Q4 2016 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.
- Ryan Michael Connors, Analyst, Boenning & Scattergood, Inc.
- Spencer E. Joyce, Analyst, J.J.B. Hilliard, W.L. Lyons LLC

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to American Water 2016 Year-End Earnings Conference Call. All participants will be in listen-only mode. Please note this event is being recorded.

I would now like to turn the conference over to Ed Vallejo. Please go ahead.

Edward D. Vallejo {BIO 16076814 <GO>}

Thank you, Amy, and good morning, everyone, and thank you for joining us for today's call. As Amy said, we will keep the call to about an hour. And, at the end of our prepared remarks, we will have time 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. Now these statements are predictions based upon our current expectations, estimates and assumptions. However, since these estimates deal with future events, they are subject to numerous 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 2016 Form 10-K, each has filed with the SEC. Reconciliation tables for non-GAAP financial information discussed on this conference call, including adjusted earnings per share, adjusted return on equity and the O&M efficiency ratio, can be found in the appendix of the slide deck for this call. The slide deck itself can be found on 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 before I turn the call over to Susan, let me briefly talk about the American Water Investor Relations team. As you know, Melissa Schwarzell was promoted recently to a new position in our rates team (02:20). And almost at the same time, Cathy DeMots, our IR Executive Assistant, decided to retire after 30 years with American Water.

I'd like to take this opportunity to thank Melissa and Cathy for all their hard work, dedication and camaraderie during their time in the Investor Relations group. Now, as part of American Water's commitment to developing talent from within, we promoted Ralph Jedlicka, who's been part of the finance team since 2007, to be our new Director of Investor Relations.

And then, we were lucky to find Kelley Uyeda, a professional with 10 years of IR experience, to be our new Executive Assistant. I'm personally very excited about our new team. Most of you folks have already interacted with Kelley and Ralph and we look forward to meeting you all when we go out on the road on investor visit.

And with that said, now, I'd like to 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 fourth quarter and full year financial results; and our COO, Walter Lynch, will give key updates on our operations. We will highlight a number of 2016 company records and achievements throughout our presentation. Just to name a few, we accomplished record levels in safety, capital investment, O&M efficiency and regulated acquisitions.

All of these achievements are possible because of our engaged employees, our safe and efficient operations and our smart investments. And this enables us to achieve top-quartile customer satisfaction, continued 7% to 10% long-term EPS growth, and top dividend growth. Our employees delivered another strong year of results by successfully executing our strategy. In 2016, we invested about $1.5 billion, the highest in our company's history.

$1.3 billion of that was invested in our regulated system to improve service reliability and water quality for our customers. We're able to increase our investment to this level because our hard working employees continually improve both O&M and capital efficiency. We're proud of our ability to deliver on our growth goals, while effectively managing every dollar, so we can deliver excellent customer service, while limiting the impact on our customers' bill.

Most importantly, we know our customers need to trust that the water we provide them is clean and is safe. Once again, we met or surpassed EPA requirements in 2016. In fact, our systems were 21 times better than the industry in drinking water quality and compliance as measured by the EPA's drinking water database. This is absolutely foundational to our business.

Our customer base is growing by a record 82,000 customers through closed and pending regulated acquisitions. This is in addition to the 13,000 customers added from organic growth in our existing service areas in 2016. Our Military Services Group completed two price redeterminations in the fourth quarter for a total of $0.75 million in annual fee adjustments.

Keystone Clearwater ended 2016 as we projected. For 2017, natural gas prices have rebounded and both drilling rig counts and well completion activity have increased significantly. Keystone continues to increase market share by offering total water management solutions at competitive pricing to Appalachian Basin E&P. At the same time, they expanded their overall services outside the oil and gas industry to the municipal water services market.

As you can see on slide seven, operating revenues were $802 million during our fourth quarter. We experienced continued growth in our Regulated Businesses from investments, acquisitions and organic growth. And while we faced headwinds throughout the year in our Market-Based Military Services Group, we benefited from two price redeterminations in the fourth quarter and four in the full year.

Linda will discuss the quarter's drivers in more detail in just a few minutes. Operating revenues for the year increased 4.5% over 2015. And our 2016 annual earnings, without the effect of the Freedom Industries' binding agreement in principle, were $2.84 per share, up 7.6% over 2015 EPS.

Turning now to slide eight. Today, we affirm our 2017 guidance of $2.98 to $3.08 per share and continue our progress toward achieving 7% to 10% EPS growth through 2021. Additionally, we project we will grow our dividend in 2017 at the top of our long-term EPS growth range, following the double-digit growth we have had for dividends over the past four years. In summary, it was another really good year and we thank all of our employees who made it happen.

With that, Walter will now give his update.

Walter J. Lynch {BIO 6064780 <GO>}

Thanks, Susan, and good morning, everyone. As Susan mentioned, our Regulated Businesses had a strong year all-around with historic capital investment, strategic acquisitions, and continued O&M efficiency gains that benefit our customers.

Let's walk through some of the regulatory highlights of the fourth quarter 2016. In December, we received an order adjusting rates for Illinois American Water. The case was driven by approximately $340 million in infrastructure investments across Illinois to ensure reliable service. The order will result in $35.2 million in additional annual base rate revenue. Additionally, it included a volume balancing account, which is a type of revenue stabilization mechanism. We'd also like to note that Illinois American Water was rated the top water utility in customer satisfaction in the Midwest by J.D. Power.

In West Virginia, we received approval for a distribution system improvement charge, which will enable us to accelerate our infrastructure replacement and reliability program. Through DSIC, West Virginia American Water will make approximately $29 million in system-wide upgrades in 2017, which would mean a 40% increase in pipeline replacement from 2016 and only impact our average customer by about $0.52 per month.

We're also waiting the West Virginia Commission's decision of an agreement related to the PSC's review of the Freedom Industries' chemical spill. The settlement recognize the important changes made over the past three years to improve customer confidence in the water systems and additional efforts planned in areas like source water monitoring, protection planning and public communication.

We believe this resolution is in the best interest of our customers, our employees and our company. As always, we'll continue to bring our customers the best service possible. And we believe that we're positioned to be an industry leader in source water protection and planning.

In addition, California American Water has requested an extension of its current cost of capital and is awaiting a response from the California Public Utilities Commission. This would affect rates starting in January 2018 and, of course, we'll keep you updated.

I also want to mention that last week we announced multiple promotions in state leadership positions. From time to time, we talk about our commitment to developing talent within, leveraging our internal expertise and having robust and sustainable succession plan. Last week was a perfect example of that. Longtime leaders with proven record of accomplishment were promoted to take on new challenges at American Water.

Having a strong bench is a critical part of any company's success. We believe that our efforts in this regard position American Water very well for the future from a talent perspective. I congratulate all our newly promoted leaders.

On slide 11, our employees drive legislative and regulatory relations. And through their efforts, we made additional progress in 2016. Fair market legislation continues to expand, most recently in Indiana and Pennsylvania. And in the past five years, legislation has been enacted in five of the states we serve that directly help communities address distressed water and wastewater systems. Our employees will continue to work with state and federal officials to help the nation and our states tackle serious water infrastructure challenges beyond our own company.

Turning to slide 12, 2016 was also a great year for growth. We added 13,000 customers through organic growth in our existing service areas. And through pending and closed acquisitions we'll add approximately 82,000 customers in our Regulated Businesses. This includes our newest wastewater customers in Scranton and Dunmore.

We completed the acquisition in Scranton last December. And we were so pleased to welcome 31,000 new customers as well as the new employees who joined our Pennsylvania American Water team. Moving on to slide 13, doing right by our customers is key to our ability to grow. This means smart investments balanced by efficient operations and capital deployment.

As Susan mentioned, we invested more capital this year than in any other, with $1.3 billion going into our regulated operations. This is critical to reliable service, but it's also about affordable service. We spoke about this at our investor conference.

You can see the progress we made in our O&M efficiency ratio going from 44.2% in 2010 to 34.9% for the last 12 months ending December 2016. We established a new target of 32.5% by 2021. And our success here is 100% due to our employees and a culture of continuous improvement and a commitment to our customers.

For example, in our Pennsylvania operations, we found and repaired more than 5 million gallons per day of unknown non-surface leaks using cell loggers. This technology provides remote alarming and automatic data uploads from any location were cell service is available. We estimate that we'll save $75,000 per month in just one operating area. We'll now look to expand this across our footprint, saving money and valuable water for our customers.

Finally, on slide 14. I just want to highlight some examples of how our operations really demonstrate our vision, Clean Water for Life every day. In both New Jersey and Tennessee, we helped areas struggling with water source channels. A local leader in the surrounding county of Bledsoe asked Tennessee American Water if we could help a small community in private wells during the exceptional drought of 2016. We were able to quickly mobilize the water tanker and delivered it to the local volunteer fire department.

As soon as we arrived, residents were lining up to fill containers for use in their homes. In New Jersey, we transferred four million gallons a day to the northern part of the state under a drought watch. We were able to provide assistance here because of our expansive distribution network and the interconnects throughout the state. We're also completing an internal project that will increase our capacity of the transfer volumes greater than 10 million gallons a day in cooperation with the New Jersey Department of Environmental Protection.

In California, our project to remove the San Clemente Dam and reroute the Carmel River was named Green Project of the Year by the American Infrastructure Magazine. This project was a win for the local people and the environment. The removal of the dam and restoration of the river has many benefits, including the recovery of threatened wildlife, the preservation of more than 900 acres of coastal watershed land and the permanent removal of the public safety risk posed by the San Clemente Dam.

And, of course, we're proud of the excellent water quality results, as Susan mentioned. These results give our customers confidence in the water they drink and use every day. So, it was a great year of 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 now for more detail on our financial performance.

Linda G. Sullivan {BIO 7300156 <GO>}

Thank you, Walter, and good morning, everyone. We reported earnings of $0.57 per share in the fourth quarter of 2016, up $0.02 over the same quarter last year. As shown on slide 16, our

Regulated segment and Market-Based Businesses were each up $0.01 and Parent was flat to the prior year. For the full year, we reported earnings of $2.62 per share.

Excluding the $0.22 charge from the binding agreement, our adjusted earnings per share were $2.84, up $0.20 or 7.6% compared to the prior year. These adjusted results were driven by our Regulated segment, which was up $0.23, or 8.7%. Our Market-Based Businesses were down a $0.01 and Parent was down $0.02, as expected.

Turning to slide 17 let me discuss the quarterly results by business segment compared to fourth quarter last year. Our regulated operations were up a $0.01 overall. Revenue was up $0.12 from authorized rate cases and infrastructure mechanisms to support investment growth, acquisitions and organic growth. O&M expense was higher by $0.05, $0.03 of which was due to timing. As we mentioned in our third quarter earnings call, we expected about $10 million of certain maintenance, repairs and tank painting expenses to be completed in the fourth quarter of 2016.

We also had higher depreciation and general taxes of $0.03 each, driven primarily by our investment growth. For our Market-Based Businesses, we were up a $0.01, mainly from the 2016 addition of Vandenberg Air Force Base in our Military Services Group and price redeterminations at several military bases. We record price redeterminations related to prior periods in the quarter they are completed.

Turning to slide 18 let me walk through our 2016 adjusted earnings per share compared to the prior year. The Regulated Businesses adjusted earnings were up $0.23 or 8.7% with four major drivers. First, revenue was higher by $0.43 per share. Of this $0.43, $0.32 was from infrastructure surcharges and authorized rate increases to support investment growth, $0.08 was from acquisitions and organic growth, and $0.03 was from balancing accounts and other.

Second, adjusted O&M expense increased $0.06 from several factors. We had higher production and employee-related costs to support growth in our business. We also had a $0.05 negative impact from several non-recurring items, including a judgment on a contract dispute, a technology write-off and the 2015 benefit from finalization of the California general rate case. These increases were partially offset by lower casualty insurance claims and lower uncollectible expense.

Third, depreciation expense increased $0.09 from investment growth. And, finally, general taxes, interest and other increased $0.05, again, attributable to our investment in infrastructure to provide reliable service to our customers. I would also like to point out that although there was no year-over-year weather impact in our Regulated Business we did have a favorable weather impact of $0.05 in 2016, mainly from the dry weather conditions in New Jersey that Walter discussed.

Next, the Market-Based Businesses were down a $0.01 year-over-year. We previously shared with you some headwinds we were facing from lower capital upgrades in our Military Services Group and Keystone's efforts to manage their business to be earnings neutral, despite a very challenging natural gas market. With that said, the Military Services Group ended the year flat compared to last year.

Although revenue was down $21 million due to lower capital upgrades compared to 2015, the impact was offset by the addition of Vandenberg Air Force Base and price redeterminations in the fourth quarter. In our Homeowner Services Group, revenue was up $11 million compared to last year, but it was more than offset by higher claims, increased marketing expenses and costs associated with investment in a new Homeowner Services Group customer information system.

And, lastly, Keystone's results for the year were essentially earnings neutral, as we anticipated. Parent & Other costs were higher by $0.02, primarily from higher interest expense on long-term debt, higher short-term debt balances and increased interest rate on short-term debt compared to the prior year. Also, in 2016, we contributed $2.3 million to the American Water Foundation, a 501(c)(3) organization, which exists to help the communities we serve offer a better quality of life to their citizens.

Turning to slide 19, we have a total of $125.4 million in annualized new revenues effective since January 1 of 2016. This includes $92.2 million of new authorized revenue in 2016, of which about two-thirds was from infrastructure mechanisms with the remaining one-third from rate cases. And we have another $33.2 million in new annualized revenues that have been authorized since the beginning of 2017. We have also filed and are awaiting final orders on four rate cases, a California step increase and two infrastructure surcharge requests for a total outstanding revenue request of $71.7 million.

Slide 20 highlights our key financial performance metrics that continue to create customer and shareholder value. You heard Susan and Walter talk about our record level of capital investment this year of $1.5 billion. This includes $1.3 billion of regulated system improvements to better serve our customers. These investments increase our estimated rate base at year-end 2016 to $10.7 billion, a 7% increase from the prior year. The remaining $200 million was for acquisition with Scranton being the largest acquisition with an adjusted net purchase price of $151 million.

Our cash flow from operations grew 8.2% to $1.3 billion in 2016. This was driven by our strong adjusted net income growth and higher working capital. Working capital increased from lower capital upgrades in our Military Services business, continuous improvements in collection efforts in our Regulated Businesses and the timing of expenses.

Our adjusted return on equity improved from 9.4% to 9.6%. With the conclusion of our Illinois rate case, including the 45 basis point improvement in the authorized ROE in that state, 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 21 and looking forward to 2017, we are affirming our 2017 earnings guidance of $2.98 to $3.08 per share. The major variables included in our guidance range are consistent with what we've shown you before with plus or minus $0.07 of weather or what we consider normal weather variability being the most significant. Events or variations outside of these ranges could cause our results to differ.

We also continue to be a leader in dividend growth compared to the Dow Jones Utility Average, the UTY and our water utility peers. In fact, over the last four years, we have had dividend increases at the top end of our long-term 7% to 10% EPS compound annual growth rate. Subject to board of directors' approval, we project our 2017 dividend growth to be at the top of that 7% to 10% long-term EPS growth range.

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

Susan N. Story {BIO 3335156 <GO>}

Thanks, Linda. Before taking your questions, I want to highlight very briefly our company value of environmental leadership and what it means to our customers. As a company that relies on environmental protection for the services we provide, American Water is naturally focused on sustainability, not just because it's the right thing to do, which it certainly is, but also because it's our business imperatives.

It is more than just compliance with laws and regulations. Although we are proud that our systems are 21 times better than the industry, it extends to partnerships with environmental groups in our local watershed to foster protection and education on water issues. It also means that we are front and center on national policy issues around sustainable water supply, water quality, and replacing aging infrastructure.

There are approximately 53,000 water treatment plants in the United States with about 400 of those participating in the EPA and AWWA's Partnership for Safe Water Program. In 2016, only 33 plants received the President Award, the program's highest honor. Pennsylvania American Water was awarded nine of these 33 out of a total of 53,000 water treatment plants.

Also, in 2016, American Water was recognized by the Environmental Business Journal for our water quality and sustainability and named by Newsweek as one of America's Top Green Company. Our efforts have also translated into eight patents, most dealing with water treatment technology as well as $43 million of research grants awarded over the years. And, of course, that is because of the people we have at American Water.

Our R&D group of 15 employees includes eight PhDs and four people with other advanced degrees. They work hard every day with researchers across the globe to find better ways to sustain, treat, deliver and recycle our precious water resources. And our 6,800 employees, including operation, engineering, water quality, and environmental lab professionals, are always finding better ways to serve our customers and protect our environment. While awards are good, the best recognition is highly satisfied customers and their peace of mind.

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

Q&A

Operator

The first question comes from David Katter at Baird.

Q - David Katter {BIO 20266889 <GO>}

Hi, 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 that you could comment a little bit on Keystone's ability to continue to take market share, even if – especially in light of rising natural gas prices?

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

Right. So our Keystone operations are in the Appalachian Basin. And we're the only water services provider that does the cycle of water management, except, of course, we do not at the end of the cycle take the waste at the sites and put them into the deep wells that have been controversial. So because of that, we're finding that more and more of the E&Ps want to deploy their capital for their own, for example, development of pipelines and for their own services. So we can step in and basically handle providing the water and recycling the water on the site and they don't have to worry about it.

So we've gone from 20% when we purchased them in July of 2015 to 35% now. We still believe that there are opportunities for growth in the area. And, in fact, what we're finding now is that there's so much work in the area that we're seeing some of the pre kind of 2016 downturn. We're seeing some of the pricing come back for the services and the need for the large E&Ps especially to feel comfortable that they have a partner who has a very strong commitment to environmental sustainability. So we do think that there's further room to grow in Appalachian Basin.

Q - David Katter {BIO 20266889 <GO>}

Excellent. Thank you. And you guys touched a little bit on this in your prepared remarks but I was hoping you could maybe talk a little bit about some of the leverage you have to continue to improve O&M efficiency?

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

Hi. This is Walter. Yeah. We're continually working on reducing our expenses, as you know, when we talk about – I think a big enabler is the technology and that's why I highlighted the technology we're using at Pennsylvania. One of the big advantages we have as a company is we're able to deploy technology in one area, take the learnings of that technology and then apply it across American Water to realize significant value.

So I would say the technology I highlighted, the technologies I've highlighted in the past around non-revenue water and finding leaks in West Virginia, doing things like using technology to streamline our routes, so that our people in the field are more efficient, those are the things we're going to be doing across American Water to drive efficiencies. And a lot of the low-hanging-fruit we've already gotten but the technology is going to be a key enabler.

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

One of the things we're excited about, for example, there's a lot in the press about drones and delivering packages. We are actually a New Jersey American utilizing drones and infrared to actually go over pipes in the ground from the air. And we're finding that we're able to spot leaks and find leaks before they ever occur in main breaks. And you don't have to dig up the ground or anything. It's pretty cools on those things we're doing. And there was an FSR that I was out with in Northern New Jersey a few months ago, David.

And he had the smartphone. And when I say we went into a house, I say the royal we. He went in and changed the meter and I was with him in the house and we walked outside. And this gentleman has been with the company 38 years. And he looked. He goes, watch this. He said I can read this meter immediately on my smartphone. So there is a lot of really neat things going on in terms of deploying technology in very practical ways, not just the high-tech level ways, but things that make it easier for our frontline employees to serve our customers better. And we're just at the beginning of that we believe.

Q - David Katter {BIO 20266889 <GO>}

Excellent. Thank you, guys. That was helpful.

Operator

The next question is from Angie Storozynski at Macquarie.

Q - Angie Storozynski {BIO 15115714 <GO>}

Thank you. So, since your Analyst Day, there's been a lot of updates that could have had impact on your M&A prospects, right. We had a little bit more clarity around the Trump's infrastructure plan and the type of flat water infrastructure he would actually focus on. We have a New Jersey bill that seems to be pushing for similar CapEx requirements for municipal water utilities versus investor-owned utilities. Could you talk about those trends? And also we seem to be having a little bit more movement on the corporate water M&A. If you could just give me a sense of how you think about M&A since the Analyst Day.

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

Sure, Angie. Thank you for the question. I will start and then Walter can talk specifically about the New Jersey situation. So, interestingly, I've been involved with a Bipartisan Policy Center working on looking at the whole infrastructure issue around the administration and their effort. And it's interesting. There are a lot of parties that are interested. We have a coalition with the U.S. Chamber and NAM and several groups that are looking at this. I think the question remains is where is the money coming from. So, for us, and the infrastructure, we are very excited that there is a focus on infrastructure.

We like that there is a lot of interest from both sides of the aisle on public private partnerships. So, we'll just have to see how that plays out. But the good news for us is, regardless of what plays out nationally, we have such a strong capital investment program. And being an investor-owned water utility, we could see a bump. But, for us, we're just continuing to do our business, which is robust. And, as we said, we continue to invest more and more capital. So there could be something down there. We're monitoring it closely and hopefully we will see something come from that.

The last question you asked – and then Walter can talk about what's going on in New Jersey with the issue around municipalities. We are constantly – as we said at Investor Day, we survey the landscape of all municipalities and companies that are out there that meet our guidelines and our discipline in terms of acquisition, but we are very disciplined. So when we look, we don't see the need to grow for the sake of growing, unless it is a good investment for us for the long-term.

Our financial models – we're always looking at, so what will this mean in five years, 10 years, 15 years, and ensuring that we have a discipline around those acquisitions. But that doesn't mean we're not looking or that we don't have substantial data and information on these opportunities. It just means that we will not get out there and do something for the sake of just saying that we have an acquisition.

And I do think it's interesting. We've been waiting, as you know, following the water industry as long as you have. Everybody keeps talking about there will be – no pun intended – the floodgates open on municipalities to be privatized. But it's a one by one battle as municipalities have to look at their own particular circumstances and at all the options that they have available to them.

So our entire strategy is we're in these communities. We're on the ground. We're there to be a solutions provider. We think, in many cases, we can provide services at a lower cost. And we believe that we can improve water quality, improve service and give predictability of cost in many locations better than what exist there. And it's incumbent upon us to make sure that we tell our story. And the New Jersey situation is very interesting. Walter, if you want to talk about that.

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

Yeah. Thanks, Susan. Yeah. What we're referring to here is Water Quality Accountability Act. And it was introduced by Senator Sweeney recently in New Jersey. And it's working its way through the Senate. It's got to work its way through the Assembly, obviously, and then get signed by the Governor. But what it does is really requires the same things with municipalities and investor-owned utilities. And let me give you a couple of examples of what they're looking at. The testing of valves and hydrants per New Jersey Board of Public Utilities requirements would be not just required of investor-owned, but were required of all the municipalities within New Jersey.

Cyber security program requirements, action plans for any notice of violation, developing a comprehensive long-term capital plan and a replacement rate for pipe targeted about 150 years. These are all the things that we're required to do on the investor-owned side and it's really going to have the same requirements for municipalities throughout New Jersey. And the whole purpose is to make sure that the water quality is protected in New Jersey. And that's really the focus of Senator Sweeney's bill that he introduced.

Q - Angie Storozynski {BIO 15115714 <GO>}

But you think on the back of it, municipalities will basically face incremental CapEx and that could actually push them to potentially privatize their systems?

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

Well, I think it will cause them to take a look, do we want to do this as a municipality or do we call in American Water who has been doing it for decades and decades in New Jersey with great success and leverage our expertise. I think that's something that they're going to have to take at and we'd be glad to talk to them about it because we are a solutions provider.

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

I think the thing to point out, Angie, is not just for the EPA, what we have found in the past is whereas we would immediately need to and would address issues that came up in terms of any non-compliance in wastewater. For example, that there are many municipalities and cities that have had non-compliant items for decades and there was just a different standard of holding them accountable than us.

And I think one of the things we learned from Flint, Michigan is safe water is for everybody. And, regardless of who provides that water, whether it's private or public, there should be the same standards for safe, clean water. And that we have great wastewater services and sanitation services. So I think that as some of these things have happened, people have realized it doesn't matters who the purveyor is, there needs to be standards that everybody follows. And, for us, it's the ability to have a level playing field.

Q - Angie Storozynski {BIO 15115714 <GO>}

Great. Thank you.

Operator

The next question is from Ryan Connors at Boenning & Scattergood.

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

Hi, Ryan.

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

Great. Thanks and good morning. I had a question with regard to the Scranton and McKeesport transactions. And I'm just trying to get a better handle on kind of how this impacts the guidance for 2017 as you do these larger transactions. Can you just walk us through kind of layman's back of the envelope on how that impacts returns this year?

In other words, if – presumably until you get in for your next base rate case in Pennsylvania, there's some kind of a drag there on the returns coming from those systems in particular and that would be maybe trued up once you do get rates and be a tailwind beyond 2017. Is that a fair way to think about that or can you just give us – walk us through the dynamics on that?

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

Absolutely, Ryan. So, in the investor material and in our slides, we outlined, kind of, the overall acquisition process. And if you look at page 12 of our slides, it really starts with the agreement process. So when we look at the Scranton acquisition, we have now closed Scranton as of December 2016.

That means that we take on the customers. We begin to integrate them into our system. And, generally, from a financial standpoint, during the timeframe between when we close and when we get through a final rate case decision, we finance those acquisitions with shorter-term debt. And we would expect these acquisitions to meet certain financial metrics, including being accretive to earnings.

And so, that is kind of the process that we go through until we file our next rate case decision or rate case. In the rate case process, then we will, coming out of that process, have our authorized amount that is included in rate base upon which we would have the opportunity to earn a full return.

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

Okay. So if I can paraphrase that, it's accretive right away. But then it becomes more accretive once you actually get base rates in place. Is that a fair statement or no?

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

It's different for every acquisition. But, yes, once you get that full amount in the rate base that's what you would generally expect.

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

Okay. Good. And then my other question was just big picture. I know we had the NARUC Winter Meetings recently. And I wasn't able to get there but I'm sure you had a number of people there. I think I saw the agenda. You had some folks on panels and things. Any takeaways there in terms of big picture, emerging themes? What's around the corner from a regulatory standpoint?

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

This is Susan, Ryan. I think everybody is just kind of wondering what's going to come out of Washington. They're looking at the issue of infrastructure and what that means. They're looking at any potential changes in the EPA and for the electric side the Clean Power Plan and what does this mean and the waters of the U.S. And I think everybody is also carefully watching for the tax issues.

So I think there are state issues that continue to be state to state. But, I think, at NARUC, just like everywhere else, we're kind of watching to see what is going to happen on the new landscape. And we're all kind of speculating and we can draw general models. But, at the end of the day, we're waiting to see even proposals. If we have proposals, we can model and see what the impacts are.

At this point, we're just kind of guessing. And I think everybody is pretty much in that situation. We continue, though, to look at investment opportunities, regardless NARUC does, with the President of NARUC, Rob Powelson, of course. Pennsylvania has always been very innovative in the way that they look at infrastructure in ensuring that their citizens are taken care of that are our customers. So I think it was kind of the same themes (40:40), but an uncertainty of so what will the new rules be and how long will it take for us to know what those new rules are.

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

Got it. Thanks for your time this morning.

Operator

The next question is from Spencer Joyce at Hilliard, Lyons.

Q - Spencer E. Joyce {BIO 17611965 <GO>}

Hi. Good morning. Thanks for taking my call.

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

Hi, Spencer.

Q - Spencer E. Joyce {BIO 17611965 <GO>}

A couple questions here jumping back to Keystone. Have you all disclosed or would you mind disclosing the capital budget for or specifically for Keystone for this year?

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

No. Spencer, we don't do that because it's so small. Basically, they were extremely capital-light. We are open to looking at design build on a five-year basis. And we would actually look at that five-year for any capital investment from a depreciation standpoint, at least for our model. But, right now, it's just not significant enough and we're just not really disclosing it because it's so small.

Q - Spencer E. Joyce {BIO 17611965 <GO>}

Okay. And with the rebound in nat gas prices, is it possible that 2017 could be kind of a quote unquote normalized year for Keystone or is it too early to say that?

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

Well, I think, it depends on your definition of normal, what normal is. I think going back to the low turn we've had from the middle of 2015, say, through the end of last year, we know things are picking up. I mean, you can just look at natural gas prices. Even though they have come down a bit because of the really warm weather we've had this winter, we know that, of course, going into the summer – 2015 natural gas was 33% of power generation. Coal was 33%. Nuclear was 20%. Now we're starting to see as gas prices are so affordable that that will probably continue. And we will probably see gas increase. And those of you all who cover electric also know that, regardless of what happens with the Clean Power Plan, a lot of plans are already underway. And people are already building significant new combined cycle facilities.

So we believe that we've turned the corner. We see activity tremendously growing, as I said in my comments. We're seeing rig counts up. We're seeing well completion activities up, along with the natural gas prices. We believe that we're getting back to a more normal. What that normal is? I think we're going to have to see over the next few months. And we'll continue at our quarterly discussions to say is it higher than we thought or less than we thought. But we do, as we always are, want to be conservative and make sure that we have a few more months under us to see what can we look at that more predictable. So it's much better than last year. Will it be back to 2014 – 2013, 2014? I think we'll just have to wait-and-see.

Q - Spencer E. Joyce {BIO 17611965 <GO>}

Okay. Fair points there. Very helpful. Switching gears more of a housekeeping question. I know a few months back when we got the West Virginia binding settlement or agreement there, there was kind of an outstanding piece with your own insurance companies that could ultimately net us some cash. Is that still outstanding or has that been settled? Is it possible we get a bit of an influx at some point this year?

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

Well, it's not settled. And we had two different firms who did not participate. And so we currently – one of them requires arbitration and we have begun the arbitration process. The other, we have filed a lawsuit in West Virginia against and that's public information. So we're continuing. As you know, these things don't happen quickly. But we are in process. October 28, we actually filed in Kanawha County against Starr Indemnity and that one is public record.

And then the other insurer we have actually started the arbitration process. Since they are located offshore, there was mandatory arbitration. And we actually have had the panel – the chairperson of the panel has been selected. So we're continuing that process and both of those – that level of insurance together is $50 million, $25 million each.

Q - Spencer E. Joyce {BIO 17611965 <GO>}

Okay. And that would be, I guess, simply a cash flow adjustment or an item perhaps at some point? I guess, obviously, if it were to be on the income statement we could adjust that pretty easily?

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

Yes. It would be both. And if it were, as you know, the entire settlement was on West Virginia American Water's books because they were the ones that the lawsuits were against. And so if we do recover any additional funds, it would go back to West Virginia American.

Q - Spencer E. Joyce {BIO 17611965 <GO>}

Okay. Perfect. That's all I had. Congrats on a really nice year and look forward to seeing you all soon.

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

Thanks, Spencer.

And I would tell you that for those that we have not been able to answer your questions, our Investor Relations will get back with you. We appreciate all of you participating today. We appreciate those of you who were at our Investor Day. If you have any questions again please call Ed and Ralph. They will get back to you if we didn't get a chance to answer your questions. I'd like to remind everyone that our 2017 first quarter earnings call will be on May the 4 and our Annual Shareholders Meeting will take place on Friday, May the 12. Thanks again for listening. We hope you have a great spring and we will talk to you again in May.

Operator

The conference is now concluded. Thank you for attending. You may now disconnect.