S&P Global Ratings

Sustainable1

Environmental, Social, And Governance Evaluation

American Water Works Co. Inc.

Summary

American Water Works Co. Inc. (American Water) is a publicly traded utility holding company that provides, through its subsidiaries, water and wastewater utility services to about 15 million people in about 1,700 communities across 46 U.S. states. Based in Camden, N.J., American Water is the largest investor-owned water utility company in the U.S. and one of the largest in the world measured by operating revenues and population served.

American Water's ESG Evaluation score of 87 reflects our view that the company prioritizes commitments to safety, environmental stewardship, and public health in its strategy, and that ESG goals are a natural fit for and align well with its business model. Examples include the company's commitment to provide safe drinking water to its customers and safe workplace conditions to its employees. American Water also has a demonstrated commitment to diversity and inclusion. Furthermore, the company's governance benefits from strong structure and oversight, as demonstrated through its board structure and remuneration policies.

Additionally, we view American Water's preparedness assessment of 'best in class' as reflective of its ability to identify, assess, and act on risks and opportunities its business faces, such as climate change, infrastructure replacement, water contamination, and an aging workforce. The company fosters an effective culture to contend with sustainability-related risks, and it prioritizes safety and compliance with mandated regulations across all lines of operations to protect and enhance its financial and reputational standing.

PRIMARY ANALYST

Kimberly Garen
New York
+1-212-438-4615
kimberly.garen
@spglobal.com

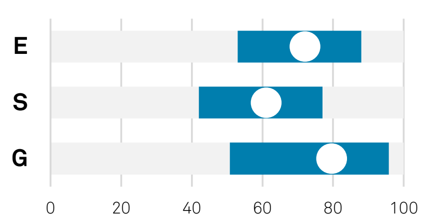
SECONDARY ANALYST

Sloan Millman
New York
+-212-438-2146
sloan.millman
@spglobal.com

Thomas Englerth
New York
+1-212-438-0341
thomas.englerth
@spglobal.com

ESG Profile Score

72 /100



Company-specific attainable and actual scores

Preparedness Opinion (Scoring Impact)

Best in class (+ 15)

ESG Evaluation

87 /100

A higher score indicates better sustainability

Component Scores

Environmental Profile

Sector/Region Score		38/50
	Greenhouse gas emissions	Good
	Waste and pollution	Good
	Water use	Strong
	Land use and biodiversity	Good
	General factors (optional)	None
Entity-Specific Score		**34/50**
E-Profile (30%)		**72/100**

Social Profile

Sector/Region Score		27/50
	Workforce and diversity	Strong
	Safety management	Strong
	Customer engagement	Good
	Communities	Good
	General factors (optional)	None
Entity-Specific Score		**34/50**
S-Profile (30%)		**61/100**

Governance Profile

Sector/Region Score		31/35
	Structure and oversight	Strong
	Code and values	Strong
	Transparency and reporting	Good
	Financial and operational risks	Neutral
	General factors (optional)	None
Entity-Specific Score		**49/65**
G-Profile (40%)		**80/100**

ESG Profile (including any adjustments) **72/100**

Preparedness Summary

American Water's best-in-class preparedness reflects a very high level of awareness of its risk environment, both near and long term. The company engages in a wide array of scenario planning to anticipate both the physical impacts of climate change as well as changes in regulation that could affect its business. It partners with a number of outside parties to inform its understanding of risks and has successfully implemented changes to its business model in the past in response to perceived opportunities. Despite an effective culture that is geared toward sustainability, the company faces challenges maintaining this culture as it acquires new, and often underperforming, water systems.

Capabilities	
Awareness	Excellent
Assessment	Excellent
Action plan	Excellent
Embeddedness	
Culture	Good
Decision-making	Excellent

Preparedness Opinion (Scoring Impact) **Best in class (+ 15)**

ESG Evaluation **87/100**

Note: Figures are subject to rounding.

Environmental Profile

72/100

Sector/Region Score (38/50)

Water utilities face moderate exposure to environmental risks such as water-borne illnesses, quality risks, and efficient water use. There is foreseen water scarcity induced by climate change and scrutiny on water efficiency. There is also a concerted focus on water recycling, proper handling and disposal of biosolids and other waste related to sanitary sewer treatment, and greenhouse gas (GHG) emissions, as energy use can be significant to sustain operations.

Entity-Specific Score (34/50)

Note: Figures are subject to rounding.

Greenhouse gas emissions	Waste and pollution	Water use	Land use and biodiversity	General factors
Good	**Good**	**Strong**	**Good**	**None**

American Water is focused on water use and efficiency, and they have developed favorable leak detection and water use reduction methods. These efforts and associated targets are strong compared to other water utilities. They have a target of saving 15% in water delivered per customer by 2035 compared with 2015 and have already achieved a 4% reduction. Further supporting the commitment to water management is its investment in infrastructure and pipe replacement with a goal to achieve a 100-year pipe replacement cycle, compared with an industry average of about a 250-year replacement rate.

Water scarcity risk is relatively small, with only 6.8% of water sources coming from stressed regions in the U.S. We view the risk to be lower than peers even as this becomes more significant for the sector due to climate change. American Water has taken the intiatiave to track this exposure and explore other water sources. Two-thirds of the water supply comes from surface water, although this source requires more treatment than groundwater to achieve potable standards, as there is a lower risk of subsidence or seawater intrusion.

American Water's recently annouced plans to increase water system resiliency, which has a strong forward-looking approach. The purpose of this is to respond to more extreme events by increasing the Utility Resilience Index (URI) by 10% in 2030, from a 2020 baseline. No other peers have similar targets.

We consider their exposure to waste lower than other utility peers. The company's exposure to wastewater is smaller as drinking water treatment generates less sludge than sewage treatment. The company follows environmental protocols regarding the proper handling and disposal of biosolids and any heavy metals or hazardous waste associated with wastewater treatment. Although the company does not track components of its waste footprint, this is generally consistent with its water utility peers.

The company's total GHG emissions are below the global peer average. American Water relies more on purchased power with energy use stemming from both its drinking water and sanitary sewer treatment facilities and the regional transmission organizations resulting in evelated Scope 2 emissions. The company is in line to achieve its target to reduce absolute scope 1 and 2 GHG emissions 40% by 2025 (compared with 2007 baseline), with a 36% reduction through 2020.

Social Profile

61/100

Sector/Region Score (27/50)

The sector is exposed to community risk as water basins can be geographically large and water stewardship can involve multiple stakeholder groups. The ability to provide water at affordable rates and limit service interruptions are important to customer engagement. Additionally, safety and the ability to meet standards, due to the health concerns from poor drinking water quality are material. Failure to manage these factors can result in fines, disputes, and litigation.

Entity-Specific Score (34/50)

Note: Figures are subject to rounding.

Workforce and diversity	Safety management	Customer engagement	Communities	General factors
Strong	**Strong**	**Good**	**Good**	**None**

American Water has maintained high safety standards, avoided high profile incidents, and is in compliance with regulatory contaminant levels across its water systems, with support from policies and commitments that exceed those of the subsector. Overall safety and safe drinking water remain highest priority and is evidenced by metrics better than the industry average for drinking water compliance indicators attributed to upgrades of existing infrastructure including pipes. Key performance indicators are consistently stronger than industry peers and it has reduced its OSHA reportable incidents rate by about 80% and its days away, restricted, or transferred rate by about 70% since 2015, targetting further reductions going forward.

We believe American Water's workforce is significantly more diverse than peers. A diverse workforce is evident at all levels but especially among executive leadership and the board, with female and minorities making up close to 73%, an 11% increase from 2017-2018. We believe the company benefits from high job satisfaction, based on a turnover rate that is about half of the industry average. However, an aging workforce remains a risk. The company has invested in attracting younger talent, which has been a challenge for other entities. They have been able to integrate talent through its acquisitions and improve working conditions for employees that are transitioning from distressed or acquired systems.

American Water has been acquisitive and invested in failing systems and their respective communities. The company's strategy is to improve systems and bring them up to American Water's portfolio quality and scale while remaining committed to its communities. This is evidenced through community partner programs to encourage employee-driven philanthropic efforts, including its own charitable foundation and gift matching. The company partners with middle, high, vocational, and post-secondary educational institutions to foster skill building and training to promote the development of a potential future workforce. There is always an elevated risk to community opposition as American Water takeovers often involve privatization.

The company's scale has allowed it to provide water at affordable rates compared with peers. This is evident in the more than 211,000 new customer connections in its regulated business since 2015. Through acquisitions, American Water has improved the water quality of small systems while limiting bill increases, resulting in positive customer satisfaction. Additionally, they have shown consistent improvement on measures such as main breaks per mile and unplanned service disruptions, which are lower than industry average and improve service reliability.

Governance Profile

80/100

Sector/Region Score (31/35)

We base the governance profile region score on American Water's headquarters in the U.S., which we believe has relatively high governance standards characterized by a stable political system and strong rule of law.

Entity-Specific Score (49/65)

Note: Figures are subject to rounding.

Structure and oversight	Code and values	Transparency and reporting	Financial and operational risks	General factors
Strong	**Strong**	**Good**	**Neutral**	**None**

The core business revolves around environmental stewardship and sensitivities toward social responsibilities as an essential service provider. Along with these principles, ethical values and a codified commitment to diversity and inclusion and compensation expectations are embedded among the board and senior management. The company has demonstrated an ongoing commitment to these values by maintaining an overarching strategy committed to the regulated water and wastewater utility space. In addition to establishing company-wide expectations, American Water tracks confirmed code of conduct breaches and has procedures to take immediate corrective actions, as well as to establish cultural improvements to lessen the risk of repeat violations. The company's executive-to-nonexecutive pay gap indicates a more egalitarian culture, as its CEO-to-average-worker pay gap of about 58 times is much lower than that of other large U.S.-based corporations. The company implements best practices, and the core values and expectations of employees are well-aligned with environmental and social values.

American Water's governance structure and oversight is strong compared with global best-practice standards. Ten of the 11 board members are independent directors. The only nonindependent director is the CEO, who does not serve as the board's chairperson or on any board committees. There are many board committees tasked with identifying and mitigating business risks. The board's pay structure supports director motivation for the company to perform well, as about half of director compensation is share based. Furthermore, directors must hold five times their annual cash retainer in shares by the fifth anniversary of their service as a director if they wish to stay on the board. We believe that these requirements incentivize directors to act in the company's best interest. Members have diversified and relevant experiences and the requisite skillsets to support the resultant strategies. There has not been an unexpected board member departure in the past five years, and their engagement and attendance in committees demonstrate strong commitment from board members to their fiduciary duties.

We view American Water's transparency and its ongoing commitment to disclosure as comparable to industry peers regarding timeliness and quality. Water utilities are generally required to make annual environmental reports based on water quality. In addition, the company reports through the GRI, SASB and EEI frameworks and generally discloses more information on ESG efforts than its peers, although reporting is not currently annual.

Preparedness Opinion

Best in class
(+ 15)

Preparedness	Low	Emerging	Adequate	Strong	Best in class

American Water's near- and long-term strategy shows its focus on sustainability. Continuous spending on sustainability is inherent, as the company is expected to be an environmental steward. The company focuses its operations and spending on the safe and reliable maintenance and delivery of water to its customers. It aims to limit water loss within its system to minimize the use of a finite resource, and it dedicates much of its research and development (R&D) spending to study the impact that contaminants can have on its water supply and how it can adequately address current and emerging contaminants to advance its long-term strategy.

The company recognizes the potential risks to public health and safety and emerging contaminants and has become an industry leader in reducing exposure and turning risks into opportunities. The company has R&D and central laboratory divisions that are viewed favorably by other utilities and, in turn, conduct pilot testing and sample monitoring on behalf of other U.S. water utilities. They have continually implemented measures such as promoting water conservation and efficiency, improving leak detection and implementation of advanced metering infrastructure, revenue stabilizing mechanisms and decoupling, conservation surcharges, and building floodwalls in response to growing risks around the physical impacts of climate change.

Partnership with stakeholders suchs as governmental agencies, regulatory bodies and industry groups have fostered discussions and ways to address risks and opportunities. This has allowed American Water to promote water conservation and establish other environmental, health, safety, and water quality standards and regulations. These relationships further support American Water's efforts to acquire and invest in systems that face challenges in meeting regulatory standards or are in need of investment, thereby supporting company growth. The company's economies of scale also help it limit the need for rate increases, which further contributes to positive relationships with customers, communities, and regulators.

American Water has shown it can identify long-term material disruptions and opportunities. Utilities remain exposed to disruptions related to climate change, cyberrisks, changing demographics, and customer demand. However, American Water identifies risks both from bottom-up and top-down approaches, with the executive leadership team coordinating risk identification among business lines, support functions, and an internal audit team, to ensure expertise on a topic, as well as alignment with the broader long-term strategy.

The company has identified the physical impacts (such as flooding and drought) of climate change as a risk and has quantified the impact. American Water has reported how much it could be financially affected by climate-related risks in its CDP response. These risks include scarcity and flooding, and management continuously reviews the impact that these risks can have on operations through its enterprise risk-management processes.

Despite an effective culture geared toward sustainability, the company faces integration risk as it acquires new, often underperforming water systems. American Water has a commitment to employee safety and further investment in these systems. This culture is embedded throughout the board and executive management's risk mitigation and employee goals. There is also the risk of political pushback from privatization and community interaction during the transition period. Overall, there is an effort to discover, manage, and mitigate disruptions that could pose a threat to employees, customers, or the environment.

Climate-Related Financial Disclosure

TCFD Recommendations Alignment Assessment:	Not adopted	**Partially adopted**	Adopted

We assessed to what extent the entity has adopted the Financial Stability Board's Taskforce on Climate-related Financial Disclosures' (TCFD) recommendations. We do not opine on the quality of the entity's disclosure or the climate change scenario assumptions, if any, but rather comment on the number of disclosures made, based on the TCFD's suggested disclosure list.

Based on the entity's publicly available information, in our opinion American Water Works Co. Inc. has partially adopted the TCFD recommended disclosures.

The company has adopted the majority of TCFD recommendations however, while the board does monitor climate-related risks, there is no indication as to how these risks and policies are integrated by the board into the overall strategy nor how progress against climate-related targets and goals is tracked by the board. It is clear that this is currently the role of management.

Governance	Strategy	Risk management	Metrics and targets
Description of the board's oversight of climate-related risks and opportunities.	Description of the climate-related risks and opportunities identified over the short, medium, and long term.	Description of the organization's processes for identifying and assessing climate-related risks.	Disclosure of the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.
Partially adopted	**Adopted**	**Adopted**	**Adopted**
Description of management's role in assessing and managing climate-related risks and opportunities.	Description of the impact of climate-related risks and opportunities on the organization's businesses, strategy and financial planning.	Description of the organization's processes for managing climate-related risks.	Disclosure of scope 1, 2 and, if appropriate, 3 GHG emissions, and the related risks.
Adopted	**Adopted**	**Adopted**	**Adopted**
	Description of the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	Description of how processes for identifying, assessing and managing climate-related risks are integrated into the organization's overall risk management.	Description the targets used by the organization to manage climate-related risks and opportunities and performance against targets.
	Adopted	**Adopted**	**Adopted**

Sector And Region Risk

Primary sector(s)	Utility Networks
Primary operating region(s)	United States

Sector Risk Summary

Environmental exposure

The regulated utility network sector's exposure to environmental risks stems from its infrastructure assets and exposure to the environmental characteristics of entities across value chains. These networks are generally viewed as having high responsibility for ensuring clean water and air and helping to transition to a lower carbon economy. While electric, gas, and water networks each have unique environmental risk drivers, the most material environmental risks facing these subsectors are the physical effects of climate change and mitigation policies. Each subsector also faces some land-use risk; as they grow they risk encroaching on habitable or undeveloped lands that are more exposed to biodiversity issues in some parts of the world. Electric and gas utilities are exposed to significant energy transition risks, indirectly, through their upstream partners. These risks to networks are moderated, at least financially, by the regulatory support they enjoy and their ability to absorb costs through rate increases. However, less direct reputational effects can be significant given utilities' strong brand recognition. For electric transmission and distribution networks, the physical effects of climate change, including more frequent and severe wildfires, storms, hurricanes, and tornadoes, have the potential to disrupt the functioning of critical equipment and processes. Battery storage has its own set of environmental risks, stemming from mining and end-of-life disposals of materials used in battery units. For natural gas networks, we focus on gas explosions and leaks that emit highly potent greenhouse gases and may adversely affect local biodiversity, leading to costly penalties and reputational damage. For water networks, environmental risks are mainly water quality and availability, sometimes because of inefficient and aging infrastructure. Both water quality and availability--essential for this sector--can be impaired by climate-related factors, including droughts and floods.

Social exposure

The regulated utility network sector plays a crucial community role by providing essential services that must remain affordable and reliable to ensure conciliatory regulatory and customer relationships. This is the essence of utilities' social license to operate. However, as infrastructure ages, utilities must also ensure safety as leaks, explosions and fires can yield very material financial and reputational consequences. Water utilities may also face public health risks if they are unable to avoid drinking water contamination or stop wastewater from polluting supplies. Governments and regulators focusing increasingly on affordability, which we believe could create barriers to regulated networks' cost recovery. This is especially so in areas facing upward cost pressures from ongoing high investments in renewables and grid strengthening. Longer term, increased costs and improved solar and battery technology could result in some downstream residential, commercial, and industrial customers partially defecting from electric utilities. Utilities also face significant workforce issues. Amid an unrelenting energy transition, electric utilities, specifically, must develop employee bases with appropriate skills to operate the grid of the future, as well as retain employees. Given the sector's high unionization, companies have to focus on labor-relations management to avoid labor disruptions and related costs. Given that utilities are local in nature, they play a prominent role in communities and have large numbers of local employees. This can often result in regulatory support, but also carries a responsibility to contribute to the community and support low income customers, as well as tactfully mitigating disputes around land use as they expand. Finally, given the social responsibility of providing continuous electricity, gas, and water supply, preventing any risk that could lead to a power blackout or water shortage is an important consideration. Cyber-attacks are therefore increased threats for the sector, more so than in many other sectors.

Regional Risk Summary

United States

With robust institutions and rule-of-law standards, the U.S. demonstrates many strong characteristics but lags several other countries with respect to ESG regulations and social indicators. Income inequality is higher than in other OECD countries and has been so for over a century. Social services are similarly less generous than in most wealthy countries. Governance is characterized by a very stable political system, strong rule of law, a powerful judiciary, and effective checks and balances. Conditions of doing business are generally high. The U.S. follows a rules-based approach to corporate governance focused on mandatory compliance with requirements from the major exchanges (NYSE and NASDAQ) as well as legislation. State corporate law is also a key source of corporate governance, particularly Delaware where over half over all U.S. listed companies and close to 70% of Fortune 500 companies are incorporated. Exchanges mandate high standards of corporate governance. The NYSE requires companies listing on its exchange to have boards made up of a majority of independent directors and have separate remuneration and nomination committees. However, formal requirements on ESG reporting are not as established as they are in European countries. While a growing number of companies have an independent chair, the combination of CEO and chair roles is still popular. This can undermine management oversight. Remuneration continues to be a contentious point, because U.S. executive pay dwarves global pay levels. The CEO-to-worker pay ratio is ever-increasing, leading to social tensions and shareholder criticism.

Related Research

- "The ESG Risk Atlas: Sector And Regional Rationales And Scores," published July 22, 2020
- "Our Updated ESG Risk Atlas And Key Sustainability Factors: A Companion Guide," published July 22, 2020
- "Environmental, Social, And Governance Evaluation: Analytical Approach," published December 15, 2020
- "How We Apply Our ESG Evaluation Analytical Approach: Part 2," published June 17, 2020

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