

American Water Works(AWK)

\$123.74 (As of 01/13/20)

Price Target (6-12 Months): **\$131.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 08/23/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: D

Growth: C

Momentum: B

Summary

American Water Works is gaining from its regular infrastructure investment, acquisitions and organic growth. The company continues to add water and wastewater customers, and expand its service territory. Planned capital expenditure of \$20 to \$22 billion over the next ten years, in a bid to improve existing water and wastewater systems, will enable the company to provide efficient services to the expanding customer base. Further, improving operating efficiency will boost its margins. Shares of American Water Works have outperformed its industry in the past 24 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.

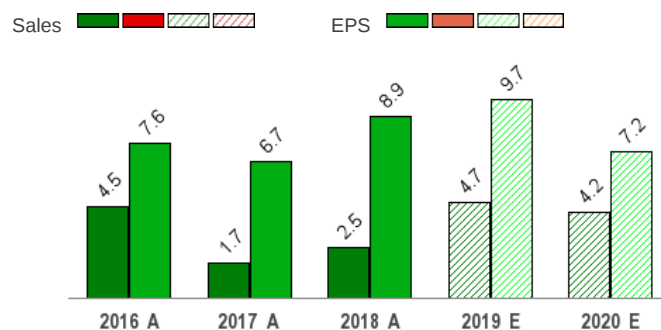
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$129.89 - \$90.33
20 Day Average Volume (sh)	829,842
Market Cap	\$22.4 B
YTD Price Change	0.7%
Beta	0.05
Dividend / Div Yld	\$2.00 / 1.6%
Industry	Utility - Water Supply
Zacks Industry Rank	Top 22% (56 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	3.1%
Last Sales Surprise	1.6%
EPS F1 Est- 4 week change	0.5%
Expected Report Date	02/18/2020
Earnings ESP	-2.1%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	834 E	923 E	1,029 E	929 E	3,752 E
2019	813 A	882 A	1,013 A	898 E	3,600 E
2018	761 A	853 A	976 A	850 A	3,440 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.66 E	\$1.06 E	\$1.37 E	\$0.85 E	\$3.88 E
2019	\$0.61 A	\$0.94 A	\$1.33 A	\$0.75 E	\$3.62 E
2018	\$0.59 A	\$0.83 A	\$1.20 A	\$0.69 A	\$3.30 A

*Quarterly figures may not add up to annual.

P/E TTM	34.7
P/E F1	31.9
PEG F1	4.0
P/S TTM	6.3

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/13/2020. The reports text is as of 01/14/2020.

Overview

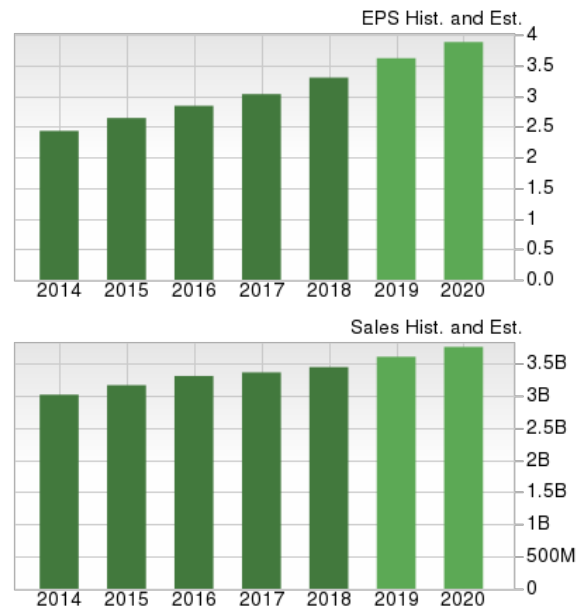
Water supply and wastewater service provider American Water Works Company was founded in 1886. The company provides essential water services to over 15 million customers in 47 states, the District of Columbia and Ontario, Canada. It has employee strength of 6,800. The company also intermittently acquires 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 **Regulated Businesses** segment. Regulated Businesses segment's operating revenues were \$2,984 million in 2018, \$2,958 million in 2017 and \$2,871 million in 2016, accounting for 87%, 88% and 87%, respectively, of the company's total operating revenues. During the second quarter of 2019, this segment contributed \$755 million to total revenues.

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 \$476 million in 2018, \$422 in 2017 and \$451 million in 2016. During the second quarter of 2019, this segment contributed \$132 million to total revenues.

Other had a negative impact of \$20 million on 2018 revenues.

At the end of 2018, the company provided water and wastewater services to 3,182,000 and 200,000 customers, respectively.



Reasons To Buy:

- ▲ American Water Works increased regulated infrastructure investment by \$800 million for the 2020-2024 capital plan and introduced a 10-year capital spending plan at a range of \$20-\$22 billion. American Water maintained five-year adjusted EPS compound annual growth rate of 7-10% from 2017 base. More than 85% of its net income is generated from regulated operations. Shares of American Water Works have gained 53.1% in the past 24 months compared with the Zacks Utility Water Supply industry's 45% rally.

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 next five years, 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.

- ▲ The company continues to optimize market-based businesses. At the end of the third quarter, it provided services to 16 military bases and expects awards from more military bases in 2019. The acquisition of Pivotal Home Solutions boosted this segment's performance.
- ▲ The company is benefiting from rate increase since the beginning of 2018. The new water rates (effective Jan 1, 2019) will increase American Water Works' total revenues by \$93 million. The company still has rate cases worth \$41 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 regulated operating revenues. It had lowered the O&M efficiency ratio from 46.1% in 2010 to 35.6% in 2018. In the nine-month period ended Oct 30, 2019, operating efficiency improved 60 basis points to 35% from 35.6% at the end of 2018. American Water Works aims to lower the same to 32% in 2022.
- ▲ The company is expanding its customer base through organic initiatives and acquisitions. In 2018, the company added 25,000 new customers in the regulated business through organic growth and acquisitions. Consolidation is the need of the hour in the fragmented U.S. water utility space. The old water utility infrastructure needs ample investments, which are easier for bigger players to make. From 2015 to Oct 30, 2019, the company closed 81 deals and added nearly 126,000 customers to the existing customer base.

American Water Works continues to widen market footprint through strategic acquisitions. The company added 46,900 customers to the existing customer base, as of Oct 30, through 19 acquisitions. The 24 pending acquisitions as of the same date, on completion, are expected to add nearly 26,400 customers to its customer base.

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.

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. The debt-to-capital ratio of the company is 58.28%, higher than the S&P 500's 42.99%. Interest expenses in the first nine months of 2019 were \$284 million, which rose 9.6% from the comparable year-ago period. Although the rate decline announced by Fed will bring some relief, servicing the existing debts will impact its margin and lower profitability.

Stringent regulations, fluctuating weather patterns, and risk of accident in old and soiled pipelines are persistent headwinds.

▼ 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 extreme cold temperatures could impact the water mains and disrupt smooth water operators. During second-quarter 2019, the company encountered wet weather conditions in its service territories, which largely affected demand. However, weather had no material impact on its third-quarter revenues as New Jersey American Water experienced at or below average precipitation, which offset Missouri's slightly above average precipitation.

▼ 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.

Last Earnings Report

American Water's Q3 Earnings Beat Estimates, View Up

American Water Works Company posted third-quarter 2019 earnings of \$1.33 per share, surpassing with the Zacks Consensus Estimate of \$1.29 by 3.1%. The bottom line also improved 10.8% year over year on the back of contributions from infrastructure investment, acquisitions and organic growth.

GAAP earnings came in at \$1.33 compared with \$1.04 in the year-ago quarter.

Quarter Ending 09/2019

Report Date	Oct 30, 2019
Sales Surprise	1.61%
EPS Surprise	3.10%
Quarterly EPS	1.33
Annual EPS (TTM)	3.57

Total Revenues

Total revenues of \$1,013 million beat the Zacks Consensus Estimate of \$997 million by 1.6% and improved 3.8% from the year-ago figure of \$976 million.

Highlights of the Release

Total operating expenses in the quarter were \$607 million, down 5.3% from the year-ago period. The decline was due to lower operation and maintenance expenses.

Operating income was \$406 million, 21.2% higher than the year-ago figure.

Interest expenses in the reported quarter totaled \$97 million compared with \$89 million in the prior-year period.

Segment Details

Regulated businesses' net income was \$236 million compared with \$213 million in the year-ago quarter. Year to date, this segment added 57,000 customers through acquisitions and organic growth. Notably, organic growth and additional authorized revenues to support infrastructure investments boosted income, despite the negative impact of wet weather conditions.

The company expects to add an additional 26,400 customer connections through pending acquisitions.

Market-Based businesses' net income was \$23 million against \$7 million loss in the year-ago quarter. This is attributable to its Homeowner Services Group's 2018 acquisition of Pivotal Home Solutions and Military Services Group's addition of two military contracts during the same year.

Financial Highlights

Cash and cash equivalents amounted to \$94 million as of Sep 30, 2019, down from \$130 million on Dec 31, 2018.

Long-term debt was \$8,640 million as of Sep 30, 2019, higher than \$7,576 million at 2018-end.

Cash flow from operating activities in the first nine months of 2019 was \$945 million compared with \$992 million in the comparable year-ago period.

Guidance

American Water Works has narrowed its 2019 earnings guidance in the range \$3.57-\$3.65 from \$3.54-\$3.64 per share.

For capital expenditures and acquisitions, the company plans to invest \$1.9 billion in 2019.

Recent News

American Water Arm to Buy Long Hill Township Sewer System - Jan 2,2020

American Water Works Company announced that its subsidiary, New Jersey American Water has signed an agreement to acquire Long Hill Township's wastewater systems for \$12.7 million. This acquisition will add 2,800 customers to its existing customer base in New Jersey.

Following approval from the New Jersey Board of Public Utilities, the acquisition is expected to close in the summer of 2020.

The company has been providing services to most of the customers of Long Hill Township's sewer systems. The decision to acquire the sewer system will ensure the continuation of high-quality services, without any immediate increase in sewer rates.

Per the agreement, American Water will invest more than \$13 million in the next five years to upgrade the old sewer lines of Long Hill Township. The company is freezing current sewer rates for residents for two years and increasing rates no more than 3% annually for three years after that.

Valuation

American Water Works Company, shares are up 6.7% in the last six months period, and up 35.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Utility sector was up 9.1% and 3.4% in the last six months period, respectively. Over the past year, the Zacks sub-industry and sector was up 32.6% and 2.8% respectively

The S&P 500 index is up 9.8% in the last six months period and 25% in the past year.

The stock is currently trading at 31.83X of forward 12 months earnings, which compares to 18.68X for the Zacks sub-industry, 13.5X for the Zacks sector and 19X for the S&P 500 index.

Over the past five years, the stock has traded as high as 34.06X and as low as 17.97X, with a 5-year median of 25.3X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$131 price target reflects 33.76X 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	31.83	18.68	13.5	19
	5-Year High	34.06	25.84	15.33	19.34
	5-Year Low	17.97	16.38	12.61	15.17
	5-Year Median	25.3	18.77	13.68	17.44
P/S F12M	Current	5.95	5.12	2.91	3.52
	5-Year High	6.34	7.46	3.26	3.52
	5-Year Low	2.7	2.86	1.7	2.54
	5-Year Median	4.05	3.43	1.95	3
P/B TTM	Current	3.61	3.85	4.06	4.49
	5-Year High	3.88	3.94	4.06	4.49
	5-Year Low	1.73	1.87	2.01	2.85
	5-Year Median	2.68	2.99	2.55	3.61

As of 1/13/2020

Industry Analysis Zacks Industry Rank: Top 22% (56 out of 254)



Top Peers

California Water Service Group (CWT)	Outperform
AquaVenture Holdings Ltd. (WAAS)	Outperform
American States Water Company (AWR)	Neutral
Consolidated Water Co. Ltd. (CWCO)	Neutral
Middlesex Water Company (MSEX)	Neutral
SJW Group (SJW)	Neutral
Aqua America, Inc. (WTR)	Neutral
The York Water Company (YORW)	Neutral

Industry Comparison Industry: Utility - Water Supply				Industry Peers		
	AWK Neutral	X Industry	S&P 500	AWR Neutral	MSEX Neutral	WTR Neutral
VGM Score	C	-	-	D	F	D
Market Cap	22.37 B	1.54 B	24.31 B	3.13 B	1.09 B	10.27 B
# of Analysts	6	2	13	1	2	2
Dividend Yield	1.62%	1.67%	1.76%	1.44%	1.64%	1.97%
Value Score	D	-	-	D	D	D
Cash/Price	0.01	0.07	0.04	0.00	0.00	0.20
EV/EBITDA	18.37	20.05	14.12	24.67	23.70	26.31
PEG Ratio	3.96	4.42	2.05	4.91	NA	4.89
Price/Book (P/B)	3.61	2.44	3.34	5.24	3.76	2.66
Price/Cash Flow (P/CF)	19.62	18.48	13.66	29.82	21.37	21.31
P/E (F1)	32.03	31.43	18.82	39.28	31.17	29.57
Price/Sales (P/S)	6.29	6.29	2.64	6.62	8.08	11.82
Earnings Yield	3.14%	3.17%	5.29%	2.55%	3.21%	3.38%
Debt/Equity	1.40	0.77	0.72	0.82	0.85	0.75
Cash Flow (\$/share)	6.31	1.94	6.94	2.84	2.93	2.23
Growth Score	C	-	-	D	F	D
Hist. EPS Growth (3-5 yrs)	7.80%	6.60%	10.56%	4.32%	13.44%	3.61%
Proj. EPS Growth (F1/F0)	7.28%	10.27%	7.49%	3.35%	2.81%	10.27%
Curr. Cash Flow Growth	10.24%	5.97%	14.83%	2.05%	27.71%	4.73%
Hist. Cash Flow Growth (3-5 yrs)	7.29%	7.01%	9.00%	0.17%	11.04%	3.86%
Current Ratio	0.54	1.04	1.23	1.11	0.34	6.19
Debt/Capital	58.28%	43.60%	42.99%	44.97%	45.73%	42.97%
Net Margin	17.85%	18.02%	11.08%	17.26%	24.23%	18.02%
Return on Equity	10.77%	9.36%	17.16%	13.23%	12.57%	8.81%
Sales/Assets	0.16	0.20	0.55	0.30	0.17	0.11
Proj. Sales Growth (F1/F0)	4.23%	4.38%	4.23%	0.63%	5.97%	127.87%
Momentum Score	B	-	-	C	D	B
Daily Price Chg	0.96%	1.05%	0.73%	0.96%	2.15%	1.67%
1 Week Price Chg	1.31%	-0.94%	0.39%	-2.87%	-1.46%	1.32%
4 Week Price Chg	2.35%	0.15%	1.84%	-1.84%	-1.69%	4.48%
12 Week Price Chg	1.18%	1.85%	6.48%	-10.20%	-3.78%	3.01%
52 Week Price Chg	36.83%	30.44%	23.15%	32.17%	17.23%	41.96%
20 Day Average Volume	829,842	78,451	1,578,594	246,176	68,184	1,006,728
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.48%	0.00%	0.00%	0.00%	0.00%	0.62%
(F1) EPS Est 12 week change	-0.62%	0.32%	-0.48%	-0.46%	0.50%	0.62%
(Q1) EPS Est Mthly Chg	4.76%	0.00%	0.00%	0.00%	0.00%	0.00%

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.

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	D
Growth Score	C
Momentum Score	B
VGM Score	C

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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