Q1 2017 Earnings Call

Company Participants

- Edward D. Vallejo, VP-Financial Planning & Investor Relations
- Linda G. Sullivan, Chief Financial Officer & Executive Vice President
- Susan N. Story, President, Chief Executive Officer & Director
- Walter J. Lynch, Chief Operating Officer

Other Participants

- Angie Storozynski, Analyst, Macquarie Capital (USA), Inc.
- David Katter, Analyst, Robert W. Baird & Co., Inc.
- Dylan Campbell, Analyst, Goldman Sachs & Co.
- Jonathan G. Reeder, Analyst, Wells Fargo Securities LLC
- Michael Gaugler, Analyst, Janney Montgomery Scott LLC
- Ryan Michael Connors, Analyst, Boenning & Scattergood, Inc.

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to American Water First Quarter 2017 Earnings Conference Call. As a remainder, 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 11, 2017. U.S. 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 replay is 10104445. The online webcast will be available at American Water's investor relations homepage at http.\\ir.amwater.com (sic) [http://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.

Edward D. Vallejo {BIO 16076814 <GO>}

Thank you, Anita. Good morning, everyone, and thank you for joining us for today's call. We will keep the call for about an hour. And at the end of our prepared remarks, we will open the call for your questions.

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. 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 the 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, 2017 Form 10-Q, each as filed with the SEC. Reconciliations for non-GAAP financial information discussed on this conference call, including adjusted return on equity and the O&M efficiency ratio, can be found in the appendix of the slide deck for this call. Also, this slide deck has been posted to our Investor Relations page of our website. All statements in this call related to earnings and earnings per share refer to diluted earnings and earnings per share.

And with that, I'll turn the call over to American Water's President and CEO, Susan Story.

Susan N. Story {BIO 3335156 <GO>}

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

The employees of American Water again delivered solid results in the first quarter of 2017. Our strategies include providing excellent service to our customers, building constructive regulatory relationship, 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 is the capital investment we make in our regulated operations. We invested $242 million this quarter, with $223 million for regulated infrastructure. We plan to invest about $1.5 billion this year with $1.3 billion dedicated to water and wastewater system improvement and upgrade. We minimized our customer bill impacts, while making these investments through a continued focus on controlling O&M costs and through constructive regulatory mechanisms.

Our regulated business closed several acquisitions during the quarter and in April. The largest was Shorelands Water Company and we are pleased to welcome these 11,000 New Jersey families and businesses to the American Water family. We have added around 16,700 customers since the start of the year through closed acquisitions and organic growth.

Earnings were up slightly in our market-based businesses. We saw increases in our Homeowner Services Group as well as our Keystone Clearwater subsidiary. However, as we noted at both our December Investor Day and on February's year-end earnings call, military services continues to experience a downturn in ongoing capital projects on bases. This is due to previous sequestration mandate and their effects on base budget. The sequestration was lifted earlier this year and we could see the benefits of this in the DoD's next fiscal year, which starts October 1. Linda will discuss the financial implications of this in more detail in just a few minutes.

Keystone is continuing to see a pick-up in business with more well completions and drilling rigs operating in the Appalachian Basin. We expect to see fuller financial impacts in the second half of the year. As slide 6 summarizes, our results were solid with first quarter 2017 earnings per diluted share up 13% compared to last year.

As Linda will discuss in more detail in just a few minutes, this includes excellent year-over-year growth in our regulated businesses, year-over-year improvement in our market based businesses, and a $0.02 positive impact from a parent-related tax accounting treatment of equity compensation. She will also outline a second quarter one-time income tax headwind from our New York operations, which will likely more than offset the anticipated equity compensation pick up this year.

On April 21, our board of directions increased our quarterly cash dividend payment from $37.50 per share to $41.50 per share, a 10.7% increase. This increase is the fifth consecutive year that dividend increases are at the very top or above our long-term 7% to 10% EPS growth range. We are also affirming our 2017 guidance of $2.98 to $3.08 per share.

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

Walter J. Lynch {BIO 6064780 <GO>}

Thanks, Susan, and 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.

Let's walk through some of the highlights of the quarter. In Pennsylvania, we filed a rate case on April 28, requesting an increase of $108 million and a return on equity of 10.8%. We've invested approximately $1.3 billion in Pennsylvania infrastructure and slightly decreased O&M expense since our last rate filing in 2013. This is a great example of increasing our system's reliability and making it affordable for our customers.

California American Water's cost of capital filing was not extended, so on April 3, we filed an application of requesting 10.8% return on equity along with 55.4% equity and 44.6% debt. The outcome of this proceeding would affect rates starting in January 2018.

In Virginia, on April 5, the Legislature and Governor enacted new legislation that will benefit our customers. Senate Bill 1492 allows for statewide single tariff pricing, one for water and one for wastewater for proceedings after July 1, 2017. Consolidated rates, which we have now in nine states, allows us to spread the cost of infrastructure investments across a larger customer base and helps to ease the financial burden in any one community.

In Tennessee, the Public Utility Commission approved the infrastructure surcharge for 2017 projects. We'll invest almost $16 million in projects that improve service and reliability and will only impact our average residential bill by about $0.77 per month. This type of constructive regulatory policy allows our subsidiaries to make needed improvements, while reducing the possibility of large rate increases.

The Iowa Utilities Board issued an order adjusting rates for Iowa American Water. We invested approximately $38 million in water system improvements and reduced operating expense by almost 10% since our last rate filing in 2013. We also received approval for QIP, which is the DSIC mechanism in Iowa. This helps us make improvements, while limiting customer bill impact. This is a great job by our Iowa team. Again, for every dollar we save, we can invest seven in our systems with no customer bill impact.

Turning to slide 10, as Susan mentioned, we added 16,700 new customers through April, through completed acquisitions and organic growth. The largest acquisition was Shorelands Water Company adding 11,000 customers in Monmouth County, New Jersey. This is another case where we leverage our scale and size by acquiring a system adjacent to systems we already own and operate. We can now connect new system with our existing Union Beach system. It will enhance our supply and increase reliability for all of our customers in that county.

We also have a number of pending acquisitions, which when closed will add about 33,000 customers. Just last week, we announced that California American Water entered into an agreement to acquire the operating assets of the Fruitridge Vista Water Company for approximately $20 million and to become the new water provider to its approximately 4,800 customers.

Moving on to slide 11m, doing right by your customers is key to our ability to grow. This means, smart investments balanced by efficient operations and capital deployment. As Susan mentioned, we invested $223 million in our regulated operations this quarter. This is critical to reliable service, but it's also about affordable service. Our talented people continue to make progress in our O&M efficiency ratio, down to 34.6% for the last 12 months ended March 31, 2017.

We keep making progress towards our long-term goal of 32.5% because of our employees and their commitment to our customers. Let me give you two examples. Pennsylvania American Water's comprehensive energy efficiency program has been delivering positive results for many years. Activities include competitive electricity sourcing, pump and motor upgrades, lighting upgrades, demand response programs and utility rebates for energy efficiency projects.

At a high level, from 2010 to 2016, their fuel and power spend as a percent of total revenues dropped from 3.1% to 2.1%. This improved efficiency amounts to about $24 million of cost avoidance over the last six years.

In California, by partnering with the Sacramento Municipal Utility District, California American Water was able to save 2.5 gigawatt hours of electricity, each of the past three years. To put that in perspective, 2.5 gigawatts could power about 230 average households annually. By improving efficiency and enhancing equipment reliability, this unique partnership has helped us achieve an almost 11% reduction in yearly electricity usage, with annual savings of about $150,000.

I also want to recognize our customers in California for their response to the drought. They collectively reduced water use by more than 15 billion gallons in just under two years. To help customers save, California American Water launched award-winning communication campaigns, that included a heavy emphasis on personal outreach, social media and smartphone applications, as well as traditional communications. It was a tremendous effort by our customers and our California team.

So, it 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 G. Sullivan {BIO 7300156 <GO>}

Thank you, Walter, and good morning, everyone. Today, I will cover our first quarter results and key financial metrics that bring customer and shareholder value. Turning to slide 13, we had a solid first quarter. Earnings were $0.52 per share, $0.06 above the first quarter last year. The regulated businesses were up $0.04 per share, the market-based businesses were up $0.01, and the parent was also favorable $0.01.

I'd like to point out that our first quarter results include a $0.02 per share tax benefit related to the new accounting standard for stock-based compensation. Excluding this benefit, first quarter EPS increased 8.7% over the same period last year, again representing solid quarterly results.

Let me walk through our results by business segments. Our regulated operations were up $0.04 per share, revenue was up $0.08 per share from authorized rate cases and infrastructure mechanisms to support growth and acquisition, partially offset by slightly lower demand.

Next, we had higher depreciation and general taxes of $0.04 per share also driven by our investment growth. I'd also like to point out that, O&M expense was flat in the regulated businesses, compared to the prior year, as our employees, across the company, continue to focus on driving efficient operations that help make capital investments affordable for our customers.

Turning to our market-based businesses, they were up $0.01 compared to the same period last year. Homeowner Services was up $0.01 on revenue and contract growth, and Keystone was favorable from continued cost management. And as Susan mentioned, we are seeing improved market conditions that are expected to impact results in the second half of the year.

These increases were partially offset by lower capital upgrades in the military services group of $0.01 per share, which includes the quarter-over-quarter impact from completion of the major project at Fort Polk in mid-2016.

Lastly, the Parent was up $0.01 in the quarter from the tax benefit of about $0.02 related to the new accounting standard for stock-based compensation. This was partially offset by higher interest expense of $0.01 to support growth.

Turning to slide 14, let me provide an update on our regulatory filings. We have $46.9 million in annualized new revenues effective since January 1 of this year. This includes $34.2 million authorized through general rate cases, and $12.7 million from infrastructure mechanism. We have also filed requests and are awaiting final orders on four rate cases and one infrastructure surcharge for a total annualized revenue request of $169.5 million. This includes the Pennsylvania rate case Walter discussed that was filed on April 28.

Slide 15 highlights our key financial metrics that continue to create customer and shareholder value. Revenue was $756 million for the first quarter, an increase of $13 million or 1.7% compared to the first quarter last year. Regulated revenue increased $25 million or 3.9%, partially offset by a decrease of $11 million at the market based businesses due mainly to the lower capital upgrade. It is important to note that our Regulated revenue growth is typically lower than earnings growth due to the continued improvement in O&M efficiency across our Regulated Businesses.

Total capital investments for the quarter were $242 million primarily in our regulated businesses for replacement and renewal of transmission and distribution infrastructure. We expect capital investments including regulated acquisitions to be about $1.5 billion in 2017. Our cash flow from operations grew 6.5% to $277 million in the first quarter of 2017. This was driven by net income growth and higher working capital. Working capital increased from lower capital upgrades in the Military Services business and continuous improvement in our collection efforts in the Regulated Businesses.

Our adjusted return on equity improved from 9.4% to 9.7%. Our weighted average authorized return on equity across our regulated footprint remains approximately 9.9% and we continue to narrow the gap between our authorized and achieved returns through a continuous improvement culture that focuses on O&M efficiency, capital efficiency and constructive regulatory outcomes.

Turning to slide 16, today we are affirming our 2017 earnings guidance range of $2.98 per share to $3.08 per share. I would like to call out a few items included in the earnings guidance range. First, as we mentioned at our December investor conference and February's earnings call, we expect the lower capital upgrades in the Military Services Group, to continue through 2017, due to the completion of the large project at Fort Polk in mid-2016, and reduced military budget.

To give you additional transparency, included in our 2017, earning guidance range is an expected net income reduction from 2016, of approximately $5 million to $6 million or about $0.03 per share from these lower capital upgrades. More than offsetting this reduction is continued growth expected in both our Homeowner Services Group and Keystone Clearwater Solutions.

Second, on April 11, New York passed legislation that will no longer allow water utilities to use the zero percent tax rate for manufacturing activity. Previously the electric and gas utilities were excluded from the zero percent rate. This will result at an increase to our effective state tax rate in New York of approximately 5% beginning January of 2018.

Although this rate change will not occur until 2018, we are required to record a one-time cumulative adjustment to re-measure our deferred taxes in the second quarter of 2017 or the period of the tax law change. The portion of this cumulative adjustment calculated on a standalone basis for our New York regulated subsidiary is expected to be recovered through future customer rates and is not expected to impact earnings.

However, the remaining portion which is allocated to our state tax apportionment factors is expected to negatively affect second quarter 2017 earnings. Our preliminary estimate of this one-time non-cash charge is about $0.03 to $0.04 per share.

Now this negative tax impact will be partially offset by the $0.02 tax benefit already recorded in the first quarter related to the change in accounting for stock-based compensation. And then finally, we also include in our earnings guidance range plus or minus $0.07 per weather variability. Again, these items are included in our earnings guidance range and we are calling them out today for additional transparency.

Transitioning to dividend on page 17, we continue to be a leader in dividend growth compared to the Dow Jones Utility Average, the Philadelphia Utility Index and our water utility peers. On April 21, we announced a $0.415 common stock dividend which represents a 10.7% increase over the previous dividend. This dividend is payable on June 1, 2017 to stockholders of record of as of May 5, 2017. This increase represents the fifth year in a row that we've had dividend increases at or above the top end of our long-term 7% to 10% EPS compound annual growth rate.

And with that, I'll turn it back over to Susan.

Susan N. Story {BIO 3335156 <GO>}

Thanks, Linda. Before taking your questions, many of you have asked about the Trump administration infrastructure plan and how they might impact us. So, I'll speak to that very briefly. As you know, tackling our nation's infrastructure challenges for road, bridges, airport and water infrastructure is a priority for administration, and for good reason.

First and foremost are the safety and health of our citizens and there are also compelling economic and competitive justifications. We know reliable infrastructure is foundational for communities and businesses to thrive, and investment also stimulates the economy through job creation. For example, every $1 million in water infrastructure investment yields 16 jobs. So, American Water's $1.3 billion invested in water and wastewater infrastructure year will support 165,000 jobs.

The details of an infrastructure package are still not clear, but the administration has been clear on the need for private sector involvement. For us, a focus on the need to invest in infrastructure is a good thing. For as long as you have been listening to our calls, we've been talking about the need for and our efforts to upgrade and maintain our system to ensure clean, safe and reliable water services, all while running our business safely and efficiently so that our customer bills are affordable.

So, as we applaud these efforts by the administration and are actively involved in these policy development efforts to support our customers interest, it doesn't really change our ongoing investment scope, plans or commitment. Regardless of what happens in Washington, we will continue to focus on serving our customers, assuring water quality, and strengthening our infrastructure. And we will do this as we also partner and assist communities seeking help with their own water and wastewater service challenges.

And with that, we're happy to take your questions.

Q&A

Operator

We will now begin the question-and-answer session. Our first question comes from Ryan Connors with Boenning & Scattergood. Please go ahead.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Great. Thanks for taking my question.

A - Linda G. Sullivan {BIO 7300156 <GO>}

Hi, Ryan.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Hello. I'd like to just talk about Pennsylvania, the related issues of the Pennsylvania rate case and sort of the acquisitions there, and obviously, the rate case is sort of hot off the press. But can you tell us about how the – well, first of all, whether or not that includes the Scranton addition which I assume that it does and if so, whether there's any unique elements to how that's being treated in terms of that being a wastewater system and it being a pretty large implementation of Act 11, and any just unique dynamics or things to watch for in terms of how Scranton will be now pulled into the rate orbit for Pennsylvania?

A - Walter J. Lynch {BIO 6064780 <GO>}

Ryan, it's Walter. How are you?

Q - Ryan Michael Connors {BIO 15032883 <GO>}

I'm well. Thank you, Walter.

A - Walter J. Lynch {BIO 6064780 <GO>}

Good. Good. Yeah, the Scranton acquisition is included in this rate filing, and because of Act 11, it's going to be integrated into the proceeding, and with the same way that the water systems worked. So it's going to take again 8 to 10 months to work through the proceeding and we just – we're going to work with the commission and make sure that the Scranton customers are represented in a right way.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Okay. So you don't anticipate anything unique or any kind of unique sort of pushback in terms of the scale of that system and that being causing an issue in terms of single tariff pricing or anything like that? I mean you think it will be pretty straightforward and be treated similarly than any other rate case?

A - Walter J. Lynch {BIO 6064780 <GO>}

That's what we expect, Ryan. And again, when you consider the size, $1.3 billion worth of investment over the last four years, this is a significant investment but still it's part of the much bigger capital program we have in Pennsylvania.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Right. Yeah, good point. Now, what about the broader Pennsylvania. I mean it seems like that deal – at least the announced deal has slowed a little bit. I mean, you had Scranton, was obviously big one, McKeesport, but lately there haven't really been any additions. I mean should we interpret that as meaning there is a little bit of a deceleration or are there are a whole lot sort in the hopper that we are seeing yet and the cadence remains really strong?

A - Walter J. Lynch {BIO 6064780 <GO>}

Well, let me say that we continue to work with communities to address their issues and be a solutions provider for them. And again, we know that we've got a compelling story and we can add tremendous value to our customers.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Okay. And then one last one, just more sort of a housekeeping short-term issue, but we are – Linda, you mentioned the variability on weather and appreciate the transparency there in terms of the guidance. But any early read on 2Q, we're almost halfway through, on whether that will be a headwind or a tailwind for the second quarter results?

A - Susan N. Story {BIO 3335156 <GO>}

Hey, Ryan. This is Susan. Before Linda answers, if we're able to project what the weather is going to be, none of us may be sitting around this table. But Linda, what do you say?

A - Linda G. Sullivan {BIO 7300156 <GO>}

Yeah. In the first quarter, Ryan, we did see a little bit of lower demand, but it was really in line with declining usage that is normally expected.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Right.

A - Susan N. Story {BIO 3335156 <GO>}

And if you have any inside information we would love to hear it.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Well, I just mean we're five weeks into 2Q, right? So, I'm just trying to get an idea whether there is any sense of whether it's been in the first five weeks of 2Q, whether it's been a headwind or a tailwind to sales.

A - Linda G. Sullivan {BIO 7300156 <GO>}

Yeah, and we're not really seeing any large indicators through the April timeframe. I will say that, when we look at weather variability, historically, we have seen the largest variability occur in the late summer months or in the third quarter of the year.

A - Susan N. Story {BIO 3335156 <GO>}

And, Ryan, you bring up a good point.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Got it.

A - Susan N. Story {BIO 3335156 <GO>}

One of the thing that really helps us, if you remember of the past couple of years especially because of our geographical diversity even when we may see, unfortunately as we have flooding at different times in the Midwest and dryer weather in the North East, they have tended to offset each other.

So, one of the benefits in terms of quality of earnings are being able to see through the weather is the geographical diversity we have. So you bring up a good point, with all the rains that Missouri has had, we've not seen that in the Northeast. So, that kind of helps us kind of net out, and we think that's good.

Q - Ryan Michael Connors {BIO 15032883 <GO>}

Yeah, great point. Well, thanks for your time this morning.

A - Susan N. Story {BIO 3335156 <GO>}

Thanks, Ryan.

Operator

The next question comes from Angie Storozynski with Macquarie.

Q - Angie Storozynski {BIO 15115714 <GO>}

Thank you. So, continuing on the M&A front. So I'm wondering you have made two relatively high profile hires in your business development department. Is this a signal that maybe you might consider corporate M&A in addition to municipal M&A or those are completely unrelated?

A - Susan N. Story {BIO 3335156 <GO>}

So Angie, hello, first of all. And thanks for that question.

Q - Angie Storozynski {BIO 15115714 <GO>}

Good morning.

A - Susan N. Story {BIO 3335156 <GO>}

So, the quick answer is, it really – there's no changes to our strategy. And just as some background and I'm really glad you asked the question. So, if you look at American Water, in the past four years, we've actually doubled our market capitalization. We've increased our regulated acquisitions. We've also increased our capital investment, and you also pair that with the fact that we have an aging workforce. And so we've, over the past two to three years, been looking at strengthening an already really strong team. And we have so many professionals who have worked here for a long time, but for example, last year we brought in a new Chief Innovation and Technology Officer, Radha Swaminathan, because he brought some unique capabilities from his time in the electric utility industry and what they had done in technology.

We brought in a new head of R&D and emerging technology because Dr. Mark LeChevallier is retiring at the end of this year. We brought in a new Controller, Melissa Wikle, and we also promoted several people inside to bigger and higher jobs. So, really with Eric and Brian, it's a continuation of that. And Eric is actually in business development in Mark Strauss' group. And that group, as we talked about at Investor Day in December, that group supports the regulated acquisition strategies that are states employ.

But also we're always looking at the landscape of, are there new states we want to enter, we've talked about the conditions that we would have to have before we did that, and we also look at, are there other opportunities? But that's not the basis of our growth triangle, and that's not the focus mainly what we're dealing. And with Brian, actually, it's a different role than that is that as we've gotten bigger and as we look at our corporate strategies and our financial strategy convergent, we're bringing in talent that has decades of experience of looking at creative financial planning, how you integrate corporate strategy with financial planning, being able to look at financial modeling, how we evaluate, making sure we make really good smart financial decisions.

And I'll tell you, with the addition of Melissa and Brian, and the continued outstanding work that Ed Vallejo brings, our VP and Treasurer, Jen Gambol, our team here, really we brought these hires in to really make us even stronger than we have been in the past and it's pretty exciting.

Q - Angie Storozynski {BIO 15115714 <GO>}

Very good, thank you. And – but again, can you – we don't obviously see the backlog of municipal deals that you've been working on, and I've heard the comments from Walter. But is there anything more you could let us know? I mean, you have a number of high profile cases in your service territories or close to them with all kinds of issues, water-related issues, lead poisoning or high levels of lead. We would have thought that those would have led to more imminent announcements regarding at least public-private partnerships with companies like yours, but we haven't heard anything yet.

A - Susan N. Story {BIO 3335156 <GO>}

Right. And it is – one of the reasons that in December we shared kind of the long – and you see in the deck today that we shared the long process it takes in terms of acquiring a municipality is that even if there is interest and they expressed an interest, when you're a municipality there is a lot of efforts, politics that are in play. You have to get a lot of people on board. You have to get a lot of people aligned. It's not quick. It would be much faster if the business was corporate acquisitions which has its own set of issues.

But in the municipality we also understand that these are our liken (33:12) officials and they want to make sure not just that they are getting a good price for their system but that the people who buy their system and their assets are able to serve their citizens well over the coming years and this is big interest. A lot of the mayors and council folks say, yeah, price is one thing and yes, we need to have more capital, but on the other hand, I have to make sure that this is going to last for the next several years, and that we don't put our city in a situation where we have service issues.

So you're exactly right, Angie, as we do more and more work with emerging contaminant, as we are looking not just to lead but other contaminants that aren't regulated that we have growing concerns about and we're looking at ways to deal with them, we are sharing with municipalities all over the country, our efforts, our value proposition. And some of them are interested, some of them aren't, but it's not a fast process, and I don't think it will ever be a fast process because of the politics involved.

And I know one thing that will help though and Walter can mention, the Water Quality Accountability Act in New Jersey is one thing that it takes effect across the country because basically private water companies like us are held to higher standards or where actually the regulations are enforced more strongly with us than they are with municipalities. And we believe that all people deserve clean water. And so, you may want to talk about what's going in New Jersey, Walter.

A - Walter J. Lynch {BIO 6064780 <GO>}

Absolutely, Susan. And if I can add to that as well, it does take a long time as we know, but our teams in the states are focused on executing and delivering value for the communities that they serve and will serve in the future.

So the Water Quality Accountability Act right now was approved in the environmental committees in both the House and Senate in New Jersey. The next step is to go in front of the Budget Committee which should happen at the end of this month, and then a floor vote in June, and then the Governor has got 45 days to sign it. So it is moving forward. We expect it to move forward and get approved. But we think this is going to be good not just for New Jersey, but as other states look to New Jersey as a leader in this area that they'll look at something similar in those states.

A - Linda G. Sullivan {BIO 7300156 <GO>}

Yeah. And if I could add to that, when we look at our long-term growth triangle, we continue to see 1% to 2% growth, EPS, compound annual growth rate from regulated acquisitions and that translates into about 30,000 to 60,000 customer additions per year. And they ebb and flow. They can be lumpy as we go through. But we've added 13,000 customers year-to-date.

Q - Angie Storozynski {BIO 15115714 <GO>}

Very good. Thank you.

A - Susan N. Story {BIO 3335156 <GO>}

Thank you, Angie.

Operator

The next question comes from David Katter with Baird. Please go ahead.

Q - David Katter {BIO 20266889 <GO>}

Good morning, guys. Thank you for taking the question.

A - Susan N. Story {BIO 3335156 <GO>}

Hi, David.

Q - David Katter {BIO 20266889 <GO>}

I was hoping you could just discuss and give a little more color on the Senate Bill in Virginia and how it adjusts? How you might evaluate opportunities in state?

A - Walter J. Lynch {BIO 6064780 <GO>}

Yeah, we're really proud of that. We did play a role in moving that forward in Virginia. So what we have is the single tariff pricing, one in the water and then one the wastewater side and we're going to use that like we do another states. So if we acquire system, we can spread those costs across a bigger customer base. And so, we'll just continue to work with our municipal leaders in Virginia to promote the benefits of that. We've seen in all the other states and I think they recognized that because they passed it, the House and Senate and the Governor passed this for a reason because it's going to benefit customers within Virginia.

Q - David Katter {BIO 20266889 <GO>}

And so, would that make acquisitions in the state incrementally more attractive do you think?

A - Walter J. Lynch {BIO 6064780 <GO>}

Yeah. We believe so. And that's why, we're big believers in the single tariff pricing because, again, it allows us to buy a system and the most of the time, they need significant investment and we're able to spread that investment across a larger customer base. So...

Q - David Katter {BIO 20266889 <GO>}

Got it. Thank you. And then one more question on California. After two years of a drought, how should we think about a potential rise in demand or usage rates? How do consumer trends adjust after conservation from a drought, do you think?

A - Walter J. Lynch {BIO 6064780 <GO>}

What we expect the behaviors that continue in California. I think the customers there work very, very hard over the last six years to seven years to bring their usage down to levels that they can sustain. So, that's the way we look at it, the continued behavior around conservations very important in California and our customers recognize that.

A - Susan N. Story {BIO 3335156 <GO>}

And also, in California, we have revenue decoupling, which aligns the conservation goals of the commission of our customers and our company.

Q - David Katter {BIO 20266889 <GO>}

Right. All right. Thank you, guys.

A - Susan N. Story {BIO 3335156 <GO>}

Thanks, David.

Operator

The next question comes from Dylan Campbell with Goldman Sachs. Please go ahead.

Q - Dylan Campbell {BIO 19352445 <GO>}

Hi. Good morning. Thanks for taking my questions.

A - Susan N. Story {BIO 3335156 <GO>}

Good morning, Dylan.

Q - Dylan Campbell {BIO 19352445 <GO>}

Good morning. Given the recent cost of capital application filed in California, we're just curious, what is the revenue sensitivity for every 25 basis points change in return on equity?

A - Linda G. Sullivan {BIO 7300156 <GO>}

So, we can give that – we can give that to you offline. I don't have it right in front of me, but what I can say is that, our cost of capital filing was not extended. So, we did do a filing on April 3. We requested a 10.8% ROE and that is up from our current authorized level of 9.99%. We also requested an increase in the equity ratio from 53% to about 55%. So, we can run through that calculation and get it to you.

Q - Dylan Campbell {BIO 19352445 <GO>}

Okay. Thank you.

A - Edward D. Vallejo {BIO 16076814 <GO>}

Yeah. Dylan. It's Ed. We'll give you a ring after I go back to my office and look at the numbers, okay.

Q - Dylan Campbell {BIO 19352445 <GO>}

Okay. Thank you. And also when do you expect the rates from the new Pennsylvania rate case to go into effect?

A - Walter J. Lynch {BIO 6064780 <GO>}

Typically, it takes 10 to 12 months to work through the process there in Pennsylvania.

Q - Dylan Campbell {BIO 19352445 <GO>}

Okay, thank you. And then finally following up on slide 19 as it relates to a potential infrastructure spending bill, I guess we're wondering if an increase in Federal funds for water infrastructure spending could potentially, I guess, limit state incentives for a fair amount value legislation, so Washington, D.C. might not necessarily impact investments in American Water's current assets but may provide headwinds when it comes to future acquisitions.

A - Susan N. Story {BIO 3335156 <GO>}

That's a really good question. So from everything we're seeing, when you look at the amount of money spent by the private industry a year, which is between $2.5 billion and $3 billion and you look at the money that's out there for 84% of the water systems and 98% of the wastewater, they actually are spending less from public fund. So it would take such huge numbers of, I'll call, free money to have a big impact. However, there's always the issue and one of the things that we're doing to watch out for our customers is our customers pay taxes just like the customers of municipalities.

So what we're asking for is a level playing field. For example, the state revolving funds that get funding nationally, federally, we can participate in states that allow us to on the water side, but not on the wastewater side. So we're working on policy efforts to ensure that if there are pools of low cost money that we have access to them equal to what the municipals have access to and, again, because all of our customers pay taxes also.

So for us it is, there is also in some conversations what we've been involved with in Washington, the $1 trillion infrastructure is not a $1 trillion in actual funding. It is finding ways that you've offset the need for that. So our ability to invest in job creations, those type of things could actually be used as a measure to count toward that and that's one thing that we're involved in making sure that we get recognized for that.

Q - Dylan Campbell {BIO 19352445 <GO>}

Okay, very interesting, thank you.

A - Susan N. Story {BIO 3335156 <GO>}

Thanks.

Operator

Our next question comes from Jonathan Reeder with Wells Fargo. Please go ahead.

A - Susan N. Story {BIO 3335156 <GO>}

Hi, Jonathan.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Hey, good morning, Susan. How you're doing?

<<A – [063D6J-E]Susan Story – American Water Works Co., Inc.>: Good.

Great. Two quick questions, when you originally established the 2017 guidance, did it contemplate the $0.03 to $0.04 one-time charge for the New York State manufacturing deduction?

A - Linda G. Sullivan {BIO 7300156 <GO>}

Okay, Jonathan. This is a Linda. It did not and so as we began to look at our guidance and affirming our guidance, there were two really discrete tax items that we were looking at that impacts from New York, but also from the change in the new accounting standards for stock-based compensation and so those largely are offset.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Okay. So, you hadn't contemplated that stock tax benefit though either?

A - Linda G. Sullivan {BIO 7300156 <GO>}

Yeah, we knew about it. This is something that is really hard to predict because it's based upon a level of stock option exercises, the stock price, et cetera. And, so yeah, we did not include it in the guidance. So, that's why we wanted to make sure that we outlined these items for you for additional transparency, so that you could determine the overall quality of earnings.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Right, yeah. I guess that kind of goes to my next question. Just given the one-time nature why not just back it out the $0.03 to $0.04 item at least?

A - Linda G. Sullivan {BIO 7300156 <GO>}

Yeah, it really is a one-time accumulative non-cash item.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Okay.

A - Linda G. Sullivan {BIO 7300156 <GO>}

Just try to be very careful. You get some companies that outline everything so special and back out and all this. We try to be pretty transparent and clean. So unless it's something – that's why we say we had touched upon (43:29) weather that we should be able to adjust for a weather gets within a certain band and only if it's extraordinary. A great point, Jonathan, but we just try to keep everything simple and clean as we can.

Right. And I'll add to that. That is our preliminary estimate. The new legislation came out on April 11, these are very detailed calculations and so we're working through the process now.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Okay. And then just building on Ryan's earlier question, I guess for Walter, probably about the PA rate case. I know, you indicated that you expect to be relatively straight forward, but I think it is the first time, I'll use the forward-looking test here, do you expect any issues with that transition during the process and potentially during settlement negotiation?

A - Walter J. Lynch {BIO 6064780 <GO>}

No, we don't expect any issues there, Ryan (sic) [Jonathan]. We're just going to work through it like we do with our other investments in Pennsylvania.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Okay. And using the forward-looking test, that didn't allow you to, I guess, grab McKeesport since that one hasn't closed. Is that the way to kind of think about that?

A - Walter J. Lynch {BIO 6064780 <GO>}

Yeah. That's correct.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Okay. But if it closes during the next few months or whatever, you wouldn't be able to adjust that case, would you?

A - Walter J. Lynch {BIO 6064780 <GO>}

No.

Q - Jonathan G. Reeder {BIO 18909775 <GO>}

Okay. Great. Thanks for the time, guys.

A - Walter J. Lynch {BIO 6064780 <GO>}

Okay.

A - Susan N. Story {BIO 3335156 <GO>}

Thanks.

A - Linda G. Sullivan {BIO 7300156 <GO>}

Thanks.

A - Susan N. Story {BIO 3335156 <GO>}

Okay. I think operator, we have one more.

Operator

Yes. Our next question comes from Michael Gaugler with Janney Montgomery and Scott. Please go ahead.

Q - Michael Gaugler {BIO 7139923 <GO>}

Good morning, everyone.

A - Susan N. Story {BIO 3335156 <GO>}

Hi, Michael.

Q - Michael Gaugler {BIO 7139923 <GO>}

I would appreciate it, if you could provide an update on the headquarters move and what your expectations are for tax savings at this point.

A - Linda G. Sullivan {BIO 7300156 <GO>}

Absolutely, Michael. This is Linda. And we are really excited, because we have broking ground on the construction and so you can now probably see it from the Philadelphia skyline, you can see the steel going up if you will. So, we expect the cost of the building to be up to $165 million. For 2017, we would expect to spend about $75 million this year on the construction, as long as we stay on schedule which is expected. We are looking at completing the construction towards the latter half of 2018 and then taking occupancy there.

Now, in terms of the tax credit, the way that this works is that once we move into the building, we become eligible to receive up to $165 million in tax credit over a 10-year period subject to meeting certain criteria. And our goal here is really to make this revenue neutral for our customers and so that is what we're working towards. And we are going to be utilizing grant accounting for recognition of these tax benefits which allow us to recognize those tax benefits over the life of the asset and that's very consistent with our approach to make this revenue neutral for our customers.

Q - Michael Gaugler {BIO 7139923 <GO>}

Okay. So, what would you anticipate the life of the asset to be?

A - Linda G. Sullivan {BIO 7300156 <GO>}

Buildings are generally 39 years.

Q - Michael Gaugler {BIO 7139923 <GO>}

39 years. Okay, that's all I had. Thank you.

A - Susan N. Story {BIO 3335156 <GO>}

Thanks, Michael.

A - Linda G. Sullivan {BIO 7300156 <GO>}

Absolutely. Thank you.

A - Susan N. Story {BIO 3335156 <GO>}

And I'd like to thank you all for participating on our call today. Please note that we value you as our investor owners and as the financial analysts who research our company for the benefit of your clients and their futures. We always want to be open and transparent in all of our discussions and dealings with all of you so that you can have complete confidence in your decisions around our company and your investments in our stock.

If we have not been able to address your questions or 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 week from tomorrow, next Friday, May 12. Thanks again for listening, and we look forward to talking with you soon.

Operator

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