Q4 2023 Earnings Call

Company Participants

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

Other Participants

- Angie Storozynski, Seaport
- Anthony Crowdell, Mizuho
- Durgesh Chopra, Analyst, Evercore ISI
- Gregg Orrill, Analyst, UBS
- Jonathan Reeder, Analyst, Wells Fargo
- Julien Dumoulin-Smith, Analyst, Bank of America Securities
- Shar Pourreza, Guggenheim Partners
- Steve Fleishman, Wolfe Research

Presentation

Operator

Good morning, and welcome to the American Water's Fourth Quarter and Year-End 2023 Earnings Conference Call.

As a reminder, this call is being recorded and is also being webcast with a accompanying slide presentation through the company's Investor Relations website. The audio webcast archive will be available for one year on American Water's Investor Relations website.

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

Aaron Musgrave {BIO 22474483 <GO>}

Thank you, Dave. Good morning, everyone, and thank you for joining us for today's call. At the end of our prepared remarks, we will open the call for your questions.

Let me first go over some Safe-Harbor language. Today, we will be making forward-looking statements that represent our expectations regarding our future performance or other future events. These statements are predictions based on our current expectations, estimates and assumptions. However, since these statements deal with future events, they are subject to numerous known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from the results indicated or implied by such statements. Additional information regarding these risks, uncertainties and factors, as well as a more detailed analysis of our financials and other important information, is provided in the fourth quarter earnings release and in our 2023 Form 10-K, each filed yesterday with the SEC.

And finally, all statements during this presentation related to earnings and earnings per share refer to diluted earnings and diluted earnings per share.

After our prepared remarks, we'll then close by answering your questions.

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

Susan Hardwick {BIO 16618718 <GO>}

Thanks, Aaron. Good morning, everyone. As we announced yesterday, we finished 2023 with very strong financial results that we're right on plan. As shown on Slide 5, earnings were $4.90 per share for the year, which included $0.13 per share of favorable weather, most of which we discussed earlier in the year. Excluding the estimated weather impact, earnings of $4.77 per share were at the midpoint of the guidance range we shared originally back in November of 2022.

I'm very proud of our company's ability to stay focused on serving our customers safely and reliably through numerous economic events this past year, which gave us the ability to confidently execute on the plan we had for 2023. I'm also proud of the resilient service we consistently deliver, and especially over the past few months during the cold January and active storm season across the country. I want to thank our employees for safely providing reliable service to the 14 million people we serve in their homes, businesses and communities.

You can see here on Slide 5 an abbreviated list of some of our key accomplishments in 2023, and John and Cheryl will add to these in their remarks. Overall, we believe the takeaway today for investors is that our strong execution in 2023 amidst the challenging macro backdrop coupled with our clear top-tier growth plan, demonstrates American Water's ability to deliver on our long-term plan. I'm very confident, we will execute our plans in 2024 and beyond with the great momentum we have from 2023.

Turning to Slide 6. As you can see, we have delivered an excellent total shareholder return over the past five and 10 years, including our growing record of significant dividend increases. We're proud of this history, which compares very favorably to other utilities.

I want to acknowledge though that our stock and utility stocks in general did not perform nearly as well as the S&P 500 in 2023, which dampened the outperformance we've had versus the S&P 500 over the last decade or so. Relative valuations of utility stocks fell without regard to specific performance, all of that while we continued our very strong performance.

I'm confident our company's fundamentals and the execution of our strategies will continue to produce superior shareholder value and very competitive total shareholder returns for years to come, which takes us to Slide 7. The comments that we'll share today are largely an affirmation of the financial plan, long-term targets and guidance we laid out last November, highlighted by 7% band 9% EPS and dividend growth. Later, John will recap the drivers for our growth in 2024, including the increase to our EPS guidance range that we announced yesterday.

Good picture though, we believe the combination of our EPS and dividend growth, our low-risk capital plan, our ESG leadership, and the affordability of our service continues to be rewarded by investors and distinguishes us from other utilities in the sector. I'll remind you that we believe the runway for our growth and for achieving these targets is very long, certainly through 2028 and our five-year plan and beyond that. This of course is driven by significant investments in infrastructure and acquisitions, coupled with our track-record of constructive regulatory outcomes, all with a keen focus on affordability. And on-top of all of that, we continue to grow organically, including in our Military Services business, that successfully serve 18 military installations across the country.

One final thought I want to leave you with, as we began 2024, American Water continues to receive tremendous support at the state and federal level for the work we do across the country. The impact we are making in communities across our 14 states to improve water and wastewater service is critical to the well-being of the citizens we are proud to serve.

And as we've told you many times, we are committed to solving local infrastructure issues while at the same time driving efficiencies in our business to remain very affordable to our customers. Policymakers frequently encourage our leadership to keep growing, keep investing and keep solving problems in their states.

And this includes Pennsylvania, where we applaud the Public Utility Commission's proposal on February 1st to enhance the process around the implementation of fair market value legislation. We believe the spirit of the enhancements is to increase public awareness and establish greater procedural consistency all-in supportive of much-needed consolidation of the Commonwealth Water and Wastewater systems. While the business of providing these critical services can at times lead to enhancement in the way we do business, including in the regulatory construct. We have no doubt about the overwhelmingly positive support we received from stakeholders as we pursue our company's mission.

With that, I'll turn it over to Cheryl to talk more about rate base growth, our regulatory plan, and some recent news around lead service lines. Cheryl?

Cheryl Norton {BIO 17107572 <GO>}

Thanks, Susan, and good morning everyone. Let me start by turning to Slide 9 where these graphs illustrate that our continued successful execution of our capital investment plan is succeeding in growing regulated rate base consistent with our long-term rate of 8% to 9%. Rate-based growth, of course, will drive earnings growth. We believe the high degree of visibility to our capital investment plan, combined with the low risk nature of the plan, uniquely positions American Water in the utility sector and is fundamental to our investment thesis.

Turning to Slide 10, I'll cover the latest regulatory activity in our states, beginning with our most recently filed cases. In Pennsylvania, we've filed a general rate case in November and are seeking recovery of $1 billion of investments. The case is proceeding as planned, including testimony and evidenciary hearings that are scheduled for February and March with rate still expected to be effective in August. As a reminder, Pennsylvania uses of forward test year for rate-making purposes.

In New Jersey, we filed a general rate case in January and are seeking recovery of over $1.3 billion of investments through December 2024. This case includes, for example, infrastructure improvement projects at all seven of our surface water treatment plants in the state. We expect the New Jersey case to be completed sometime later this fall.

We also filed a general rate case last month in Illinois where we have invested over $550 million, since our last case. Our general rate cases in California, West Virginia and Virginia, are all progressing well and as expected. In California, we reached a partial settlement in the case in November, related to the revenue request. We will prepare to implement the new rates retroactively to January 1, 2024 upon receiving the CTUC's decision on the settlement agreement and an outstanding topics related to rate design and revenue stabilization mechanisms. Our request for a one year extension on the cost of capital was also granted pushing the next filing out to May of 2025.

In Indiana, we received a final order just yesterday and it looks very constructive. We are currently evaluating it and we will share key takeaways in the next day or two. But overall, we are generally pleased. And finally in Kentucky, we expect to receive a final order very soon.

As a reminder, we expect to file a general rate cases about every two years in our larger jurisdictions. Because we make prudent investments and have skilled and dedicated employees working on these cases, we're very confident in obtaining constructive outcomes again in 2024 as we did in 2023.

On the legislative front, in New Jersey, new legislation supporting capital investment was passed and was signed by the Governor in January. The Resiliency and Environmental System Investment Charge or RESIC for short establishes a new regulatory mechanism that will enable water and wastewater utilities to recover in a more timely manner, capital spending related to investments in resiliency, environmental compliance, safety and public health. This includes capital related to PFAS remediation. In fact, most of our states where PFAS is present, there are either existing environmental mechanisms that we believe PFAS investments will fit under or we'll proactively advocating for such mechanisms.

To show the magnitude of our regulatory execution efforts, you can see on Slide 11 that we have $390 million (inaudible) in annualized new revenues and rate since January of 2023. This includes $273 million from general rate cases and step increases and $117 million from infrastructure surcharges. We also have $670 million of total annualized revenue request pending. As a reminder, American Water recovers about 75% of our overall capital spend through infrastructure mechanisms for forward test years, which greatly reduces regulatory lag. Alongside all of the investments we're making, we remain extremely focused on customer affordability and operating efficiently.

We are continuing to evolve our strategies around rate design and programs to assist our customers who are challenged with affordability. We are also continuing our focus on technology, efficiencies of scale, and cost management to deliver on customer affordability, especially as the regulatory demands such as the proposed PFAS rule and Lead and Copper Rule Improvements drive increases in - on our capital program.

On Slide 12, I'd like to cover our recent announcements regarding the US EPA's proposed Lead and Copper Rule Improvements. Like PFAS, we think clear rules are important and should be in force for all providers. American Water consistently meets water quality standards related to the Lead and Copper Rules across our footprint and believes removing the risk of lead service lines over time is the right thing to do for the health and safety of our customers. But also like PFAS, we believe all stakeholders must understand the costs associated with the proposed improvements to the Lead and Copper Rule and that the EPA estimates are likely understated.

The cost to identify the material of all unknown service lines and replace all lead service lines, including the customer own lines and galvanized lines where needed by 2037 will require significant investment for all water systems. We are currently developing preliminary estimates based on the proposed rule. Unlike PFAS though, the expected timeline for complying with the Lead and Copper Rule Improvements is much longer. So, the impact on capital spend will be more gradual.

Providing safe, reliable and affordable water is American Waters business. We continue to work with the EPA, Congress, regulators and policymakers, to ensure that the implementation of any final standards protect customers, communities and the general public.

As I close on Slide 13, you can see that our five-year capital plan, which is unchanged from November has $1 billion for PFAS and approximately $500 million for lead service line replacements. We have been proactively investing about $100 million per year to replace lead service lines for several years now and expect to continue that level at least through 2030 or beyond. Depending on the EPA's requirements in the final Lead and Copper Rule Improvements such as for customer-owned service lines, our annual investment level may need to be revised and likely over a longer period of time.

Also, we are still awaiting a final rule from the US EPA on PFAS. We continue to expect that there will be no material changes to the proposed rule and we have not changed any of our announced plans or estimates from last November related to PFAS compliance. We continue to treat for PFAS, in compliance with state regulations. And we continue to prepare for full compliance with the new federal rule once released.

Previously, we have disclosed that we are a party to the multi district litigation or MDL lawsuit in US District Court for the District of South Carolina, against manufacturers of certain PFAS like 3M and DuPont for damages. In early December, there were deadlines to decide whether or not to remain party the two potential settlements with manufacturers and we did remain a party to both settlements. We believe this is the optimal path to recouping the most dollars possible from PFAS manufacturers in an expedient manner for our (inaudible) estimates.

On February 8th, the MDL court issued its final approval of the DuPont settlement. We will now begin the process of perfecting our claims under the settlement within the time period provided by the MDL. A fairness hearing on the 3M settlement was held on February 2nd. This matter remains pending.

In closing, it's important for investors to understand that the ever-changing regulatory environment is leading to significant industry challenges, including those related to lead and PFAS but also with issues like cyber security, for example. Each change on its own is significant but the layering effect of all these changes is even more dramatic. The expertise we bring to the table to solve these challenges is well-recognized across the states where we operate and sets us apart from others. It's a privilege and a great responsibility to deliver safe, clean, reliable and affordable services to our customers and communities.

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

John Griffith {BIO 22806522 <GO>}

Thank you, Cheryl, and good morning, everyone. Turning to Slide 15, let me provide a few more details on financial results for 2023. The appendix also has details of fourth quarter EPS.

Consolidated earnings were $4.90 per share in 2023, up $0.39 per share compared to 2022 and up $0.32 per share on a weather-normalized basis. Increased revenues were driven by general rate cases we completed in late 2022 and early 2023 in our larger states. These additional revenues are driven by the significant investments we have made and continue to make in our systems.

As noted, earnings were higher in 2023 by an estimated net $0.13 per share as a result of weather in the second, third and fourth quarters due to warm and dry conditions, primarily in Missouri, New Jersey and Pennsylvania. This compares to net favorable weather in the third quarter of 2022 of $0.06 per share, which related mostly to warm and dry conditions in New Jersey.

And looking at [ph]our credit costs, higher pension expense of about $0.13 per share and increased chemical costs of about $0.11 per share including inflationary pressures are being recovered in large part through higher revenues we proactively sought in general rate cases we completed in the last 12 months to 18 months. In the fourth quarter, we also had higher costs of about $0.10 per share related to waste disposal, equipment repairs, tank painting, and other maintenance costs across our footprint.

Supporting our investment growth, depreciation expense increased $0.24 per share and the cost of additional long-term financing increased $0.38 per share, primarily related to share count dilution. As I mentioned all year, the EPS impact of the higher share count from our equity issuance back-in early March was offset by avoided interest on the year.

An additional benefit realized this year from the equity issuance is the interest income, we have been earning from the cash balance held since March. Other reflects primarily post-closing acquisition adjustments in 2022 from the sales of HOS In New York, which added to EPS.

Turning to Slide 16, you'll see that we continue to be set-up for strong growth through acquisitions. We closed on 23 acquisitions totaling $77 million across eight states in 2023. We also have 25 transactions under agreement across seven states at year end, totaling $589 million and 88,000 customer connections. This total includes both the Butler Area Sewer Authority wastewater system in Pennsylvania and the Granite City wastewater treatment plant in Illinois. We are very close to completing the Granite City acquisition where we already provide wastewater collection service for approximately 12,000 customers.

In Pennsylvania, as Susan briefly discussed, the regulatory environment relating to acquisitions is undergoing change, which we think is ultimately necessary and positive, but will take a period of time to sort out. We are very confident that Act 12 fair market value legislation will remain in place and continue to have strong support. As is often the case, implementation of legislation needs to be worked through in the regulatory arena and that is what is happening now.

In the meantime, closing of our current pending transactions will likely take more time than usual. But to be clear, we are confident that the previously approved Butler acquisition will close soon. We're continuing to invest in regulated acquisition opportunities in Pennsylvania, driven by the continued need for system consolidation and upgrading for the benefit of communities in Pennsylvania, who deserve safe and reliable water and wastewater service.

As you know, we have a strong track record of closing acquisitions. Over the past five years, we've closed over 100 acquisitions across 12 states, totaling nearly 200,000 new customer connections. Of course, as we close transactions, the work to build and refill our acquisition pipeline is continuous. Our pipeline of more than 1.3 million customer connections with meaningful contributions from across our platform continues to be a strong leading indicator that supports this piece of our rate-based growth outlook.

As you recall, in November, we introduced our long term target of 2% annual customer growth from acquisitions as shown on Slide 7. This equates to about 70,000 acquired customers per year based on our current customer count of approximately 3.5 million customers. We are proactively investing in our capabilities across our platform to bolster our system-wide contribution to acquisitions to support this growth and are confident in meeting our 2% long-term target.

Turning to Slide 17, here we show the build up from 2023 weather-normalized actual to the 2024 EPS guidance range of $5.10 to $5.20 that we introduced last November, which reflects 8% growth at the midpoint of $5.15. Working from that same build up yesterday, we announced an increase of $0.10 per share to our 2024 EPS guidance range, which is now $5.20 to $5.30 per share. The increase is due solely to additional interest income we will receive in 2024 and expect to receive annually through 2026 from the amended terms of the secured seller note from the sale of HOS.

As we described in the 8-K we filed on February 5th, the note balance has been increased to $795 million from $720 million, which satisfies payment of the contingent consideration owe to American Water of $75 million, triggered by the extension of HOS' service agreement with the New York City Water Board. In addition, reflecting current market interest rates and removal of

American Waters' option to require prepayment of the note at a future date, the annual interest rate on the note has been increased from 7% to 10%.

American Water is pleased to see the continued growth of the HOS business under its new ownership including the service contract extension with New York City as well as a significant acquisition recently announced by HOS, which will be funded with new equity from HOS' owners.

As it relates to future earnings guidance, it will be important for investors to be able to track the ongoing growth of American Water from its core regulated strategy before this additional interest income. Therefore, when we provide forward year EPS guidance each November, we will be sure to note the EPS associated with the additional interest income from the secured seller note in that guidance.

To wrap-up, Slide 18 is a summary of our continued strong financial condition, which we further solidified in 2023. Just last month, Moody's affirmed our solid BAA 1 investment-grade credit rating and stable outlook and noted, our improved FFO-to-debt ratio. We are confident in our FFO-to-debt ratios will continue to support our current credit ratings.

Our total debt-to-capital ratio as of December 31st net of our roughly $330 million of cash-on-hand is 55%, which is comfortably within our long-term target of less than 60%. While having moderated somewhat, the current higher interest rate environment continues to be challenging. As I said in November though we are in a position of strength on a number of fronts in dealing with this challenge. Our strategy of issuing debt at the holding company level, allows us to take advantage of our scale and pricing debt issuances, and we will remain proactive in managing risk and achieving a low cost of capital to (inaudible) our customers and shareholders.

With that, I'll turn it back over to our operator to begin Q&A and take any questions you may have.

Questions And Answers

Operator

We will now begin the question-and-answer-session. (Operator Instructions) Our first question comes from Shar Pourreza with Guggenheim Partners. Please go ahead.

Q - Shar Pourreza

Hey, guys. Good morning.

A - Susan Hardwick {BIO 16618718 <GO>}

Hey, Shar.

Q - Shar Pourreza

Good morning. Yeah. I don't usually -- I don't usually lead off with sort of an M&A question but I know John loves talking about M&A and we saw that in the prepared remarks. And obviously it's timely given the Eversource news yesterday where they essentially put acquiring on the block. Can you speak maybe to your appetite for larger inorganic opportunities? And specifically, any geographic aversions to the Northeast in light of the developments yesterday. Thank you.

A - Susan Hardwick {BIO 16618718 <GO>}

Sure. I think it's a great question. Obviously, we saw the news as well. And John, certainly can comment more. I'd say, first of all, of course, we don't comment on any activity in the M&A space of that nature. I think, for us, it continues to be our standards that we've shared. We have to be confident in the ability to grow. We have to have confidence in regulatory environments, confidence in policy and support in any jurisdiction that we're currently in or other jurisdictions we may be looking at. So, I think that's always the case, which we evaluate opportunities. So I'd probably just say that.

John, any additional comments from your side?

A - John Griffith {BIO 22806522 <GO>}

No. Well said.

Q - Shar Pourreza

Perfect. And then just a follow-on. I know you're still kind of working through some of the ins and outs of the Lead and Copper Rule. Is there even a general CapEx upside amount you could give us to think about with the spend sort of be additive in your view to the current plan or would it shift out some spend out like we saw with you know obviously with PFAS spend on the last update. Thanks guys.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, sure, let me again sort of generally answer and then Cheryl, can add to it. I think it's first of all, sort of too early to be able to give any additional guidance around impacts to our overall plan. I think the important thing to remember here is it is over a much longer period of time than what we're seeing with the PFAS rules for example. So it will give us more time to figure out what the actual impacts are to the plan, gives us more opportunity to look at opportunity to move other projects around to sort of accommodate whatever spend we think may be incremental here for us. So we just probably need a little bit more time to sort through it and then we can give a clear guidance. Again, as Cheryl said in her prepared remarks, we know it will be significant. I don't think it will have a dramatic impact on our plan for shorter-term window like we saw with PFAS, for example.

Q - Shar Pourreza

Got it.

A - Susan Hardwick {BIO 16618718 <GO>}

Cheryl, anything you want to add to that?

A - Cheryl Norton {BIO 17107572 <GO>}

Yeah. The only thing I would add, Shar, is just that we have been making really good progress in that space, and we'll continue to be focused on removing our lead service lines and the customer lead service lines where they exist. But this is a more inclusive rule that, as Susan said, is over a longer period of time. So we'll continue to look at how we can layer that in.

A - Susan Hardwick {BIO 16618718 <GO>}

I think just to sort of punch line on that one and Cheryl again made the comment in her prepared remarks. You know this is about unknown service lines, unknown material. And it is about customer own. So as we've been working through our own program of replacing our lines, now we have the added requirement to look at unknown pipe and customer service lines. So that's why it gets bigger, and then again the long-term time horizon to deal with it I think is also important to keep note of.

Q - Shar Pourreza

Fantastic. Thank you, guys. I'll pass it to someone else. See you soon.

A - Susan Hardwick {BIO 16618718 <GO>}

Thanks, Shar.

Operator

Next question comes from Durgesh Chopra with Evercore ISI. Please go-ahead.

Q - Durgesh Chopra {BIO 20053859 <GO>}

Hey, good morning, team. Thanks for getting me turn. Hey, just Susan...

A - Susan Hardwick {BIO 16618718 <GO>}

Good morning.

Q - Durgesh Chopra {BIO 20053859 <GO>}

Hey, good morning, Susan. Just I hate to go back to the M&A, I know you're kind of going to be very limited in what you can say. But we've been getting a ton of questions on this, so I just wanted to be clear about something. And you see -- your peers generally describe M&A as a high hurdle rate, right, with the organic growth opportunities that they have as a company. How would - how would you characterize the Connecticut Water assets? Are these ones one of a kind assets, those large assets that don't - don't often come to market is extremely attractive. Or would you say, you know, the M&A opportunity is still high hurdle rate versus the organic CapEx that you have. I don't want to put words in your mouth, but I just wanted to see how you're thinking about it.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, Durgesh. I'll tell you at the outset, you're not going to be happy with my answer, because I'm not going to sort of go into a whole lot of detail here. I think our focus continues to be on the communities and the states that we currently operate in. As you know, we're in 14 different states. We think there are just a significant number of opportunities in those states and we're going to continue to focus on that. As you would expect any one to do, we'll take a look at this kind of an opportunity as everyone would. But I think again our screens are the critical thing you should focus on. Regulatory environment, legislative environment, business climate and the ability to grow. And that we're always going to look at opportunities from that perspective.

Q - Durgesh Chopra {BIO 20053859 <GO>}

Understood. Thank you, Susan. I appreciate that. Maybe then switching gears, can you just update us on the Pennsylvania rate case, the commission, I think came out in December. I think they may have suspended the rate case schedule. Maybe just talk to that what does that mean, what are the next steps there, please. Thank you.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. Cheryl I think laid out the details around timing. We've disclosed the size of the case, et cetera. Sort of big picture for me on this case as is the case really with all of our general rate cases we have in progress, it's all about investments. We're not trying to do anything tricky in any of these cases. No significant policy changes from our perspective. This is simply about investment, that's what this Pennsylvania cases about. And we'll continue to work through the process (Technical Difficulty) indications of any issues associated with this case as we work through the process and we'll continue to, to stay on that path. I'd say, that's generally the case on all of our jurisdictions. All the cases that we have on file today.

We've been signaling this I think for quite some time that the expectation to be in for general rate cases on this roughly two-year cycle. We've been saying that for probably two, three years now. And this is just the continuation of that program. And it's all really driven again by our investment, the pace of our investment. You know, we've been increasing our capital spend plan for a number of years now to really address the needs that exist in the communities that we serve. And I think our regulatory strategy is consistent with that approach. So, Pennsylvania is no different than any other state in terms of our approach to it. And we'll continue to work the process there, like we always do. And we think Pennsylvania again is a - is a very constructive state, and we're confident in our ability to work through that case.

Q - Durgesh Chopra {BIO 20053859 <GO>}

Got it. Thanks. Just a quick follow-up there, Susan, like do -- does the procedural -- like the steps in the rate case in terms of testimony, intervener testimony and all that stuff, does that go along as planned with the suspension or is that on pause. I might have seen something that, you may be on pause. So I'm not sure, you know, if (inaudible).

A - Susan Hardwick {BIO 16618718 <GO>}

No change. Yeah, no change. Yeah, it's on schedule and on the normal process.

Q - Durgesh Chopra {BIO 20053859 <GO>}

Thank you.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. Thanks, Durgesh.

Operator

Next question comes from Angie Storozynski with Seaport. Please go-ahead.

Q - Angie Storozynski {BIO 15115714 <GO>}

Good morning.

A - Susan Hardwick {BIO 16618718 <GO>}

Hey, Angie.

Q - Angie Storozynski {BIO 15115714 <GO>}

Good morning. I'm going to ask about Illinois first. I mean we have some bad outcomes, regulatory outcomes, on the electric and gas side in the state. You have a case there, we're already seeing some noise around it. So I'm just wondering how you know if there's any lessons learned from what happened in December. And if you've incorporated that into the current timing.

And then secondly on PFAS. So, you know, we're seeing some lawsuits against investor-owned utilities on the back of PFAS. I understand that you've mentioned that you've been in compliance and going beyond requirements. But I'm just wondering how you manage this risk.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, again let me sort of start-off here. On Illinois, I would take my answer to Pennsylvania and insert the word, Illinois. We are proceeding there as scheduled with no significant issues in that case. It is about investment. And we'll continue to process that case like we always would. Certainly, there is noise around the electric and gas industry cases there. We think again our cases are different in that they are about investment-only and we're confident in our ability to continue to work through that case as well.

On PFAS, Cheryl, you might just actually want to comment on Illinois, if you like. And then on PFAS, there's obviously a lot going on hereto. I think the litigation environment around this is probably not surprising. There'll be all sorts of plaintiffs' attorneys looking for an angle here. And I think that's probably what mostly you're referring to in what we're seeing.

But Cheryl, anything you want to add-on either of these topics?

A - Cheryl Norton {BIO 17107572 <GO>}

Yeah. I would just say, you know Susan, you completely accurate on Illinois. We've built a really strong case based on capital investment and we feel-good about that case and the process. We're just going to go through the process there the way we normally would.

As far as the PFAS stuff, I do believe that, you know, there we've seen some lawsuits out there and as you mentioned, but we've been working really hard both to make sure that we're in compliance with all the rules that are out there that we're being proactive in our approach. But we're also working with EPA on the circular designation and working at the federal level to try to get protections for water utilities all across the US. Because we believe that we shouldn't be held accountable for polluted waters that are coming to us and we're doing everything we possibly can to treat for that pollutant. And so we think that we should be protected from that. So we're going to continue to work in that vein and in that space. And you know being part of the MDL, that's one-step in that process to get recovery from the people who cost the pollution in the first place.

Q - Angie Storozynski {BIO 15115714 <GO>}

Great. Thank you.

Operator

The next question comes from Julien Dumoulin-Smith from Bank of America. Please go ahead.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Hey, good morning, team. Thank you very much for the time. Appreciate it. Nicely done on the guidance here. I got to say. Maybe actually to that point on guidance, given the bump here. Just with respect to resetting higher -- the CAGR going-forward. I just wanted to recognize that this goes through 2026. Implicitly, could we say, this (inaudible) through the forecast period are is this more nuanced to the specific three-year forecast period 2025, 2024-2026 year, if you will.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. I think we've tried to be clear, Julien on the sort of duration of this additional interest will have on. But, John, you want to -- you want to comment on this further?

A - John Griffith {BIO 22806522 <GO>}

Yeah. I think you've got it right Julien. It's, think of this as an increase over our ongoing guidance for that period through 2026 and that's you know -- but we've not made changes as we've tried to describe in our comments from our original guidance on the -- on the regulated strategy from back in November.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Right. Yeah, understood. I just wanted to clarify that. Extra clear. With respect to Illinois here, obviously, you've got this case out there -- there is a certain degree of attention. Can you comment a little bit about maybe some of the rate mitigation factors. What other pieces could help offset some of the rate increases to customers in Illinois and any other mitigating factors and circumstances around that case that we can speak to here for instance.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, I'll comment on sort of overall strategy on that point. I think we treat Illinois the team as we do our other states. I mean, we've been very focused on mechanisms or approaches to regulatory solutions that will help lessen and mitigate the direct impact of inflationary cost pension and other things. We've done that via trackers. We've done that via deferrals. We've done that sort of across many of our jurisdictions. And we have a good amount of those costs actually frankly already sort of dealt and embedded in rate structures across our territory. No one really no different than that.

And as Cheryl said, you know, that we're just not experiencing other issues currently in that case. Now, we obviously have to finish it. We have to get through the rest of the procedural schedule and -- and work through any issues that may come up. But we're -- we're not anticipating anything materially different there.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Yeah, Excellent, thank you. And then lastly, just going back to the M&A point you're making earlier. I thought you were pretty clear about it. It needs to be accretive and/or provide robust visible growth. I just want to make sure I'm hearing you right about the growth piece there in terms of a key element and ingredient.

A - Susan Hardwick {BIO 16618718 <GO>}

Well, I don't know that I said it has to be accretive. Are you -- I guess you're talking about the M&A piece. I think, again, I'll just repeat it. I think our view is that, for us to look at new jurisdictions, it has to be productive regulatory legislative business environment. And the opportunity for growth, I really I guess was referring to you know sort of footprint growth there. And obviously you would you would apply a you know a meaningful financial contribution from that too. So it's the same screens we've always had. It's the same dialog we've always had on potential expansion into other territories. So I don't think this particular situation changes anything about how we feel about, you know, growth in other jurisdictions.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Got it. And just going back to lastly on that PUC, you guys commented extensively here, but just a timeline on getting that clarity there and you know you talked about being a little bit more protracted. Just how does this sort of at least from a process perspective, finally get to some resolution as far as you guys are concerned. And then you know prospects on expanding it even from there, given where we stand.

A - Susan Hardwick {BIO 16618718 <GO>}

Well, Julien, you're going to have to help me on first part of your question. I'm not sure what you're referring to.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Well, I just on the fair market value. Just in terms of potentially taking a little bit longer. Yeah, indeed.

A - Susan Hardwick {BIO 16618718 <GO>}

Got you. Got you. I just didn't hear the first part. Yeah. I think that as I said in my remarks, and John expanded on a bit.I think that what the PUC has done in Pennsylvania is actually quite helpful. And I've got a lot of experience in the regulatory world over the last 40 years or so. I'd see many pieces of legislation enacted and I've seen many situations where commissions have to work-through the implementation of that legislation. And I think that's exactly what we're doing here. And as we said, we applaud the commission for taking this approach and really being thoughtful about it and understanding the importance of this legislation to the larger strategy in the Commonwealth. So, I think the steps are be taken make, make good sense.

Now, having said that, we do have to continue to work through how those guidelines ultimately may be employed. But we think it's just helpful and we'll give a framework for all of us to be able to work more productively in. Now having said that also, we do have to sort out what it means in terms of timing and we've got a number of cases, acquisitions that we're working on in Pennsylvania through the regulatory approval process. And it's obviously impacting that a bit currently, but we expect that to clear soon and be able to get back on our way here.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Great. Excellent, guys. Thanks for the patientce.

A - Susan Hardwick {BIO 16618718 <GO>}

Thanks, Jullien.

Operator

Next comes from Anthony Crowdell with Mizuho. Please go-ahead.

Q - Anthony Crowdell {BIO 6659246 <GO>}

Hey, good morning. Just a quick housekeeping question after Julian. You talked about the, the HOS note in the income and you're very clear about that that's more -- were not much of an ongoing earnings number. I think you're talking about maybe it rolls off in 2026. When we move forward, right, post 2026, should we think about additional rate base that maybe backfill that on a more linear growth rate or -- and I know $0.10 of a $5 number is very small, but just something backfill that they keep their earnings trajectory pretty linear.

A - Susan Hardwick {BIO 16618718 <GO>}

I think you hit on it, Anthony, there at the end. It's not terribly material. We think this is a great benefit from a cash flow perspective. You know, the additional interest is nice to have. We think the certainty associated with the -- that contingent payment we had on the New York contract extension is quite helpful. Now, we have that secured. So we think there's just a variety of things about the restructuring debt made a lot of sense for us, that don't necessarily translate into any material impact to our overall plan.

So long answer to your question, we would not expect there to be a need for finding additional capital to sort of fill in that very minor hold that this $0.10 will create.

Q - Anthony Crowdell {BIO 6659246 <GO>}

Great. And just if I could squeeze one more. And it's still -- it's Cheryl the comments earlier and unfortunately it looks like most of the Q&A has been sidetracked by Eversource questions. So I'm not asking you to Eversource question just when Cheryl talked about the increased needs on water systems, cyber security, you just think of that. Is that maybe a foreshadowed that maybe the smaller and bolt on acquisitions may come at a greater frequency because of the requirements that are being -- the compliance requirements that are being put on the smaller systems. I mean was that where that was headed?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. I think this is an area we've tried to signal I think for the last several discussions we've been having. And I think really probably what prompted that even was PFAS, as an example. You know we see that as just another area that may be difficult for some of these smaller systems to be able to manage both from an investment standpoint as well as an expertise standpoint. Cyber is another great example, you know, interest rates is another great example. I mean the list just gets longer, not shorter for these communities to sort of have to deal with.

And from our perspective you know we have always been very focused on trying to define what the need is for a community and helping satisfy those needs. And again from an M&A perspective or an acquisition perspective as that list gets longer, it creates more opportunity for us to have that dialog and work with communities to solve those kinds of problems.

So, yeah, we think it does have upside to our acquisition strategy. It's probably not a Tsunami though to use a water term. It's probably a much sort of longer-term impact. I think it takes a bit of time for communities to sort of wrestle with these issues and determine you know impacts to them before they're ready to make a move. So again, we use these kinds of issues in our discussions. I think it will take some time before we see any measurable impact directly related to these issues.

Q - Anthony Crowdell {BIO 6659246 <GO>}

Great. Thanks so much for taking my questions.

A - Susan Hardwick {BIO 16618718 <GO>}

Sure. Thanks, Anthony.

Operator

The next question comes from Steve Fleishman with Wolfe Research. Please go-ahead.

Q - Steve Fleishman {BIO 1512318 <GO>}

Hi, good morning.

A - Susan Hardwick {BIO 16618718 <GO>}

Morning, Steve.

Q - Steve Fleishman {BIO 1512318 <GO>}

Not an M&A question. So the -- couple of things on the a HOS changes. So just the thinking about the shift in the interest rate on the note 7%, 10%, which is great. I mean, that's a pretty high rate to pay for this for the seller, and I guess -- I guess soon to get rid of the prepayment. And so, I guess I'm just wondering, you know, how do I think about just making sure that that seller, you know, in terms of getting paid back. Getting paid.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, it's a great.

Q - Steve Fleishman {BIO 1512318 <GO>}

Yeah.

A - Susan Hardwick {BIO 16618718 <GO>}

Great question, Steve.

Q - Steve Fleishman {BIO 1512318 <GO>}

(multiple speakers) pay you.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. John, you want to take this question.

A - John Griffith {BIO 22806522 <GO>}

Sure. Good morning, Steve. From a credit perspective, we stay very close to the HOS business. We're in fact a partner and as lender, we're constantly in touch with the business. The company has evolved, the credit has improved. You know extending the New York contract is a significantly positive credit move. And as I mentioned in my comments, the company is currently making an acquisition with new equity funding from their owners as well as cash on their balance sheets. So we do have covenants. They've remained in compliance with the covenants. And in fact, we've taken the opportunity to tighten covenants as well. But when you look at the underlying business, it's frankly doing better than it ever has. So we feel very, very good about the underlying credit here.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay. Does the owner -- does as the private -- does the firm back it up too or is it just the business backs up paying rest.

A - John Griffith {BIO 22806522 <GO>}

Yes, the owner backs it up. And that's what I was trying to say. So when there's fresh equity coming into the business to make this acquisition, that's coming from APAC who owns the business.

Q - Steve Fleishman {BIO 1512318 <GO>}

Got it. And then just -- I know you had a sharing mechanism too, for the business. Could you just maybe let us know kind of how much income you made on the sharing mechanism part in, let's say, 2023. Yeah.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, Steve, I don't know if we had that disclosed. Is it separate 10-K. Yeah. Steve, we can point you to it, I'll have Aaron follow back up with you to point you to it, but I think it is in the 10-K, which obviously we filed last night. And this is the revenue sharing mechanism you're referring to where we collect a share of the revenue that's generated from the warranty work that they're doing into our various state jurisdictions where we have (multiple speakers) Yeah, Aaron will direct you to them.

Okay, great. Thanks, Steve.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay. On the Pennsylvania case, I think to the Commission sent a letter at the beginning of the case. Just kind of framing it. But I'm not sure -- is that abnormal would you say or is that normal for your Pennsylvania cases. How would you characterize that?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. I would say it's probably not necessarily customary. But again, we think that this case is proceeding as it should. We don't really see again any issues here. It's a big case. So. I mean, its $1 dollar worth of investment, you know. We were in just a little under two years ago on this case. So certainly material. And again, solely driven by investment in the jurisdictions that we or the communities that we serve there.

Q - Steve Fleishman {BIO 1512318 <GO>}

Yeah. Understood. Thanks for your time.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. Thanks, Steve.

Operator

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

Q - Jonathan Reeder {BIO 18909775 <GO>}

Hey, good morning, team. Just wanted to come back to EPA and the fair market value stuff. Do you anticipate that all the changes to the fair market value will come via the Commission process. Or do you think some of the bills in the legislature will make it across the finish line.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. Our view is that this is -- this is the best path and the likely path to sort of resolve issues around fair market value in Pennsylvania. Again, I think this is normal practice and I'm not being specific to Pennsylvania. I'm just saying normal in my 40 years of experience, which happened, fairly regularly where commissions, you know, are charged with interpreting legislation and applying the provisions of it. And that's what I think this Commission is doing. And I think they took a very proactive step here to do exactly what you're talking about, to resolve the issues and be able to effectively implement the legislation.

I think there is no one -- well, I shouldn't say, no one. There are few probably that have you know conceptual problem with what fair market value legislation was intended to do. I think there is a -- there's a good understanding of the need for consolidation in the state. And this is the mechanism to allow for that to occur. So I think it's -- I think it stands. And I think the commission will do the work necessary to make sure that the legislation is effectively enacted and implemented.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Yes. So, I mean, you're saying PA is in your opinion, very much fully behind continued promotion of consolidation.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. I think as a state, as the Commonwealth, I believe that is a true statement. Yes.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay. What sort of impact do you think it will have on the deal activity. And would you say the proposed RRR will make it tougher for AWK to deliver on the M&A CapEx placeholders.

A - Susan Hardwick {BIO 16618718 <GO>}

I think we'll have to see how it plays out and how, ultimately, it gets worked from a procedural standpoint. But I'd say, generally speaking, no, we do not see it having a material impact on available opportunities and then ultimately the outcomes on transactions.

Q - Jonathan Reeder {BIO 18909775 <GO>}

And then last question for me, I saw that in at least the PA New Jersey rate case filings that revenue decoupling requests were made. You know possibly. It's in Illinois case too. Do you typically make those detailed decoupling request and just don't get them or is that something new that you're pursuing?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, it's a good question. I'd say, it varies across jurisdictions. And again part of our job here is to really understand what each commission is comfortable with and what mechanisms work or don't work-in a particular jurisdiction. And it's also part of our responsibility to educate and to inform commissions and their staffs about how various mechanisms can work and what the impacts are. So we do that across our jurisdictions, And I think we have really been more proactive in that regard over the last couple years.

And so. I think as we do that education and that dialog, it will inform where we propose what mechanisms. So, I wouldn't necessarily say it's a broad application the decoupling is always on our list in every jurisdiction. I think it's all circumstantial what mechanisms work best in what jurisdictions, and we work accordingly.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay, but for PA New Jersey, are these new proposals or have they've been there and say your most recent case too?

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah. I'd have to go back and look to see if we have those specifically in those cases. I don't actually recall, but again, I wouldn't necessarily think this is breaking new ground on either of these proposals.

Q - Jonathan Reeder {BIO 18909775 <GO>}

Okay, great. No. I appreciate the time this morning. Sure. Thanks, Jonathan.

Operator

Your next question comes from Gregg Orrill with UBS. Please go-ahead.

Q - Gregg Orrill {BIO 1532939 <GO>}

Yeah, thank you. Just a question on the PFAS settlements. Just sort of your expectation on the outcome following-up on the 3M settlement there. And, you know, thanks for the additional updates. I'm just curious if anything has changed around, you know, your view of the companys sort of legacy liability to PFAS if there is one. Thanks.

A - Susan Hardwick {BIO 16618718 <GO>}

Yeah, on the first question, Greg, around just settlement expected outcomes. Obviously, that process is proceeding. And we had one settlement approved and the other one in fairness hearing has occurred. And we would expect it to ultimately get approved. And then the process begins of claims submittals and really going through the settlement allocation process. So, obviously, it's too early for us to be able to give you any indication of what we think the outcomes will be financially. But as we've said all along, these will be cents on the dollar in terms of recovery. We don't expect obviously for it to cover the full-cost of exposure here. But the amounts to be recovered through the settlement we think is quite important.

And the best avenue as Cheryl said in her remarks to collect dollars on behalf of the customer to reduce the overall obligation the customer has. So it's a good process. We've been happy to be involved in it. Our team, I think in a lot of ways is leading most of the effort around getting this work through the courts and getting outcomes here that are quite favorable.

And to your second question on how do we view sort of legacy exposure here. I don't think our view changes. As we said earlier, this will be an environment like all where there'll be Plaintiffs' attorneys that are looking for an opportunity here. And how that ultimately gets worked through the larger process around the MDL the multi district litigation is yet to be teen. But in terms of our exposure, we don't have any different view than we've had from a legacy perspective. Again, as Cheryl said on a go-forward basis, we are treating and we're preparing to treat and we're confident in our ability to do that on a go-forward basis.

Q - Gregg Orrill {BIO 1532939 <GO>}

Thank you. Sure. Thanks, Gregg.

Operator

This concludes our question-and-answer session. The conference has now concluded. Thank you for attending. You may now disconnect.