# Q1 2016 Earnings Call

## Company Participants

- Gregory S. Panagos
- Linda G. Sullivan
- Susan N. Story
- Walter J. Lynch

## Other Participants

- Jonathan G. Reeder, Wells Fargo Securities LLC
- Richard A. Verdi, Ladenburg Thalmann & Co., Inc. (Broker)
- Walter Scott Liptak, Seaport Global Securities LLC

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning and welcome to American Water's First Quarter 2016 Earnings Conference Call. As a reminder, this call is being recorded, and is also being webcast with an accompanying slide presentation through the company's Investor Relations website.

Following the earnings conference call, an audio archive of the call will be available through May 12, 2016 by dialing 412-317-0088 for U.S. and international callers. The access code for replay is 10084204. The online archive of the webcast will be available through June 6, 2016 by accessing the Investor Relations page of the company's website located at www.amwater.com. After today's presentation, there will be an opportunity to ask questions.

At this time I would like to introduce your host for today's conference, Greg Panagos, Vice President of Investor Relations. Mr. Panagos, you may begin.

### Gregory S. Panagos {BIO 17562275 <GO>}

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

During the course of this conference call, both in our prepared remarks and in answer to your questions, we may make forward-looking statements to 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 actual results to be materially different from the results indicated or implied by such statements. Additional information regarding these risks, uncertainties and factors is provided in the earnings release and in our Form 10-Q each as filed with the SEC.

I encourage you to read our Form 10-Q for a more detailed analysis of our financials and other important information. Also reconciliation tables for non-GAAP financial information discussed on this conference call including adjusted return on equity and our O&M efficiency ratio can be found in the appendix of the slide deck for this call which is located at the investor relations page of the company website as well as our earnings release.

We will be happy to answer any questions or provide further clarification if needed during our question-and-answer session. All statements in this call related to earnings' earnings per share referred to diluted earnings and earnings per share from (2:51) continuing operations.

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

## Susan N. Story {BIO 3335156 <GO>}

Thanks, Greg. Good morning, everyone and thanks for joining us. With me today are

Linda Sullivan, our CFO who will go over the first quarter financial results; and Walter Lynch, our COO who will give key updates on our regulated business.

The employees of American Water delivered solid results in the first quarter of 2016 through the continued execution of our strategy. These strategies include building constructive regulatory relationship through transparency, providing excellent service to our customers, growing our businesses, and continuing to become even more efficient in our operations to ensure affordability for our customers.

As you can see on slide six, we're off to a solid start in 2016. We reported operating revenues of $743 million, a 6.4% increase above first quarter 2015. Earnings from continuing operations were $0.46 per share for the first quarter, a 4.5% increase above first quarter 2015.

Turning now to slide seven, let me discuss a few highlights of our strategy execution. As you know, this foundation for our earnings growth is the capital investments we make in our regulated operations to provide clean, safe, and reliable service to our customers.

Capital investment through March 31, 2016 totaled about $236 million, with $202 million in our regulated infrastructure investment. We plan to invest $1.3 billion to $1.4 billion this year of which $1.2 billion will be dedicated to water and wastewater system improvement.

We're able to make these needed investments while minimizing our customer bill impact by our continued focus on controlling O&M costs and through constructive regulatory mechanisms.

Walter will talk more about these in just a moment.

We had excellent growth news during the first quarter. A special highlight with our announced acquisition agreement with the Scranton Sewer Authority. Our Pennsylvania employees have provided water service to this community for decades, and we're excited for the opportunity to be the future wastewater services provider to those 31,000 customers in Scranton and Dunmore.

We also closed seven acquisitions in six different states during the quarter, welcoming another 7,000 customers to the American Water footprint. Walter will also share with you an exciting announcement from just last night which will add 3,100 more new customers.

Moving to our market-based businesses. In February, we began providing water and wastewater services to the City of Camden, New Jersey through our contract services group.

We already serve a portion of Camden through our Regulated New Jersey American Water subsidiary and we're excited to serve the rest of that community. Camden will also be the home of our future corporate headquarters later this decade.

We continue transition activities at Vandenberg Air Force Base and we look forward to serving our country's fine military men and women and their families there beginning June 1. This is our 12th military contracts which we announced toward the end of last year.

We do see a few challenges this year in American Water Enterprises or AWE and Keystone Clearwater.

Earnings were flat in AWE compared to the first quarter of last year, mainly because we accelerated $1.5 million in Homeowner Services' marketing costs into the first quarter of this year. The first quarter results in our Military Services Group were up compared to the same period last year, but we expect federal budgetary constraint to impact planned future capital upgrade projects for the remainder of 2016. That said, we are seeing significantly more bases in a RSP pipeline for privatization. We continue to believe in the long-term growth potential of this business segment.

Keystone continues to manage through the current challenging market characterized by low natural gas prices and excess supply. These conditions have persisted longer and been more severe than we originally anticipated and discussed with you at our Investor Day on December 15, when we shared that we believe that Keystone would be accretive to earnings in 2016.

However, through a sharp focus on cost management, as well as, continuing to expand our customer market share in the Appalachian Basin, we expect that Keystone will be earnings neutral and cash flow positive for us in 2016. The Energy Information Administration and many industry experts are predicting decreasing natural gas supply by late fall, and increasing prices later this year and into 2017, and our own analysis tracks with these projections.

We believe our business model, growing market share, and solid balance sheet for the business will be a competitive advantage for us as the market recovers and other water services providers have found it difficult to survive. We're committed to Keystone and still believe it's a good strategic fit for us going forward.

As slide eight summarizes, we continue to make progress toward our achieving our near and long-term goal. Based on the results for the quarter, we affirm our 2016 guidance of $2.75 to $2.85 per share. We also continue our progress toward achieving our long-term goal of 7% to 10% EPS growth through 2020.

Based on our solid performance, our Board of Directors increased our quarterly cash dividend payment by 10.3% from $0.34 to $0.375 per share in April. This is our fourth consecutive double-digit increase in dividend. This also continues our commitment to provide strong dividend growth aligned with our financial performance while also providing needed investment in our system for the benefit of our customers and our community.

With that, Walter will now give you his update.

## Walter J. Lynch {BIO 6064780 <GO>}

Thanks, Susan. Good morning, everyone. As Susan mentioned, we're off to a solid start in 2016, growing our customer base, continuing our commitment to investing in our infrastructure while focusing on improved O&M efficiency and cost reductions to mitigate the rate impact for our customers.

In recognition the investments we make to ensure clean, safe and reliable service, we received the rate order in West Virginia during the quarter, reflecting an annual revenue increase of $18.3 million. The main driver of the request was the $167 million we've invested since 2012. Key to this investment is our continued commitment to manage expenses. We reduced operations and maintenance expenses by $1.1 million compared to our last rate filing which was about four years ago. This past week we filed a request for a DSIC mechanism (10:21) in West Virginia known as an Infrastructure Replacement Program or IRP. IRP is modeled after rate mechanisms recently at 40 gas utilities (10:30) in West Virginia. If approved, the IRP would begin in January 1, 2017.

Our commitment to invest in infrastructure, while focusing on customer affordability is clearing the cases filed during the first quarter. In Illinois, we invested $342 million in 2012 and reduced operating expenses by 3%. In Kentucky, we invested almost $79 million since 2012 while keeping operating expenses flat.

We also filed three other rate cases since the end of the quarter. In Iowa and New York, we requested an additional $13.6 million (11:06) in combined annualized revenue. In California, we filed a proposed application to set new rates in each of our service areas for 2018 through 2020. The new rates would take effect January 1, 2018, pending approval by the California Public Utilities Commission.

The application is seeking to raise revenue by approximately $50 million over the next three years beginning with a $34.8 million increase proposed for January 1, 2018. The California Public Utilities Commission which is the lead agency for the environmental review of the desalination portion of the water supply project has informed us that the review is delayed for about a year.

Our team in California along with public officials and many other stakeholders is working with the Commission to mitigate the impacts of this delay. Following our request, the Commission issued a ruling agreeing to expedite consideration of two other portions of the water supply portfolio which includes groundwater replenishment and aquifer storage and recovery. And together these projects would provide nearly half of the water needed in the moderate water district.

Finally as part of our ongoing investment in our systems, we dedicated and new $18 million dewatering facility in Tennessee. This plant will reduce sludge effluents sent to the local sewage treatment plant by 95%. While the capital cost of this facility impacted rates about $1 a month for the typical Chattanooga Water customer, the project reduces operating expenses and has added a couple of permanent jobs. It also provided 150 to 200 jobs during construction.

As you can see in slide 11 those benefits were recognized by City Council Chairman Moses Freeman who said: "This is proof positive that these rate increases are improving the water for our people. All of this is for the betterment of our water and the community."

On slide 12 you'll see the success we've had in working with state governments on legislation enabling solutions to water and wastewater challenges. In Pennsylvania this past April the Governor signed fair market value legislation into law. This authorizes water and wastewater companies to pay for and earn on municipal water and wastewater systems at appraised value rather than at the depreciated cost.

In Indiana, the Governor signed two pieces of legislation into law. Act 257, the Distressed Water and Wastewater Utilities Act allows for water and wastewater systems of any size to qualify as distressed. This opens the appraisal process to a simple agreement between a Mayor, a Council and a prospective buyer. And the utility determined to be distressed will not be subject to the existing referendum laws.

The second piece of legislation signed into law was the System Integrity Adjustment Act. This Act creates the first water and wastewater revenue stability mechanism in state history, allowing for a recovery of differences between authorized revenue and actual revenue.

As you can see on slide 13 during the first quarter we closed on seven acquisitions in six states, welcoming approximately 7,000 new water and wastewater customers. As Susan mentioned, we're pleased to reach an agreement with the Scranton Sewer Authority. This is the perfect example of the type of solution we can bring to communities, with long-term rates stability being one of the most important benefits for customers.

In fact, a cumulative savings in customer sewer bills will total more than $350 million over the next 30 years. This translates to approximately $7,600 per residential customer. A pending regulatory and environmental approvals as we anticipate closing this acquisition by September 30th.

Additionally, Pennsylvania American Water just announced that we signed an agreement pending regulatory approval to acquire the wastewater system of the borough of New Cumberland. This system serves 3,100 customers. Again, this system is an area where we already provide water services. So we're really excited about the opportunity to be a future of wastewater services for our New Cumberland customers. You can also see in this slide how legislative efforts are helping us provide water solutions across our footprint.

Moving to slide 14 we continue to improve our O&M efficiency ratio, achieving 35.6% for the last 12 months. Again we are on track to meet our O&M efficiency target of 34% by 2020.

Let me give you a couple of examples of what we are doing to drive these results. The first example is in Illinois, where were using Geographic Information Systems or GIS to map key components of our systems. This work improved our hydrant and valve inspection program by removing the overlap in routes and reducing travel time and fuel costs. In one district alone we were able to cut annual travel distance by more than a 5,500 miles.

The GIS mapping information is also used to better identify and prioritize areas to invest capital. By locating areas more prone to main breaks, we can maintain our systems while minimizing cost.

The second example is in West Virginia, where our team has deployed new technology and practices to reduce unaccounted for water. By investing in a new leak detection system and utilizing a number of management tools such as industrial site audits and district metering area analysis, we identified specific areas for corrective action. These efforts have reduced unaccounted for water from 28% to 22% in a 12 month period, reducing the amount of unaccounted treated water by 1 billion gallons in that period. These are just two examples of what we're doing to achieve this target. It's a great effort across the business and it's all about bringing value to our customers.

And now I'll turn the call over to Linda for more detail on our first-quarter financial results.

## Linda G. Sullivan {BIO 7300156 <GO>}

Thank you, Walter, and good morning, everyone. In the first quarter of 2016 American Water continued to deliver solid financial results. Slide 16 shows the contribution by business segment to our quarterly results. Earnings per share from continuing operations for the first quarter was $0.46, up $0.02 or 4.5% over the same period last year. The Regulated Businesses contributed $0.49, up $0.04 compared to the first quarter of 2015. The Market-based Businesses contributed $0.03, down $0.01 compared to the same period last year, with AWE coming in flat compared to the prior year and Keystone coming in with a slight loss. Parent which is primarily interest expense on parent debt was, as expected, down $0.01 versus the same period last year.

Turning to slide 17 let me walk through the components of our quarter-over-quarter increase in earnings per share. The primary driver was our Regulated Business, which was up $0.04.

Regulated revenue was up $0.06 from authorized rate increases, infrastructure surcharges and the new revenue from recently completed acquisition. Depreciation was up about $0.02 primarily from growth associated with our Regulated System investments.

The Market-based Businesses were down $0.01 for the quarter. Keystone which was not included in first-quarter 2015 results reported a net loss of about $1 million or $0.01 per share. As Susan mentioned, natural gas market conditions are more challenging than we anticipated at the start of this year. The rig count in the Marcellus and Utica is about half of what it was last year. As a result, we are not planning for drilling activity to pick up in 2016 and Keystone has taken austerity measures which began in early March to position it to be earnings neutral in 2016 and we expect Keystone to generate positive operating cash flow.

AWE was flat for the quarter due to accelerating $1.5 million of pre-tax marketing expenses in our Homeowner Services Group to the first quarter. We accelerated these expenses because of a planned system implementation in July. Military Services results were up for the quarter but we expect a reduction in the amount of capital upgrades on our existing basis in 2016 due to reduced military base budget. As we have noted previously, these capital upgrades can be lumpy in nature from year-to-year based on the Department of Defense budget cycle. However, we are seeing stronger activity for base privatization request for proposal and we continue to see the long-term growth potential of our military business consistent with our five year plan.

Now let me cover the regulatory highlights on slide 18. We currently have six general rate cases in process for a combined annualized rate request of $110.6 million. This includes three cases we filed post quarter in Iowa, New York and the preliminary application in California. Additionally, in April, the Missouri PSC approved the stipulations in our general rate case. These provide for $4.7 million of additional revenue which excludes infrastructure replacement surcharges of $25.8 million. This case is subject to final order by the Missouri PSC.

For rates effective from April 1, 2015 through today, we received a total of $82.8 million in additional annualized revenues from general rate cases, infrastructure charges and step increases including yesterday's approval of our D6 filing in Indiana of $3 million. More information is included in the footnotes on this slide.

Slide 19 highlights our continued strong financial performance. During the first quarter of 2016 we made total capital investments of $236 million primarily for regulated system investments, mainly replacement and renewal of transmission and distribution infrastructure. We expect capital expenditures to be in the $1.3 billion to $1.4 billion range for 2016 included in this range is our agreement to purchase the wastewater system from the Scranton Sewer Authority.

We are seeking to close this by September 30, 2016 once the necessary approvals are obtained. The purchase price of $195 million includes cash of approximately $38 million and is subject to purchase price adjustments. As part of the acquisition we have assumed the obligations to comply with the Consent Decree from the EPA and the Pennsylvania Department of Environmental Protection requiring system upgrades of $140 million over 10 years providing future capital growth potential.

For the first quarter 2016, cash flow from operations increased $49 million or 24.7% to about $247 million mainly due to stronger collection of accounts receivable and the timing of unbilled revenue.

Our adjusted return on equity for the past 12 months was 9.41%, an increase of 53 basis points compared to last year from continued execution of our strategy. We also announced in April a $0.375 common stock dividend payable on June 1, 2016 to stockholders of record as of May 9, 2016. This represents a 10.3% increase over the previous dividend.

Turning to slide 20 let me discuss our earnings guidance. The headwinds we are currently facing in our Market-based Businesses fall within the key variables of the earnings guidance range we shared with you at our investor day in December of last year. In addition, we are taking appropriate measures to mitigate some of these headwinds. As such, we are affirming our earnings guidance for the year in the range of $2.75 to $2.85 per share.

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

## Susan N. Story {BIO 3335156 <GO>}

Thanks, Linda. Before we move on to Q&A, I do want to mention that we were very honored to be named to the S&P 500 on March the 4. We're proud to be the only water utility in S&P 500 as well as in the Dow Jones Utility Average, which we joined in 2015.

Additionally, in recognition of our environmental and sustainability leadership, we are also very pleased to be part of the Dow Jones Sustainability Index. To be named to the S&P 500 is a direct reflection of our employees' commitment to deliver clean safe reliable and affordable water to our water – to our customers every day.

Our employees put our customers first. This results in a more positive constructive relationship with both customers and regulators. When regulators can trust our efforts to serve customers efficiently and effectively, they have confidence in our ability to invest productively in our water systems.

Investing more in our water systems gives us more reliable service, better satisfied customers and growth. It's this virtuous cycle that begins and ends with the employee-customer relationship. The successful execution of this equation is what drives our performance. The actions of our employees every day are the reason American Water is part of the S&P 500, the Dow Jones Utility Average and the Dow Jones Sustainability Index, and I'm proud to be a part of their team.

And, with that, we're happy to take any questions you've got.

# Q&A

## Operator

Ladies and gentlemen at this time we'll begin the question-and-answer session. We'll pause momentarily to assemble the roster.

Our first question today comes from the line of Walter Liptak from Seaport Global. Please go ahead with your question.

## Q - Walter Scott Liptak {BIO 1541340 <GO>}

Hi. Thanks. Good morning, everyone.

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

Good morning, Walter.

## Q - Walter Scott Liptak {BIO 1541340 <GO>}

I wanted to ask about the Market-based Businesses and, specifically, Keystone. It looks like market-based was nicely profitable this quarter. And so I assume that the Keystone was profitable as well. But I wonder what is it about the rest of the year that brings it down to breakeven?

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

Well, actually, if you look at the charts, Walter and Linda mentioned that in the first quarter we had a $1 million loss at Keystone that starting the 1st of March they have taken on several austerity measures to get back to the earnings-neutral and cash flow positive for the rest of the year. So actually we're mitigating what happened in the first quarter and moving to earnings-neutral for Keystone.

On AWE, we basically – if you look at the chart that Linda ended with, it's within the realm of plus and minus, as we looked last year at investor day and projected the growth of AWE. So the business is running well. Also, Linda mentioned, if you look at AWE being year-over-year, quarter being the flat we did accelerate some of the homeowners services marketing cost because we have system implementation in July and we didn't want to have marketing material and what we tend to get our extra calls during a period of time when we were doing that. So actually we are pretty much on our plan as we looked at AWE and Keystone based on the actions that we've taken in the first quarter.

## Q - Walter Scott Liptak {BIO 1541340 <GO>}

Okay. That's sounds good.

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

Walter, this is Linda. And I'll add to that that. In terms of the Military Services Group for the quarter we were slightly up on a year-over-year basis. But we do see headwinds associated with the capital future upgrades for the remainder of the year based on the military service or the Department of Defense budget.

## Q - Walter Scott Liptak {BIO 1541340 <GO>}

Okay. Got it. Thank you for that. Which is going back to the Keystone, $1 million loss doesn't sound bad considering the deep depression that the energy sector is in and it's great that you'll be able to get it back to breakeven. And I guess there seems like there's a lot more consolidation opportunity in this business as some of the providers go into distress or market share gains as you call now. I wonder if you can provide us with a little bit of outlook about any potential M&A or market share gains, and I'm sure you're seen as a very strong player in that energy business.

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

Right. Walter, so let me talk about the Water Services providers first because Keystone and we mentioned they had about 20% of the market share when we bought them and due to being affiliated with American Water not owned by a competitor E&P company we did start seeing market share grow up to now close to 30%. We picked up several new large customers this year. So while the market has gone down from an E&P our share of that market for Water Services has gone up.

Just like the industry experts EIA are basically targeting fall to see this supply numbers based on some projections for the summer going down and having to increase production we see the same thing based on our discussions with our customers. So – but we are very conservative in our outlook in our projections.

So as Linda mentioned in her script we are assuming no increase in production through the year and looking at cost controls for Keystone that include – about 80% of our costs can be variable. We're looking at a lot of process improvements we continue to grow market share.

And you're exactly right we're seeing some of the smaller Water Services providers who simply can't make it through this year. It's very difficult when you don't have a strong of a balance sheet as we do nor have a growing customer segment for those Water Services.

So our Keystone management team has done an outstanding job as you noted in a time like this with a market like this to get us to the position we're in and we're very proud of that.

## Q - Walter Scott Liptak {BIO 1541340 <GO>}

Okay. Great. Thank you.

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

Thank you.

## Operator

Our next question comes from the line of Richard Verdi from Ladenburg Thalmann. Please go ahead with your question.

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

Hi, Rich.

## Q - Richard A. Verdi {BIO 15139674 <GO>}

Good morning. Hi good morning guys and congrats on another good quarter here. I kind of wanted to follow up on the first call as inquiry pertaining you had two questions here, first pertaining to the Keystone side.

I am just curious are you guys seeing any sort of – or are you – maybe customer bankruptcies on the horizon or having to enforce any of those take-or-pay contracts or what's the sense of that customer base because when I look at some of the other companies that are somewhat similar you are seeing that happen?

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

Yeah, well first of all when we bought Keystone, they did not invest in a lot of pipeline. Those are relatively new this is for the future of building pipelines and we are ensuring there are strong third-party creditors, credit-worthy partners there. So we don't really have the take-or-pay exposure now so that's good.

But you're right, what we are seeing and you all read the papers everyday, you have bankruptcies of some of the smaller EMPs and you're seeing a consolidation in the oil and gas industry. And let me remind you that in the Marcellus and Utica, the Appalachian Basin basically all of our support is for natural gas, it is not for oil. And we are also seeing to that effect the consolidation of the oil and gas companies are also seeing that they won't credit worthy partners, so to have a larger water services backed by a company by American Water is very attractive to some of our partners. Also keep in mind that you have to build an infrastructure for water before you need it or before you actually start producing natural gas, so we are seeing some interest expressed later in the year to start some projects.

## Q - Richard A. Verdi {BIO 15139674 <GO>}

That's great. Thank you Susan and then continuing on the non-regulated side. You guys want to keep it somewhat of a smaller portion compared to the overall consolidated company, but obviously with the water thing and the (31:44) of American Water that regulated side is going to at least in our view meaningfully grow over the next five to 10 years. And so that means you're going to probably have to go the non-regulated side to kind of keep it consistent with its current percentage of overall sales. And so what's the internal thinking of let's say over the next five to 10 years for the non-regulated side? Where American Water might dive into that is still the core water competency, but expands that non-regulated side or (32:19) intend to grow what we have in the portfolio right now?

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

Rich, that's a good question. First of all let me tell you that dealing with faster regulated growth is a problem that we sincerely hope that we have and just because we've said that 15% to 20% that's more of a limitation not a target. So if the regulated business, if we see that through things that are happening nationally that there is an acceleration in the number of governmental entities that want to sell their water and wastewater and people of been saying this for a long time, we see it very steady, legislation helps. If that happens it doesn't mean we necessarily must ensure that market base is 15% to 20% it's more of a limiter that from a risk profile standpoint it will not be more than that. That does not mean it has to be that percentage. So I'll just say that upfront now in terms of growing the business, so we believe at American Water that there's enough opportunity related very tightly to our core competency that we like to keep our growth engines related pretty directly to water and wastewater.

So I will tell you that as we look at our businesses and market-base we are looking at, of course, our Homeowner Services military and contract. We look at any potential new business and say, does this really play off our competencies because our market base business benefits because of the tremendous amount of expertise in our regulated business. It also helps our regulated business by bringing in a lot of competitive entrepreneurial type ways to look at things. So we think it's a very healthy relationship.

We go through a very disciplined process to look at new businesses. Just as one example and this is public. We are very excited about the pilot project; we did on geothermal on Long Island at a school where geothermal's been around for decades but its always utilized ground as the heat transfer agent.

And you have to have pipes for example, they're vertical 250 feet in the grand or horizontally you need a lot of land. We're basically using our water main system to be the agent and it's not having effects on the water and it's able to heat and cool buildings through geothermal system. Well we know that our military bases and this is another cross connection between our businesses several of our military bases, or all of them are under a – eventually a net zero charge from an energy standpoint.

This type of technology can save 30%, 40%, 50% on energy costs. So we are looking at those areas that we have expertise that we're aligned with that have really good applications as we look at different ways to grow in the Market-based Business.

## Q - Richard A. Verdi {BIO 15139674 <GO>}

That's great. Thank you, Susan. And then my next question pertains to the metering side of things. Obviously smart metering is an initiative that American is pursuing and I'm wondering if there's a possibility, where instead of building out some of the infrastructure that will be required for smart metering, if you've ever thought – if American and I should tell you is that – has ever thought about sharing the same infrastructure with the electricity companies to save on costs?

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

Well, you know, actually it's interesting you bring that up. We actually are doing some sharing in two locations in the Monterey Peninsula where, of course, we have the conservation measures and drought. We have a pilot in Monterey that we are partnering Pacific Gas & Electric to use their backhaul system, use water meters, smart water meters, use their backhaul system to actually look at the data.

We just announced about two months ago that we are partnering with Commonwealth Edison ComEd. We serve parts of metro Chicago and we're actually partnering with them to utilize a different type of smart meter technology to again utilize some of their backhaul infrastructure.

How this is a win-win is that in our business, as we've said, one of the strong parts of our investment thesis is that we have years-and-years of capital investment we need to make because of the system nationally of the water and wastewater infrastructure system.

So for us to say, we will put in the meters and the electricity company may already have some backhaul capability there from their smart meters, then we – where we can partner and utilize some of that infrastructure. It's great for customers and the regulators love it because it shows directly a reduction in the amount of cost per customers. It benefits the electric utility and it benefits us because if we are not building the backhaul, we just put that money into more pipes, plants and pumps replacement.

## Q - Richard A. Verdi {BIO 15139674 <GO>}

That's great.

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

And this is Walter. These are two great examples but our AMI strategy, we are looking for other opportunities across our footprint because, as Susan said, the benefits to our customers are huge and that's what we want to drive in the business.

## Q - Richard A. Verdi {BIO 15139674 <GO>}

Thank you Walter and thank you very much Susan, I appreciate it, and that's it for me. Congrats again guys. I appreciate your time.

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

Thanks, Rich.

## Operator

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

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

Hey. Good morning, Susan and team. So in terms of the 2016 guidance you mentioned the non-regulated weakness expectations for the remainder of the year. Our regulated and parent segments are either those doing better or they just kind of tracking in line thus far?

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

So, Jonathan this is Linda. And what we did at the Analyst Day was we set forth some of the key variables that we expect in our earnings guidance range for the year and so we reiterated that chart here. When we look at 2016, we are square within those variables based on what we know today and the first quarter results.

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

Okay. And then, in terms of 2017 are you expecting Keystone to turn a profit or is it just too early to tell?

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

For Keystone, we are expecting that they will take austerity measures and that they will be earnings neutral this year.

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

Right, but for 2017 are these austerity measures things that are going to continue over?

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

It's too early to tell Jonathan. I think when we look at our five-year plan, we continue to see that the market expectations are about the same as they were in December over the long term, and so, we continue to believe in about 1% growth from the Keystone acquisition.

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

Okay. And then, I don't know if you can provide any more detail on the military base RFP comments. Are you seeing more bases, I guess, being put up for grabs than you expected and do you expect any 50-year contracts close to being awarded something we might see later this year.

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

Jonathan, we are seeing quite a tick up in activity in the pipeline of Request for Proposal. We currently – the Department of Defense has about nine proposals that are out right now, and that we are active in.

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

And also Jonathan, interestingly for the military bases in terms of the capital upgrade, one of the areas that has not been really identified in the past is in the area of stormwater. It's been water and wastewater. And so, the legislation we believe allows the military bases to utilize us for stormwater services, but there's been a question about clarification, and I will tell you that there have been, out of, for example, the House Armed Services Committee, as well as some of the Senate. They said, this was intended so we're working to get clarifying language so that on the bases we serve, we would have an additional opportunity to help them address their needs from a stormwater standpoint. So we see that as a potential opportunity in the future.

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

Okay. And that would just come in the form of additional, I guess, capital upgrades?

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

Yes, that's correct.

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

Okay. And then, now just turning quickly to the regulated, West Virginia, I know that – it was somewhat in a state of disarray, but now in light of kind of (40:33) your rate case outcome in the pending (40:34) infrastructure mechanism. Can you just update how you're thinking about that state as a core operation that you want to stay in?

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

Yeah Jonathan, Walter. We think, we got a fair rate case order out of the commission. We're working with them to address customer issues in the states like we're anywhere else, and we feel positive about the future in West Virginia.

The infrastructure mechanism that we just proposed last week is a positive step forward and it's going to allow us to continue to invest in -- invest more into the infrastructure in West Virginia. So, it's a positive for us and for our customers.

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

Okay, great. And then last question on the California desal plant, a one-year delayed. Does that have any impact on kind of projected total company CapEx or I know it wasn't a huge amount, so I'm assuming you're just planning on kind of backfilling that CapEx with other investments, is that accurate?

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

Yeah, that's accurate Jonathan. I mean, it's a big plant. But within our capital program, it's not significant. So, it's all going to be within the same four to five year period.

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

Right. So, you'll see some of the dollar shifting from year-to-year, but it's still within that five-year capital plan.

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

Okay. And then I guess even with that shift -- I mean the one-year shift, so you can offset like half the supply. You're talking about some mitigating measures you're taking. I mean, isn't there just an issue with, I guess, having adequate supply for those customers? I mean, what do you have to do to get the other half of the supply in the interim?

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

Yeah we're going to have to build a facility. And again, the facility is going to be delayed for about a year. We're working with the commission to mitigate that by moving these other components forward. But right now, we're looking at probably starting construction in mid to late 2018.

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

Yeah. And Jonathan to that point, if you remember Walter mentioned there were two which were the groundwater replenishment which is recycled water, as well as, the ability to do additional reservoir storage for half.

The other half that we're working hand-in-glove with the local officials there, as well as, during a hearing in Monterey. The Public Utilities Commission, because of the delay, has said that they also would advocate for us to have an extension of the Carmel River withdrawal kind of it was supposed to seize as you know into this year to extend that until we can get the desal part build.

And if fact, it was very positive that we could continue and work on these other components for half of it before we actually build the desal plant for the other half. So, it actually ensures we build part of the project earlier, and then, hopefully get a -- with everybody's supporting the communities and the state, hopefully, didn't get the extension on the water withdrawal permit for the Carmel River.

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

Okay. So there's some flexibility there from the requirements. Okay, great. Thank you so much for the time.

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

Thank you, Jonathan.

## Operator

And we do have a follow-up from Richard Verdi from Ladenburg Thalmann. Please go ahead with your follow-up.

## Q - Richard A. Verdi {BIO 15139674 <GO>}

Hi guys and thank you for letting me back into the call. I appreciate it.

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

Sure.

## Q - Richard A. Verdi {BIO 15139674 <GO>}

I just had -- I wanted to jump down, but I had one other question. I asked Mr. Panagos (44:03) yesterday, and I'm just curious what Americans take is. So, maybe at the end of March very early April, I had conversation with one of the more prominent leaders at the Ed Muzika (44:14). He was telling me that the consumer advocates (44:17) were looking to meaningfully pushback on the DSIC because basically they feel it's being abused. They think that you file a DSIC and then there's another DSIC and it's just basically one after the next. And so (44:30) yesterday if they were seeing that. I'm wondering if you guys are seeing that at all, and if you are how you – how American tends to deal with it?

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

Sure. Well, I will tell you I won't talk in general about Muzika (44:44), but in each of our state, we tried to work very closely with the consumer advocates office upfront when we're filing these mechanisms. We try to ensure and I will tell you we are very transparent about the process. This also goes back to why our ability to not only increase and improve our O&M efficiency, but we have a lot of projects on how we also increase our capital efficiency. What are we doing to ensure that every dollar we spend is being spent at the highest level of productivity. So it's a one-on-one thing.

It's not with the general Muzika (45:19) but in each of our states, our state president, our staff sit down with the consumer advocates and basically walk-through very openly what we need to do, why we need to do it and what we're doing to mitigate the cost. And I will tell you when we go in for DSIC and capital infrastructure, we say this and I know some of you think we say it too much but I don't think it can be said enough the ability to manage our O&M costs.

So that for every dollar for O&M save (45:45), we can put $6 of capital in the ground (45:47). When you hear like what Walter said is in West Virginia over four years or three and a half years, we reduced O&M costs $1.1 million. We filed in Illinois. We've reduced our O&M costs by 3%, the ability to show that we are being good stewards of the customers' dollar goes a long way.

## Q - Richard A. Verdi {BIO 15139674 <GO>}

That's great. Thank you, Susan. And if I may, you had mentioned about how each one of your employees that runs these states. I got to say and you might be happy about this. I can see that because Jim Jenkins is heart of work (46:22) for you guys. I just wanted to let you know he's doing a great job in my view. So thank you for the time, Susan. I appreciate it.

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

Thank you, Rich and thanks for the comments about Jim. He is extraordinary. And I tell you the team we've got, I could go down the list and talk about the amazing people we've got. We all just feel fortunate to work with them. Thank you, Rich.

## Q - Richard A. Verdi {BIO 15139674 <GO>}

That's great. Thank you, guys.

## Operator

And at this time, we've reached the end of the question-and-answer session. I'd like to turn the conference call back over to management for any closing remarks.

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

Thank you, Jamie. I will be sure that I appreciate everybody participating in our call today. If you've got any questions, as always, you can call Greg and Melissa and they will be happy to help you. I will remind you that we are having our Annual Stockholders Meeting on Friday, May 13 in Voorhees that will be lucky Friday May the 13th. Thanks again for participating in our call. We'll look forward to talking with you all later.

## Operator

Ladies and gentlemen, with that, we will conclude today's conference call. We do thank you for attending. You may now disconnect your telephone lines.