 22474483 <GO>}

Thank you, Chris. 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 third quarter earnings release and in our September 30th Form 10-Q, each filed yesterday with the SEC. And finally, all statements during this presentation related to earnings and earnings per share refer to diluted earnings and diluted earnings per share.

Susan Hardwick, our President and CEO, will share highlights of third quarter and year-to-date results and will comment on our 2024 EPS guidance and longer-term targets. Cheryl Norton, our Executive Vice President and COO, will then discuss our new capital investment plan, including the expected impact of PFAS-related investments and will conclude with a regulatory update, including our views on customer affordability. John Griffith, our Executive Vice President and CFO, will then discuss our year-to-date financial results in more detail, discuss our acquisition outlook and will close with details behind our 2024 outlook and longer-term goals and our 2024 to 2028 financing plan. After a few final remarks, we'll then close by answering your questions.

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

Susan Hardwick {BIO 16618718 <GO>}

Thanks, Aaron, and good morning everyone. Let's turn to Slide 5 and I'll start by covering some highlights from the third quarter and year-to-date periods. As we announced yesterday, we delivered strong financial results in the third quarter of 2023 and we're pleased to again reaffirm our 2023 guidance on a weather-normalized basis.

Earnings were $1.66 per share for the quarter compared to $1.63 for the same period last year. In the first nine months of 2023, earnings were $4.03 per share compared to $3.70 per share in the same period of '22. The estimated net favorable weather impact year-to-date in 2023 is about $0.11 per share compared to $0.06 per share favorable in '22. These weather-normalized results so far in 2023 continue to reflect our strong execution, in line with our growth expectations for the year. John will elaborate further on results later.

Moving on to some of our other key accomplishments to-date in 2023, we have invested $1.8 billion in capital projects year-to-date, reflecting great work by our teams responsible for planning and completing these investments. As you will recall, the total capital investment plan for 2023 includes approximately $400 million of acquisitions, including one sizable transaction in Pennsylvania we expect to close in December and another in Illinois around the end of the year.

As you know, we completed our -- an equity issuance of $1.7 billion in March and a $1 billion convertible debt issuance in June. These were the two key priorities of our 2023 financing plan. We were focused on completing these issuances in the first half of the year to reduce market-related pricing risk and overall execution risk, which has served our investors, customers -- and our customers well considering the current market conditions.

Turning to Slide 6, as we roll out our new five-year plan today, we are affirming our long-term targets, including 7% to 9% EPS and dividend compounded annual growth rates. We are also initiating our 2024 earnings guidance of $5.10 per share to $5.20 per share, which John will discuss further later in the discussion. This represents our expectation of 8% EPS growth in 2024 compared to our weather-normalized 2023 EPS guidance.

One thing to note on this slide is that we have revised the look of our earnings growth outlook. Recall that we had historically referred to it as our growth triangle. We believe this new version better highlights our compelling 7% to 9% earnings growth expectation and better represents the key drivers of growth. As a nearly 100% regulated water and wastewater utility, rate base growth and regulatory execution are the key drivers of growth for our company. Rate base growth continues to be driven by the accelerated CapEx plan we put forth two years ago and now with this updated plan.

Combined with our robust regulated acquisition strategy on which we've proven we can execute, we continue to expect 8% to 9% rate base growth over the next decade. Later, Cheryl will review the amount of capital we expect to spend over the next five years, including related to acquisitions.

On this slide, you can see we are highlighting our acquisition growth strategy, measured by a compounded annual growth rate in customer connections of 2%. The timing of closing on acquisitions is often difficult to control within a calendar year, which can cause volatility and acquisition investment on a year-to-year basis. This 2% customer additions CAGR target should be an easier way for investors to monitor and measure our growth through acquisitions. And as I said, rate base growth, which includes acquisition investment is the key driver to earnings growth.

Our growth outlook also includes the organic revenue growth opportunities we expect from our Military Services Group from the 18 installations we currently serve with an added upside for any new bases secured.

One of our company's competitive advantages is its diverse regulated operations across 14 states that provides us with flexibility in the timing of rate cases and capital deployment. We also have a very predictable and controllable set of capital projects annually, almost half of which are recoverable through infrastructure mechanisms. Along with our other regulatory approaches, we are confident we can deliver consistent earnings growth and dividend growth over the next five years and beyond.

While utility stocks, including ours, have seen the impact on the short-term of higher interest rates, history has shown that over medium and longer-term horizons, the utility sector and certainly American Water has delivered compelling value to investors. We believe the combination of our EPS and dividend growth, supported by our significant yet low risk capital investment plan and our focus on customer affordability and ESG leadership will continue to be rewarded by investors. Based on this long-term plan and our history of executing on our strategies, we intend to continue to deliver a very competitive sustainable shareholder return for many years to come.

With that, let me turn it over to Cheryl to talk more about our capital investment plan and our focus on customer affordability and regulatory execution. Cheryl?

Cheryl Norton {BIO 17107572 <GO>}

Thanks, Susan, and good morning everyone. Before I jump into a discussion of our current long-term capital plan starting on Slide 8, I want to first acknowledge that our teams have done a great job executing on our accelerated capital investment plans these last few years. We have consistently met our capital deployment goal and we're on pace to do it again by meeting our overall capital plan of $2.9 billion this year, which includes acquisition investments.

Looking ahead to 2024, we expect a modest increase in our investment spending level to roughly $3.1 billion. Over the next five years we expect to invest approximately $16 billion to $17 billion, an increase of about $2 billion over our previous plan. This level of spending reflects the result of our consistent risk-based project planning. Along with risk, customer affordability is a key variable in our analysis which I'll speak more about shortly.

Looking out over the next decade, we expect to invest $34 billion to $38 billion in our regulated systems and acquisitions, which is $4 billion higher than the previous 10-year plan. In addition to truck tackling PFAS, we expect the follow-on capital needs related to acquisitions to continue to increase over time and modestly higher costs for pipe and other capital goods over time.

Continuing on Slide 9, the increase in the five-year capital plan is primarily driven by three needs. First, the plan includes approximately $1 billion of needed investment to treat water for PFAS contamination across our systems. As we've said many times, American Water supports the US EPA's efforts to protect public health by proposing national drinking water standards for PFAS and we believe our company is in a better position than any water utility to remove PFAS at the level that would be required under the rule as proposed.

And we've also said the cost to comply will be significant. Roughly $1 billion of capital remains our best estimate based upon the proposed federal EPA rule, which we expect will be finalized in late 2023 or early 2024 without much modification. We expect most of these PFAS-related capital investments to -- to occur over a three-year period beginning later in 2024 and primarily in our larger states in terms of customer served like New Jersey as an example. The source water supplies for New Jersey American Water that have PFAS contamination includes -- include large surface water supplies that are more costly to treat than our groundwater sources.

And as we've said, granulated activated -- granular activated carbon or GAC will be the primary treatment method we use for PFAS remediation because it's a proven and more cost effective treatment option for our systems. However, we're also piloting ion-exchange resins along GAC to compare PFAS removal and media performance which impacts the overall cost of treatment.

While much uncertainty exists around the topic of PFAS, including the recovery of related capital and operating costs, we expect constructive outcomes for this important water quality initiative and we will continue to advocate that the ultimate responsibility for the cleanup of these contaminants should fall to the polluters. We'll also continue to advocate that all water and wastewater utility providers, regardless of ownership, have equal access to any federal and/or state funding related to treating PFAS. In addition, we'll continue our efforts to request permanent federal funding for our water and wastewater low-income customer assistance program.

The other two drivers of increased CapEx in the 2024 to 2028 plan are a higher level of spend related to prioritized renewal projects across our footprint such as for hydrant pipe and meter replacement, as well as a higher level of expected follow-on capital related to future acquisitions. Following recent acquisitions, we have continued to experience a higher level of investment need in order to bring water and wastewater systems into regulatory compliance and up to our operating standards which is driving the higher estimated capital need of $600 million.

You can also see that we have deferred $500 million of lower-risk projects to later years beyond the five-year plan. We did this as a part of our extensive risk-based project analysis in conjunction with our ongoing affordability analysis. For example, we deferred until later in the 10-year capital plan the replacement of some services in mains were it was determined that they did not pose an immediate risk to service reliability or water quality.

Let's turn to Slide 10 and I'll cover the latest regulatory activity across our states. Shown in this slide is a summary of our pending general rate cases with some key facts for each. In the appendix you'll also find some details related to infrastructure charges as well as a snapshot of the key outcomes from the most recent general rate case in our top 10 states. Our general rate cases in California, Indiana, West Virginia and Kentucky are all progressing well and as expected. All of these cases, except perhaps California, will most likely be resolved in early 2024. Just yesterday we filed a general rate case in Virginia, reflecting a $110 million in system investments covering May 2023 through April 2025. We're seeking $20 million of additional annual revenue and expect interim rates to go into effect in May of next year.

Outside of our general rate cases, as we discussed last quarter, we filed a request as authorized by California's water cost of capital mechanism seeking a 52 basis-point increase to our ROE in 2023, which was approved on July 25th or increasing the return on equity to 9.5%, effective July 31st. We filed a similar request in October for an additional 70 basis-point increase to go into effect January 1, 2024, which would bring our ROE to 10.2%.

And finally, related to the customers we have proudly served in the Monterey community for over 100 years, in October a local entity adopted a resolution enabling it to file an eminent domain lawsuit with respect to the Monterey system assets. This is not a new issue, just the latest chapter in a long-running effort by an entity that we believe lacks the expertise to own and operate a very complex water distribution system serving these Monterey customers. Bottom line, we believe, based upon existing legal precedent, we'll be able to successfully defend against an eminent domain lawsuit if it's filed. You can find more information on this topic in our SEC filings, including this quarter's 10-Q.

Moving to Slide 11, I'll wrap up with a discussion of customer affordability and this new capital investment plan. Using US Census Bureau data specific to the geographies we serve, our research and analysis concluded that projected rising levels of median household income combined with conservative assumptions around an increasing customer base would allow us to stay within our target for residential water bills of 1% or less of median household income.

One of the most difficult challenges we face in the water and wastewater industry is balancing customer affordability with the magnitude of the system investments that are needed.

Thankfully, today our industry and our company are in very good relative positions in term of -- in terms of affordability or wallet share. At the same time, we realize we must continue to evolve our strategies around rate design and programs to assist our customers who are challenged with affordability. We must also continue our focus on technology, efficiencies of scale and cost management in order to deliver on customer affordability.

Our dual focus on operating efficiency and customer affordability has been a valuable part of our company's DNA for many years. As you know, we've historically used O&M efficiency as one of our benchmark metrics to measure our success at managing costs as we grow the business. In recent years, we've emphasized that revenue growth has been just as impactful to the O&M efficiency metric as managing costs. As we look ahead, we're continuing to evaluate whether this is the best metric by which to judge our effectiveness at managing costs and running an efficient business. More to come on this in 2024.

With that, I'll hand it over to John to cover our financial results and plans in further detail. John?

John Griffith {BIO 22806522 <GO>}

Thank you, Cheryl, and good morning everyone. Turning to Slide 13, let me provide a few more details on year-to-date results. The appendix also has details of third quarter EPS, which has many of the same drivers as year-to-date results.

Consolidated earnings were $4.03 per share year-to-date, up $0.33 per share compared to the same period in 2022 and up $0.28 per share on a weather-normalized basis. The increased revenues were driven by general rate cases we completed in late 2022 and early 2023 in our larger states. These additional revenues are driven by the significant investments we have made and continue to make in our systems.

As noted, earnings were higher year-to-date by an estimated net $0.11 per share as a result of weather in the second and third quarters due to warm and dry conditions, primarily in Missouri, New Jersey and Pennsylvania. This compares to net favorable weather in the third quarter of 2022 of $0.06 per share, which related mostly to warm and dry -- and dry conditions in New Jersey.

And looking at operating costs, higher pension expense of about $0.10 per share and increased chemical costs of about $0.09 per share, including inflationary pressures are being recovered in large part through higher revenues we proactively sought through the use of forward test years and traditional updates to base cost of service and general rate cases we completed in the last 12 to 18 months. This strategy has limited the bottom line impact of those higher costs in 2023 and it is a strategy we are continuing to use in our recently filed and upcoming cases.

Supporting our investment growth, depreciation expense increased $0.17 per share and the cost of additional long-term financing increased $0.28 per share, primarily related to share count dilution. As I mentioned last quarter, the EPS impact of the higher share count from our equity issuance offsets the avoided interest expense in the current interest rate environment. We expect the impact to be approximately neutral to EPS for the full year as well based on the current outlook.

Turning to Slide 14, this graph illustrates that our continued execution on capital investments, both infrastructure projects and acquisitions, are succeeding and growing regulated rate base at a long term rate of 8% to 9%. Rate base growth, of course, will drive earnings growth. We believe the high degree of visibility to our capital investment plan combined with the low risk nature of the plan uniquely positions American Water in the utility sector and is fundamental to our investment thesis.

Turning to Slide 15, you'll see that we continue to be set up for strong growth through acquisitions. We closed on 14 acquisitions totaling $36 million across six states in the first nine months of 2023, which demonstrates our continued ability to close deals in many states. We also had 32 transactions under agreement across 10 states through the end of September, totaling $611 million, two of which we closed in early October, including one in West Virginia for $27 million.

This total also includes both the Butler Area Sewer Authority wastewater system in Pennsylvania and the Granite City wastewater treatment plant in Illinois we previously announced. We expect the Butler acquisition to close later this year and Granite City around year end, pending regulatory approvals for each, and we look forward to serving those customers.

Also included in our acquisitions under agreement is the Towamencin Township wastewater system in Pennsylvania we expect to purchase for $104 million as announced back in March. We expect to close this acquisition in late 2024 or early 2025, pending final regulatory approval and we look forward to serving those customers as well.

Our outlook for future acquisitions remains very strong as we expect to have over $250 million of acquisitions under agreement at the end of 2023 after the expected closings of Butler and Granite City. Of course, as we close on transactions the work to build and refill the acquisition pipeline is continuous. Our pipeline of 1.3 million customer connections is a strong leading indicator that supports this piece of our rate base growth outlook.

On Slide 16 we provide some considerations regarding our outlook for 2024 results and our newly established EPS guidance range of $5.10 to $5.20 per share. First, as you would expect, our growth will be driven by capital investment to serve our customers and earning a return on that investment. As we've talked about previously, 2023 is year two of our accelerated CapEx plan following the HOS sale. So we see that ramp up reflected in earnings in 2024, both from base rate increases and infrastructure mechanisms. As a reminder, approximately 45% of our CapEx is recoverable by infrastructure mechanisms. So it's a very meaningful driver of consistent earnings growth for us.

Recent regulated acquisitions that are being incorporated into active or just completed rate cases will also drive growth next year. I'd like to note that our Military Services Group does add incrementally to our earnings growth expectation as we have continued to show in our growth outlook. MSG's great work on 18 military installations it serves has built trust and resulted in the US government allocating additional funds for improvement projects, driving increased revenues.

Just as critical to our growth strategy is our ability to prudently manage the operating costs it takes to run the business which goes to my final point on this slide. Because of our strong culture of operating efficiency and cost management, we expect only modest increases in O&M in 2024. These efforts go to the heart of the customer affordability construct we want to protect, which is closely aligned with the interests of regulators and ultimately investors in managing affordability of customer bills.

Finally, related to pension, I'd simply remind you that our pension obligation remeasurement will be done at year-end 2023 and that will drive the determination of our 2024 pension expense.

Turning to Slide 17, I'll provide a financing plan update before closing with a look at our balance sheet and liquidity profile. In our prior five-year plan through 2027, we expected a total of $2 billion of equity financing need. We successfully issued $1.7 billion of the $2 billion earlier this year, leaving $300 million of equity financing needed toward the end of that prior plan.

Based on our new capital plan, our financing plan now includes an estimated $1 billion of equity issuances from 2024 through 2028. The $1 billion of equity in our new plan is expected to be issued near the middle of the 2024 to 2028 period, subject to market conditions. The $700 million increase in the anticipated external equity need is driven by the incremental $2 billion of CapEx in the new plan. As we've said many times now, we expect incremental CapEx to be funded roughly 50-50 debt and equity, which includes both external equity and cash flow from operations.

Our financing plan design also takes into account the goal of maintaining a strong balance sheet and continuing to meet our long-term debt-to-capital target of less than 60%. Another assumptions inherent in our new plan is that we will continue to be a cash taxpayer, especially as we will likely become subject to the new corporate alternative minimum tax in the coming years.

On Slide 18 we provide a summary of our continued strong financial condition. Our total debt-to-capital ratio as of September 30th, net of roughly $630 million of cash on hand remains at 54%, which is comfortably within our long-term target of less than 60%. As we are all aware, the current higher interest rate environment is challenging. We are, however, in a position of strength on a number of fronts in dealing with the challenge. Our strategy of issuing debt at the holding company level allows us to take advantage of our scale and pricing debt issuances. We remain confident that we will have strong access to capital for the long term.

In fact, we just extended the maturity of our revolving credit facility to October 2028, which has a capacity of $2.75 billion. Our diversified banking relationships with some of the largest and strongest banks in the world, coupled with our fully regulated business model and strong credit ratings gives us great confidence around liquidity.

Our laddered approach to long-term debt financings over the years is very important in environments like the current one to manage cash flows and minimize interest rate risk, which contributes to managing customer affordability. And our short duration between general rate cases allows us to minimize any lag we may experience related to recovery of debt costs.

With that, I'll turn it back over to Susan for some closing thoughts. Susan?

Susan Hardwick {BIO 16618718 <GO>}

Thanks, John. To close on Slide 20, you've heard our latest strategic thinking today and it should sound very familiar. It's all about execution at every level. As we continue to demonstrate our ability to consistently execute, we believe our industry-leading EPS and dividend growth combined with our focus on affordability and ESG leadership will continue to be highly valued and rewarded by investors.

We believe these aspects of our business and strategy separate -- separate us from all utilities. They are underpinned by our significant low-risk capital investment plan, which includes our best-in-class execution on acquisitions and our excellent regulatory execution, all while maintaining a strong balance sheet with a well planned debt maturity profile and a differentiated affordability proposition.

Through our consistent achievement of high operating standards, including our leading safety culture and water quality accolades, our team at American Water has raised the bar for success in the water and wastewater industry. And that includes the outstanding efforts by our Military Services Group team to proudly serve the 18 military installations in our footprint.

Our history of executing on our strategies has delivered a very competitive sustainable shareholder return. With this long-term plan, we have full confidence in our ability to achieve the goals we talked about today and continue our track record of delivering superior shareholder value.

And with that, let me turn the call back over to Chris to begin Q&A and take any questions you may have.

Questions And Answers

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions) Today's first question comes from Richard Sunderland with JPMorgan. Please proceed.

Q - Richard Sunderland {BIO 20365913 <GO>}

Hi, good morning. Am I coming through clearly?

A - Susan Hardwick {BIO 16618718 <GO>}

You are, Rich. Good morning.

Q - Richard Sunderland {BIO 20365913 <GO>}

Great. Thank you. I appreciate the details around the uptake here. I wanted to start with the CapEx revision and the bill outlook. Looking back to 2021 when you first outlined the accelerated investment plan, you gave some details on the -- the customer affordability angle. But I'm curious kind of bridging not back to last year, but back to '21, is there anything different in that outlook now, obviously CapEx is up significantly. Also curious if the 2% customer additions target in the language around there for M&A has factored into how you've crafted this new capital plan around the customer affordability angle as well.

A - Susan Hardwick {BIO 16618718 <GO>}

Okay, Rich. Yeah, there's a lot in there. Let me start and then Cheryl and John can add to it. I would say our focus has sharpened over the last number of years related to customer affordability. And that sharpened focus I think has really been around this sort of wallet share concept that Cheryl talked about. I think it's important for us to understand the communities that we operate in and the demographics of those communities and what are the challenges of customers in those communities.

And we've been able to do a lot of analysis at a very detailed level around affordability around household income, around, you know, just economic impacts in the various communities that we serve and our focus has been I think very clearly defined around our wallet share as a percentage of that household income and we've been developing this concept here now for a number of years and I think that our ability to confidently say this plan as we've continued to grow it will -- will continue to maintain our position of roughly 1% or less of customer's bill in the communities that we serve specifically.

And I think that focus has allowed us to really think about, you know, how to build this plan, how to continue to grow it, how to continue to grow rate base while not overburdening customers with our growth expectations. I think this plan fits very nicely in that concept.

Cheryl, you want to add anything?

A - Cheryl Norton {BIO 17107572 <GO>}

Yeah. I would just add, Rich, that as Susan said, we look at all the communities that we serve, we look at the demographics and yet the capital investments are not that different from community to community and we need to make sure that we are investing at the right level in all of those communities. New regulations like PFAS but also the Lead and Copper Rule, that is driving a lot of capital investment across the board. And so we have to continue to do that and we need to do that in all the communities.

So these -- these affordability calculations, the risk priority model that we use, we think it's really the best balance to getting the right amount of infrastructure investment in all of the communities that we serve. And as we grow the number of communities that we're serving, that will continue to increase. But we think we're getting the right balance there because we have to treat all of our customers in a fair way. They all deserve clean, safe drinking water.

A - Susan Hardwick {BIO 16618718 <GO>}

And Cheryl, I might just add one additional comment. From a regulatory perspective, you know, this is also a concept that we've been sharing very transparently with regulators, this affordability analysis that we've done and as we lay out in every jurisdiction, the plan and the investments that we have made, we're right alongside, we're talking about impacts to customers and how we've thought about the plan and -- and how it affects affordability for the customers in the service territories. So again it's a -- it's a -- it's a concept and a view that we've taken that we think is differentiating here and I think regulators just as one party are certainly recognizing that.

A - John Griffith {BIO 22806522 <GO>}

And Rich, I'll pick-up on the 2% part of your question. As Susan mentioned in her commentary, you know, 2% is a metric that we think is good to think about as as long-term metric given just the short-term variability around acquisitions. But you're right to point it out in this context, as you know that 8% to 9% rate base growth is what drives the 7% to 9% earnings growth, but being able to spread that 8% to 9% rate base growth over a larger customer base is a healthy element of our growth.

Q - Richard Sunderland {BIO 20365913 <GO>}

Great, that was very helpful color there. Thanks for laying all of that out. And then separately, turning to the financing plan here, you were clear on -- on the drivers around the equity relative to the CapEx. I'm curious on the operating cash flow side, it looks like a significant step up, '24 to 20 -- versus '22 through '27, is that just normal course kind of rate recovery, any discrete items in there, just how to think about prior versus new?

A - John Griffith {BIO 22806522 <GO>}

Yeah, it's a good question, Rich. Really there is a big step up. If you think about the increase in our capital plan as we go back from 2021, '22, '23 and forward, it's such a significant step up that when you drop '23 out of the plan and you bring '28 into the plan, the accumulation of the capital spend through that period, it accounts for a very significant portion of -- of that operating cash flow step-up. And then as you -- as you would also intuitively think, the -- there is increased cash flow in the interim years as well, just given the increase in capital plan.

Q - Richard Sunderland {BIO 20365913 <GO>}

Got it, got it. Well, thank you for the time today.

A - John Griffith {BIO 22806522 <GO>}

Thanks, Rich.

A - Susan Hardwick {BIO 16618718 <GO>}

Thanks, Rich.

Operator

Our next question is from Paul Zimbardo with Bank of America. Please proceed.

Q - Paul Zimbardo {BIO 18277958 <GO>}

Hi, good morning, team.

A - Susan Hardwick {BIO 16618718 <GO>}

Good morning.

Q - Paul Zimbardo {BIO 18277958 <GO>}

And just to clarify that last line confirm my understanding, so there is effectively no change in the kind of the growth triangle as you call it, it's just kind of a representation?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, I think that's fair. You know, we want to continue to emphasize that rate base growth is the driver. Rate base investment, which includes acquisitions is the driver. What we're trying to do here, I think, is just give some clarity around or maybe a better view as to how you can measure our progress toward growth through acquisition by giving you that sort of metric around customer additions. The -- the investment that we will continue to make in acquisitions just rolls into rate base, which it always has. So no real change in that. I just think it's a better view potentially for investors to be able to see progress we're making around the acquisition strategy.

Q - Paul Zimbardo {BIO 18277958 <GO>}

Okay. Understood. That's what I thought. And then shifting to the financing plan, so if I understand it right, and correct me if I'm wrong, it doesn't assume any kind of litigation proceeds, state funding, federal funding for PFAS, just -- is there any sense of what that kind of offset could be to help out on customer bills?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, it's a good question. Obviously, the numbers that we have laid out here, Cheryl outlined, continue to be our best estimates of the cost necessary to meet the current proposed rule. Obviously, we don't have a rule yet. So, you know, finalizing those numbers will -- will occur once we have a final rule. And we do participate in the -- the ongoing litigation around this whole issue, we've laid all that out in the Q. So you can look at that there and probably we won't talk much more about it than that since it is ongoing litigation. I think it is fair to say that our estimates today are the costs we would expect to incur. We have to see how the litigation ultimately works out to see what impact that may have.

And I think Cheryl covered this well. You know, we do believe by virtue of our participation in the litigation that polluters, you know, should be our first line here of -- of responsibility. So we are -- we are quite involved in that to make sure that that is properly executed.

Q - Paul Zimbardo {BIO 18277958 <GO>}

Okay. To make sure I understood, it does have an assumption around kind of getting external funding or it does not?

A - Susan Hardwick {BIO 16618718 <GO>}

It does not at this point, no, it's just the cost estimates that we have developed so far.

Q - Paul Zimbardo {BIO 18277958 <GO>}

Okay, that's what I thought. Okay, great, thank you very much.

A - Susan Hardwick {BIO 16618718 <GO>}

Sure.

Operator

The next question comes from Will Grainger with Mizuho. Please proceed.

Q - Will Grainger {BIO 22814912 <GO>}

Hi, good morning, everybody.

A - Susan Hardwick {BIO 16618718 <GO>}

Good morning.

Q - Will Grainger {BIO 22814912 <GO>}

Thanks for taking my question. Just wanted to ask, on the PFAS $1 billion that you've outlined today, how should we be thinking about the makeup of that over year service territories, is it pretty ratable or -- yeah, if you could unpack the underlying assumptions there that would be helpful.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, I'll as Cheryl to comment on that. We hit on it I think pretty high level, but Cheryl, you might want to just reemphasize that.

A - Cheryl Norton {BIO 17107572 <GO>}

Yeah, we -- as we've looked at this, our -- as I mentioned in my comments earlier, we expect the bulk of the spend to be in our states where we have a larger footprint of customers, New Jersey for example. And the reason for that driver of that being the largest amount of spend is that there's more contamination there in general, but also these are large surface water plants that are very costly to add treatment to. You know, we have Pennsylvania as a larger state, numerous locations there, but -- but we really haven't outlined everywhere that -- that we're going to add treatment, but anywhere that it's a surface water plant as opposed to a groundwater source, it's going to be a lot more costly to add that treatment. And so, New Jersey is our biggest dollar state for sure.

Q - Will Grainger {BIO 22814912 <GO>}

Got it, that's helpful. And then maybe just on the equity four-year plan, is that -- the incremental equity is just $700 million, if I've got my math right, the $300 million that you've still -- you're planning to issue now and then an incremental $700 million or is it an incremental $1 billion?

A - John Griffith {BIO 22806522 <GO>}

You've got it right, Will. It's an incremental $700 million.

Q - Will Grainger {BIO 22814912 <GO>}

Okay. And we -- and we should expect the timing of that to come in towards the back half of your plan or would that be issued like as an ATM and just kind of a pretty radical?

A - John Griffith {BIO 22806522 <GO>}

What we've said is, we'll issue it in the middle of our new 2024 to 2028 plan, subject to market conditions obviously.

Q - Will Grainger {BIO 22814912 <GO>}

Got it. I'll leave it there. Thank you very much for the time.

Operator

Our next question is from Jonathan Reeder with Wells Fargo. Please proceed.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Hey, good morning team. Just kind of following up a little bit on that last question, you know, despite the higher operating cash flows it looks like, you know, the external capital needs increased more than the $2 billion CapEx increase, you get the $700 million equity and then I think it's $1.7 billion of debt. Anything unique going on there?

A - John Griffith {BIO 22806522 <GO>}

No, Jonathan. You know, we really lead this analysis by -- by looking at our credit metrics. And so a lot of it just goes back to what we've said in the past where incremental CapEx, we will fund it 50-50 debt and equity. And as we think about equity there, it's internally generated funds as well as -- as well as new issuance. So it's -- it, you know, I think -- we think of it is lining up in that regard.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay, no, I was just thinking the debt portion was a little higher than I would have thought.

A - John Griffith {BIO 22806522 <GO>}

Yeah, that's just a function of the capital spend as well as the maturity schedule.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay. Okay, you have maybe the maturity schedule. Okay. So Cheryl, I know you said that California filed on 10/16 to increase the 2024 allowed ROE. Has there been any opposition filed to this request. I think there like a 30 day comment period which probably ended maybe yesterday.

A - Cheryl Norton {BIO 17107572 <GO>}

Yes, there is a 30-day period. And Jonathan, I'm unaware of any kind of intervention or any kind of concern over that.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay,

A - Susan Hardwick {BIO 16618718 <GO>}

It's pretty formulaic, Jonathan. I mean, it -- yeah, we don't expect there to be any issue with that. It really just follows a formula.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Yeah, I know. I mean I think investor concern is more on the electric side whether you see some intervention than the water, but monitor both. I think the 10-year CapEx plan, you bumped up the M&A placeholder by $1 billion. Is there anything specific driving that or is that just kind of passage of time more than anything?

A - John Griffith {BIO 22806522 <GO>}

I'd say, Jonathan, it's certainly passage of time as part of it. We are investing in our capability across the system, starting with originations and as well as due-diligence and integrations. As we look at what happens when we make acquisitions and just our -- our standards as a best-in-class operator relative to the -- to the -- to the systems that we acquire, we just continue to think that there is a lot of momentum there and a lot of strength in us continuing this program.

So it is a capability that we're investing significantly in. And yes, as you pointed out, as we move forward in time we expect those numbers to -- to become bigger to -- to maintain that relative level of contribution.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay. And then lastly, you mentioned the pension costs for '24 and you know, figuring that out. But do you have much exposure on that or do most of your key states now have tracking mechanisms for pension?

A - John Griffith {BIO 22806522 <GO>}

We have trackers and deferral accounts in certain states, Jonathan. And we can go through that with you in detail. So, there is a mix there of what we up already and what would need to be picked up in the future.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Got you. Okay. Thanks for taking my questions this morning.

A - Susan Hardwick {BIO 16618718 <GO>}

Thanks.

Operator

(Operator Instructions) The next question comes from Gregg Orrill with UBS. Please proceed.

Q - Gregg Orrill {BIO 1532939 <GO>}

Yeah. Hi, thank you.

A - Susan Hardwick {BIO 16618718 <GO>}

Good morning, Gregg.

Q - Gregg Orrill {BIO 1532939 <GO>}

Good morning. I think you mentioned you're working on an acquisition in Pennsylvania of $104 million to close in late '24, '25. How do you -- how do you think about, you know, when you go into acquisitions sort of the reasonable timeline for getting approvals? How do you think about that?

A - Susan Hardwick {BIO 16618718 <GO>}

John, do do you want to comment on that? I think the one you're referring to in particular, it's a little more complicated. I wouldn't say it's sort of a traditional process, the Towamencin acquisition. And recall we -- we stepped into that arrangement when NextEra decided to exit the opportunity. So that was just a little more complicated. But, John, you want to talk sort of typically how we think about the process around?

A - John Griffith {BIO 22806522 <GO>}

Yeah. And Gregg, it varies state to state. But since you mentioned Pennsylvania, you know, there's a process you go through to file an application. The application has to be deemed complete and then that starts a statutory clock. And so in the case of Pennsylvania, there is a six-month statutory clock that -- that runs through and then either you're settling your approval or you're litigating approval, but all within that six-month statutory timetable.

Q - Gregg Orrill {BIO 1532939 <GO>}

And so what's different about this situation?

A - John Griffith {BIO 22806522 <GO>}

Well, Towamencin is one where there is -- there is opportunity based on precedent in Pennsylvania. We'll see how the post-PUC approval plays out, but we're just allowing a little bit of latitude in the event that there is any follow-up to the PUC approval from interveners.

Q - Gregg Orrill {BIO 1532939 <GO>}

Okay. Thanks.

Operator

The next question comes from Aditya Gandhi with Wolfe Research. Please proceed.

Q - Aditya Gandhi {BIO 22175616 <GO>}

Good morning, Susan, Cheryl, and John. Can you -- can you hear me?

A - Susan Hardwick {BIO 16618718 <GO>}

We can. Good morning.

A - Cheryl Norton {BIO 17107572 <GO>}

Good morning.

Q - Aditya Gandhi {BIO 22175616 <GO>}

Good morning. Thanks for taking my questions. I just wanted to start on PFAS and curious to hear your latest thoughts around two specific topics. How are you thinking about the protection of water systems from any PFAS-related financial liability under Socla? Do you see risk if a final rule is released and it doesn't contain any protections? And then the second topic is, can you maybe give some color on what portion of the $50 million additional annual O&M sort of qualifies for -- for trackers or expense mechanisms?

A - Cheryl Norton {BIO 17107572 <GO>}

I can take those questions. This is Cheryl. As far as protections around the circular -- circular, we have been really engaged in that process and we have been pushing really hard to ensure that water and wastewater utilities are protected in that -- in that space. And so we're going to continue to fight that battle. Right now, you're right, there is a little bit of vulnerability out there, but we feel pretty confident that we're going to be able to manage through that and then we're gonna be able to impact how we're treated in that space.

So, more to come on that, but rest assured we're going to fight like crazy to make sure that we are protected there. And as far as the $50 million, I don't have an exact breakdown and we haven't talked about an exact breakdown from state to state, but whether or not that would be recovered through mechanisms just depends on the type of mechanisms that a state would have.

So, if they have a mechanism that would allow them to recover their production costs, any kind of tracker in that space would be really helpful in those costs. In some cases we have environmental riders that include capital improvements, some of them include capital and operating improvements. So, that would allow them to recover those costs as well. So, there's going to be a portion that we're gonna be able to recover right upfront, but the rest of them, we will just recover through a general rate case with very little lag I would anticipate as far as those costs are concerned.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, and the only thing I would add to that is where we don't have an existing mechanism or an approach to ensure timely recovery, we're going to work to design one. Our view here is that these are federally mandated costs and we are taking care of a problem created by someone else. And because of that federal mandate and the federal rule behind it, we think we'll have a great argument to make around recovery and timely recovery.

So, we'll be looking for where we don't have existing solutions, we will be looking to create new opportunity to do that. So, you know, there'll be a lot on the regulatory front here to do once we have a final rule and know how this plays out.

A - Cheryl Norton {BIO 17107572 <GO>}

Yeah, Susan, I would just add that that three-year implementation period that we have to put treatment in place gives us time to do those kinds of things and make those regulatory improvements.

A - Susan Hardwick {BIO 16618718 <GO>}

Right.

Q - Aditya Gandhi {BIO 22175616 <GO>}

Got it. That's super helpful color. Thank you. And one -- just one question for John. On the equity needs, you've mentioned it's in the middle of your new '24 through '28 plan. So, sort of in the '26 timeframe, you're also -- you're also going to have proceeds from the HOS note come in. I believe they are due at the end of 2026.

Just can you add a little bit more color on timing and the form of equity? Is this just going to be like a -- like a straight block or is this going to be some sort of forward where you will maybe draw down on the forward over a couple of years? How should we think about that?

A - John Griffith {BIO 22806522 <GO>}

Yeah, I would say that we haven't -- we're not close enough yet in terms of time to have made the decision on the -- on the exact form of equity. You're right on the timing of the HOS, no proceeds. But as we approach the more immediate timing, then we'll develop our thinking closer to that point, but certainly we're -- we will look and do what's best for shareholders there. You know, I'd say that, you've seen us issue the straight equity as we did this year with the $1.7 billion. We issued the convert this year for $1 billion. And so we're willing to look at everything, but I'd say that's a decision we'll make as that time approaches.

Q - Aditya Gandhi {BIO 22175616 <GO>}

Okay. Got it. And just one follow-up. Can you just clarify -- can you just clarify your -- the point you made on your cash taxpayer status? And I just wanted to confirm, is there a base for your 7% to 9% EPS CAGR at all? I can't find that in the slides or the earnings release.

A - John Griffith {BIO 22806522 <GO>}

Yeah, so -- and let me just clarify that on the equity that we've talked about. To be clear, it will be equity, not another instrument to replace the equity. With regards to our cash taxpayer status, with the Inflation Reduction Act, we do expect that we will become subject to the corporate alternative minimum tax in the coming years. Those regulations are not finalized at this point. And there are certain elements that are in play that will dictate the precise timing for when we would become subject to the AMT. But we are expecting that to be the case for us.

With regards to the -- to the 7% to 9% and a base year, I'd say on that, this is a target that we think of as a long-term target. You're aware that over the last few years, we reset the capital plan with the sale of HOS and the sale of New York and we needed time to redeploy those proceeds and which was the case in '22 and in '23. And as Susan pointed out, our '24 guidance reflects an 8% EPS CAGR at the midpoint. So, we really think of 7% to 9% is a long-term target driven by the long-term 8% to 9% rate base growth CAGR.

Q - Aditya Gandhi {BIO 22175616 <GO>}

Got it. Got it. That's super helpful. Thanks for -- thanks for taking all my questions.

Operator

At this time, we're showing no further questioners in the queue. And this does conclude our question-and-answer session as well as our conference. Thank you for attending today's presentation and you may now disconnect.