

## American Water Works(AWK)

**\$130.09** (As of 06/02/20)

Price Target (6-12 Months): **\$137.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 08/25/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**3-Hold**

Zacks Style Scores:

VGM:D

Value: F

Growth: D

Momentum: B

### Summary

American Water Works is benefiting from its ongoing investment and capital expenditure planned over the next decade to strengthen its infrastructure that will enable it to provide efficient services to the expanding customer base. The company continues to expand its service territory through acquisitions and organic means. Amid the coronavirus pandemic, it decided to continue providing services despite non-payment of dues. Shares of American Water Works have outperformed the industry in the past 12 months. However, fluctuating weather conditions adversely impact demand for water and lowers profitability of the company. The company is also subject to stringent regulations and risk of accidents and contamination due to soiling of old pipelines.

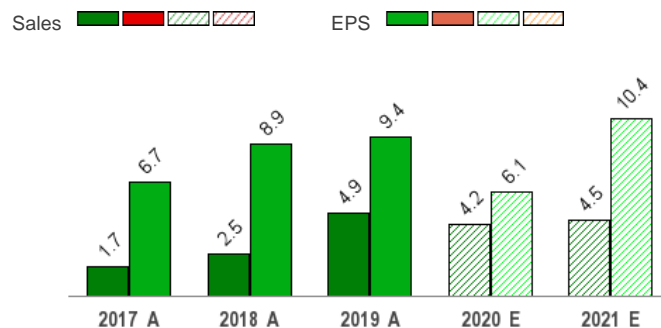
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	<b>\$141.70 - \$92.00</b>
20 Day Average Volume (sh)	<b>998,450</b>
Market Cap	<b>\$23.5 B</b>
YTD Price Change	<b>5.9%</b>
Beta	<b>0.22</b>
Dividend / Div Yld	<b>\$2.20 / 1.7%</b>
Industry	<b><u>Utility - Water Supply</u></b>
Zacks Industry Rank	<b>Top 31% (78 out of 253)</b>

### Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	<b>3.1%</b>
Last Sales Surprise	<b>0.4%</b>
EPS F1 Est- 4 week change	<b>0.1%</b>
Expected Report Date	<b>07/29/2020</b>
Earnings ESP	<b>-0.5%</b>

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	862 E	957 E	1,075 E	966 E	3,930 E
2020	844 A	924 E	1,041 E	930 E	3,760 E
2019	813 A	882 A	1,013 A	902 A	3,610 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.71 E	\$1.11 E	\$1.52 E	\$0.94 E	\$4.23 E
2020	\$0.67 A	\$0.95 E	\$1.37 E	\$0.83 E	\$3.83 E
2019	\$0.61 A	\$0.94 A	\$1.33 A	\$0.73 A	\$3.61 A

\*Quarterly figures may not add up to annual.

P/E TTM	<b>35.5</b>
P/E F1	<b>34.0</b>
PEG F1	<b>4.2</b>
P/S TTM	<b>6.5</b>

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/02/2020. The reports text is as of 06/03/2020.

## Overview

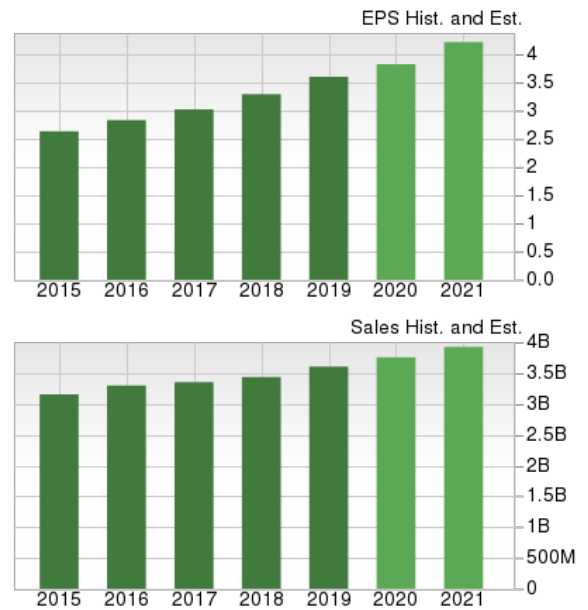
Water supply and wastewater service provider American Water Works Company was founded in 1886. The company provides essential water services to over 15 million customers in 47 states, the District of Columbia and Ontario, Canada. It has employee strength of 6,800. The company also intermittently acquires small water service providers to expand its customer base. In 2018, the company added 14,000 water and wastewater customers through acquisitions.

American Water Works Company primarily operates through the **Regulated Businesses** segment. The Regulated Businesses segment's operating revenues were \$3,094 million in 2019, \$2,984 million in 2018, and \$2,958 million in 2017, accounting for 86%, 87% and 88% of the company's total operating revenues, respectively.

The company also has **Market-Based Businesses**. Through this business, the company provides services to military bases, municipalities, exploration and production companies, commercial, industrial and residential customers that are not subject to economic regulation by state PUCs and do not require substantial infrastructure investment. Market-Based Businesses' operating revenues were \$539 million in 2019, \$476 million in 2018 and \$422 in 2017.

**Other** had a negative impact of \$23 million on 2019 revenues.

At the end of 2019, the company provided water and wastewater services to 3,205,000 and 229,000 customers, respectively.



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## Reasons To Buy:

- ▲ American Water Works has plans to invest \$8.8-\$9.4 billion in the 2020-2024 time period and \$20-\$22 billion in the next decade. American Water maintained five-year adjusted EPS compound annual growth rate of 7-10%. More than 85% of its net income is generated from regulated operations. Shares of American Water Works have gained 14.3% in the past 12 months compared with the Zacks Utility Water Supply industry's 5.3% growth.

Stable return from regulated investment allowed the company to increase its shareholders' value. The board of directors of the company raised its dividend rate by 10% on an annual basis for six consecutive years. Over the 2020-2024 period, American Water Works' dividend growth rate will be at the high end of the projected EPS growth rate of 7-10%, with a payout target within 50-60%, subject to approval of the board of directors.

Planned capital investment, expansion of customer base through organic and inorganic initiatives, and optimization of Market-Based Businesses will drive the company's long-term growth.

- ▲ The company continues to optimize market-based businesses. At the end of 2019, it provided services to 16 military bases under 50-year contracts. This is expected to contribute 1-2% to earnings growth from 2020 through 2024. The company's backlog of revenues associated with contracts with the U.S. government is nearly \$5.4 billion, with an average remaining contract term of 42 years. Its knowledge and expertise in providing services to the U.S. military installation could create opportunities for more military orders in the future.
- ▲ The company has been benefiting from rate increase since the beginning of 2019. The new water rates (effective Jan 1, 2020) will increase American Water Works' total revenues by \$53 million. It still has rate cases worth \$224 million pending in various jurisdictions, awaiting final order. The ongoing expansion of the rate base will have a positive impact on its earnings over the long term.

The company continues to improve operational efficiency. It has been successful in lowering O&M efficiency ratio through systematic cost savings and increase in revenues. Notably, O&M efficiency ratio is a company's regulated O&M expenses divided by operating revenues. It had lowered the O&M efficiency ratio from 46.1% in 2010 to 35.6% in 2018. For the past 12-month period ended Mar 31, 2020, the company's adjusted regulated O&M efficiency ratio improved to 34.5% from 35.5% in the comparable period of 2019. The improvement was primarily due to an increase in operating revenues and persistent focus on operating costs of the Regulated businesses. Efficient cost management will have a positive impact on the company's margins.

- ▲ The company is expanding the customer base through organic initiatives and acquisitions. In 2018 and 2019, the company added 25,000 and 67,000 new customers, respectively, in the regulated business through organic growth and acquisitions. Till May 6, it added 9,500 customers to the existing customer base, out of which 3,300 customers were added through the organic route. The company continues to make regular investments to strengthen existing operations.

Consolidation is the need of the hour in the fragmented U.S. water utility space and American Water Works continues to widen market footprint through strategic acquisitions. From 2015 to 2019, the company closed 83 deals and added 173,000 customers to the existing customer base. It added 53,100 customers to the existing customer base, as of Dec 31, through 21 acquisitions. As of May 6, 2020, the company added 6,200 new connections through acquisitions. The 26 pending acquisitions as of May 6, 2020 — on completion — are expected to add 45,800 customers to its customer base. The company remains customer friendly as it announced that its subsidiaries will continue providing potable water and wastewater services to customers despite non-payment of service dues amid the distress created by the coronavirus pandemic.

- ▲ Amid the unprecedented economic crisis, American Water Works has ample liquidity to meet debt obligations. As of Apr 30, 2020, the company had a total liquidity of \$2,802 million, which is enough to meet near-term obligations. Long-term debt at first quarter-end was \$8,712 million, down from \$8,733 million at the end of fourth-quarter 2019. Total debt to capital also improved to 58.4% at first quarter-end from 58.9% at the end of 2019.

The times interest earned ratio at first quarter-end was 3.2, unchanged sequentially, which indicates that the company has enough liquidity to meet debt obligations without any difficulty. At a time when every entity is looking forward to preserve liquidity amid uncertainty as a result of the outbreak of COVID-19, this stable times interest earned ratio is reassuring for investors.

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## Reasons To Sell:

- ▼ Additions and improvement in the existing water infrastructure require huge capital investments. A major portion of the existing water lines and mainline are nearing the end of their effective usage life. The company plans to invest billions of dollars over the long term to maintain the integrity of its systems. If the company fails to generate the desired returns due to the ongoing economic crisis, its margins could be hampered.
- ▼ The company envisions improving the quality of buried water pipelines to cost in excess of \$1 trillion in the next 25 years. Any disruption in the credit markets might make it difficult for the company to get the necessary or desired amount to fund capital improvements on favorable terms.
- ▼ Weather plays a significant role in the increase/decrease in demand of fresh water and wastewater services. Demand for water during the warmer months is generally higher than during cooler months due primarily to increased water usage for irrigation systems, swimming pools, cooling systems and other applications.
- ▼ The existing water system in the U.S. is getting older and is susceptible to fail at some point in time despite ongoing repairs and overhauls. The network of water and wastewater pipes and water reservoirs could result in losses and damages that may affect American Water Works' financial condition.

The risk of contamination of water supplied by the company is a concern and could lead to interruption of services provided to customers, and result in losses and damages that may affect its financial condition and reputation.

Fluctuating weather patterns, risk of failure of old and soiled pipelines, and possibility of contamination are persistent headwinds.

## Last Earnings Report

### American Water Beats on Q1 Earnings, Adds Customers

American Water Works Company posted first-quarter 2020 earnings of 67 cents per share, beating the Zacks Consensus Estimate of 65 cents by 3.1%. The bottom line also improved 9.8% year over year on the back of strong contributions from Regulated and Market-based businesses.

GAAP earnings came in at 68 cents compared with 62 cents per share in the year-ago quarter. The primary reason for the difference in GAAP and operating earnings in the reported quarter was a depreciation related to assets held for sale.

Quarter Ending **03/2020**

Report Date	May 06, 2020
Sales Surprise	0.35%
EPS Surprise	3.08%
Quarterly EPS	0.67
Annual EPS (TTM)	3.67

### Total Revenues

Total revenues of \$844 million beat the Zacks Consensus Estimate of \$841 million by 0.4% and improved 3.8% from the year-ago figure of \$813 million.

### Highlights of the Release

Total operating expenses in the quarter were \$605 million, up 5.2% from the year-ago period. The increase was due to higher operation and maintenance expenses.

Operating income was \$239 million, 0.4% higher than the year-ago figure. New water rates, which came into effect from January 2020, increased revenues by \$53 million from a year ago.

The company completed five acquisitions in four states till May 6, 2020, which added 6,200 customers to the customer base.

Interest expenses in the reported quarter totaled \$96 million compared with \$93 million in the prior-year period.

### Segment Details

Regulated businesses' net income was \$121 million compared with \$107 million in the year-ago quarter. Till May 6, 2020, this segment added 9,500 customers through acquisitions and organic growth. Acquisitions, organic growth and additional authorized revenues to support infrastructure investments boosted income.

The company expects to add an additional 45,800 customer connections through pending acquisitions.

Market-Based businesses' net income was \$22 million compared with \$20 million in the year-ago quarter.

### Financial Highlights

Cash and cash equivalents amounted to \$556 million as of Mar 31, 2020, up from \$60 million on Dec 31, 2019.

Long-term debt was \$8,625 million as of Mar 31, 2020, higher than \$8,644 million at 2019-end.

Cash flow from operating activities in first-quarter 2020 was \$180 million compared with \$168 million in the year-ago period.

### Guidance

American Water reaffirmed its guidance for 2020 earnings in the range \$3.79-\$3.89 and long-term EPS compound annual growth rate within 7-10%, anchored off of 2018 adjusted EPS.

The company has plans to invest \$20-\$22 billion of capital over the next 10 years. Subject to the approval of the board of directors, dividend growth for the 2020-2024 period is expected to be at the high end of the 7-10% range.

## Recent News

### American Water Arm to Replace Water Mains in Missouri - June 2, 2020

American Water Works announced that its subsidiary, Missouri American Water will replace two water mains, one in Ballwin and the other in St. Louis County, MO. Both the projects will replace the water main pipes installed in 1950s that have reached the end of their effective service life.

These water main replacement projects are part of Missouri American Water's projected \$92-million capital investment in water main replacements in St. Louis County in 2020. Year to date, the company has replaced more than 30 miles of water mains in the county. The upgrades and replacement of water mains will ensure service reliability, and prevent wastage and contamination of potable water.

### American Water Arm to Invest \$6M for Water Storage Upgrades - May 18, 2020

American Water Works Company announced that its unit, Pennsylvania American Water has unveiled plans to invest \$6.1 million in 2020 to rehabilitate seven water storage tanks in its service areas. This is part of Pennsylvania American Water's planned infrastructure investment of \$362 million in 2020.

Properly maintained water storage tanks ensure 24x7 supply of potable water to customers and provide fire protection to communities. Pennsylvania American Water has been active in maintaining storage tanks and has already invested more than \$34 million to maintain, rehabilitate, and construct the same. The company will continue to invest in the same as it has more than 250 water storage tanks to provide service to customers.

### American Water Arm Buys Village of Shiloh Wastewater System - May 16, 2020

American Water Works Company announced that its subsidiary, Illinois American Water has completed the acquisition of the Village of Shiloh Wastewater System for \$3.6 million. This acquisition will add 1515 wastewater customers to its existing customer base in the southern Illinois service area.

The buyout will also ensure that the Village Shiloh Wastewater system is provided with the much-needed investments. The company will work on improving both the Church and Archview lift stations.

## Valuation

American Water Works Company, shares are up 5.9% in the year to date period, and up 14.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Utility sector was down 6.6% and 10.7% in the year to date period, respectively. Over the past year, the Zacks sub-industry is up 5.3% and sector was down 15.6%.

The S&P 500 index is down 5.1% in the year to date period but up 9.1% in the past year.

The stock is currently trading at 32.53X of forward 12 months earnings, which compares to 18.81X for the Zacks sub-industry, 12.84X for the Zacks sector and 22.11X for the S&P 500 index.

Over the past five years, the stock has traded as high as 36.15X and as low as 17.97X, with a 5-year median of 25.62X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$137 price target reflects 34.33X of forward 12 months earnings.

The table below shows summary valuation data for AWK

Valuation Multiples -AWK					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	32.53	18.81	12.84	22.11
	5-Year High	36.15	25.47	15.32	22.11
	5-Year Low	17.97	16.9	11.4	15.23
	5-Year Median	25.62	19.1	13.79	17.49
P/S F12M	Current	6.15	7.43	2.75	3.44
	5-Year High	6.76	7.61	3.29	3.44
	5-Year Low	2.7	2.55	1.75	2.53
	5-Year Median	4.15	3.43	2.05	3.02
P/B TTM	Current	3.77	3.65	3.69	4.18
	5-Year High	4.16	4.06	4.13	4.56
	5-Year Low	1.73	1.97	2.01	2.83
	5-Year Median	2.72	2.96	2.61	3.66

As of 6/2/2020

## Industry Analysis Zacks Industry Rank: Top 31% (78 out of 253)



## Top Peers

Company (Ticker)	Rec	Rank
American States Water Company (AWR)	Outperform	1
Middlesex Water Company (MSEX)	Outperform	2
Artesian Resources Corporation (ARTNA)	Neutral	3
Consolidated Water Co. Ltd. (CWCO)	Neutral	3
California Water Service Group (CWT)	Neutral	3
Global Water Resources, Inc. (GWRS)	Neutral	3
SJW Group (SJW)	Neutral	4
The York Water Company (YORW)	Neutral	2

Industry Comparison Industry: Utility - Water Supply				Industry Peers		
	AWK	X Industry	S&P 500	AWR	MSEX	SJW
Zacks Recommendation (Long Term)	Neutral	-	-	Outperform	Outperform	Neutral
Zacks Rank (Short Term)	3	-	-	1	2	4
VGM Score	D	-	-	F	C	F
Market Cap	23.55 B	1.90 B	22.11 B	2.98 B	1.19 B	1.81 B
# of Analysts	6	2	14	2	3	3
Dividend Yield	1.69%	1.88%	1.93%	1.51%	1.50%	2.02%
Value Score	F	-	-	D	D	F
Cash/Price	0.03	0.05	0.06	0.00	0.01	0.02
EV/EBITDA	17.63	16.06	12.69	20.53	25.67	23.42
PEG Ratio	4.21	4.20	2.98	7.28	NA	2.17
Price/Book (P/B)	3.77	2.21	3.07	4.94	3.64	2.05
Price/Cash Flow (P/CF)	19.04	14.83	11.86	26.03	23.29	15.18
P/E (F1)	34.01	32.44	21.79	35.65	33.15	30.44
Price/Sales (P/S)	6.47	6.20	2.29	6.20	8.78	3.95
Earnings Yield	2.94%	3.08%	4.39%	2.81%	3.02%	3.29%
Debt/Equity	1.40	0.92	0.76	0.81	0.73	1.49
Cash Flow (\$/share)	6.83	1.90	7.01	3.11	2.93	4.19
Growth Score	D	-	-	F	B	F
Hist. EPS Growth (3-5 yrs)	8.04%	6.36%	10.87%	5.68%	13.99%	-1.22%
Proj. EPS Growth (F1/F0)	6.19%	3.69%	-10.74%	6.57%	2.49%	17.23%
Curr. Cash Flow Growth	8.43%	7.09%	5.48%	9.54%	6.31%	7.88%
Hist. Cash Flow Growth (3-5 yrs)	7.49%	5.42%	8.55%	2.18%	10.78%	5.46%
Current Ratio	0.65	0.70	1.29	0.96	0.50	0.54
Debt/Capital	58.26%	47.99%	44.75%	44.87%	42.18%	59.85%
Net Margin	17.36%	17.36%	10.59%	17.78%	25.78%	4.35%
Return on Equity	10.82%	7.89%	16.29%	13.44%	11.75%	4.67%
Sales/Assets	0.16	0.18	0.55	0.30	0.15	0.18
Proj. Sales Growth (F1/F0)	4.16%	2.63%	-2.67%	2.03%	4.12%	25.75%
Momentum Score	B	-	-	B	D	D
Daily Price Chg	1.82%	1.12%	0.99%	-0.30%	1.53%	1.26%
1 Week Price Chg	5.21%	5.15%	4.60%	3.01%	6.36%	5.08%
4 Week Price Chg	5.40%	5.88%	9.15%	3.80%	10.48%	9.07%
12 Week Price Chg	-5.53%	-6.62%	4.65%	-3.06%	4.93%	-3.90%
52 Week Price Chg	14.29%	4.37%	-0.30%	10.83%	15.94%	2.63%
20 Day Average Volume	998,450	113,892	2,486,038	232,147	61,386	151,356
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.14%	0.07%	-0.33%	1.79%	0.98%	-9.47%
(F1) EPS Est 12 week change	-0.12%	-5.51%	-16.13%	1.79%	0.98%	-10.25%
(Q1) EPS Est Mthly Chg	-2.06%	0.00%	-0.55%	0.00%	2.00%	-0.68%

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## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

### Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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### Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	F
Growth Score	D
Momentum Score	B
VGM Score	D

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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