

American Water Works(AWK)

\$137.30 (As of 02/20/20)

Price Target (6-12 Months): **\$146.00**

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:D

Value: D

Growth: D

Momentum: D

Summary

American Water Works' fourth-quarter earnings match estimates, while revenues surpass the same. The company is gaining from systematic investment. Planned capital expenditure of \$20-\$22 billion over the next decade to strengthen its infrastructure 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. Further, improving operating efficiency will boost its margins. Shares of American Water Works have outperformed its 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, high debt, and risk of accidents and contamination due to soiling of old pipelines.

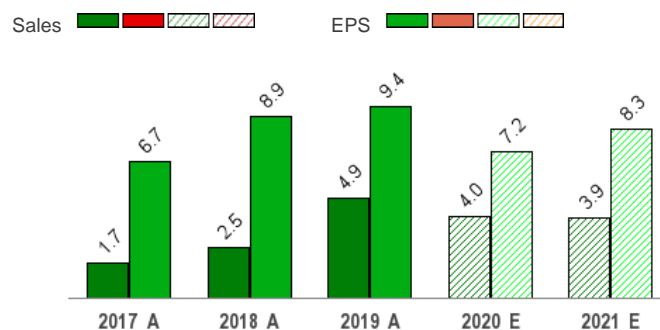
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$141.37 - \$100.00
20 Day Average Volume (sh)	953,406
Market Cap	\$24.8 B
YTD Price Change	11.8%
Beta	0.06
Dividend / Div Yld	\$2.00 / 1.5%
Industry	Utility - Water Supply
Zacks Industry Rank	Top 25% (65 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	0.0%
Last Sales Surprise	0.5%
EPS F1 Est- 4 week change	-1.1%
Expected Report Date	05/06/2020
Earnings ESP	-3.8%
P/E TTM	38.0
P/E F1	35.5
PEG F1	4.4
P/S TTM	6.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	868 E	961 E	1,073 E	968 E	3,899 E
2020	834 E	923 E	1,029 E	929 E	3,754 E
2019	813 A	882 A	1,013 A	902 A	3,610 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.70 E	\$1.12 E	\$1.49 E	\$0.95 E	\$4.19 E
2020	\$0.67 E	\$1.06 E	\$1.37 E	\$0.83 E	\$3.87 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.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/20/2020. The reports text is as of 02/21/2020.

Overview

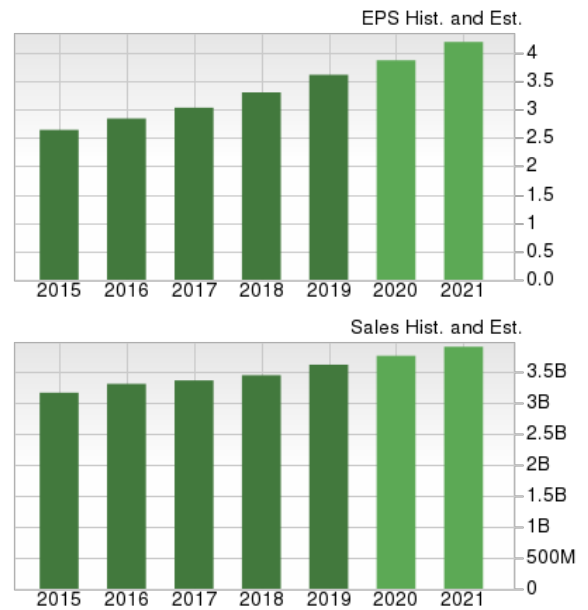
Water supply and wastewater service provider American Water Works Company was founded in 1886. The company provides essential water services to over 15 million customers in 47 states, the District of Columbia and Ontario, Canada. It has employee strength of 6,800. The company also intermittently acquires 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.



Reasons To Buy:

- ▲ American Water Works has plans to invest \$8.8-\$9.4 billion in the 2020-2024 time period and invest within \$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 35.9% in the past 12 months compared with the Zacks Utility Water Supply industry's 34.2% 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 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. 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 is 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 \$30 million. The company still has rate cases worth \$126 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. In 2019, operating efficiency improved 110 basis points to 34.5% from 2018 end levels. American Water Works aims to lower the same to 31.3% in 2024. 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. 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 2019, the company closed 83 deals and added nearly 173,000 customers to the existing customer base.

American Water Works continues to widen market footprint through strategic acquisitions. The company added 53,100 customers to the existing customer base, as of Dec 31, through 21 acquisitions. The 28 pending acquisitions as of Feb 19, 2020, on completion, are expected to add nearly 44,200 customers to its customer base.

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 42.37%. Interest expenses in 2019 were \$382 million, which rose 9.2% from the comparable year-ago period. Although the rate cut for the third time announced by Fed in 2019 will bring some relief, servicing the existing debts will impact its margin and lower profitability.
- ▼ 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.

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

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.

Last Earnings Report

American Water Q4 Earnings Match, Sales Beat Estimates

American Water Works Company posted fourth-quarter 2019 earnings of 73 cents per share, on par with the Zacks Consensus Estimate. The bottom line improved 5.8% year over year on the back of strong contributions from Regulated and Market-based businesses.

GAAP earnings came in at 54 cents compared with 62 cents in the year-ago quarter. The primary reason for the difference in GAAP and operating earnings in the reported quarter was a one-time loss on the sale of Keystone operations.

Quarter Ending **12/2019**

Report Date	Feb 18, 2020
Sales Surprise	0.46%
EPS Surprise	0.00%
Quarterly EPS	0.73
Annual EPS (TTM)	3.61

Total Revenues

Total revenues of \$902 million beat the Zacks Consensus Estimate of \$898 million by 0.5% and improved 6.1% from the year-ago figure of \$850 million.

Highlights of the Release

Total operating expenses in the quarter were \$678 million, up 12.6% from the year-ago period. The decline was due to higher operation and maintenance expenses.

Operating income was \$224 million, 9.7% lower than the year-ago figure.

Interest expenses in the reported quarter totaled \$98 million compared with \$91 million in the prior-year period.

Segment Details

Regulated businesses' net income was \$152 million compared with \$118 million in the year-ago quarter. In 2019, this segment added 53,100 customers through acquisitions. Notably, acquisitions, organic growth and additional authorized revenues to support infrastructure investments boosted income.

The company expects to add an additional 44,200 customer connections through pending acquisitions.

Market-Based businesses' net income was \$17 million compared with \$14 million in the year-ago quarter. This is attributable to organic growth at its Homeowner Services Group.

Financial Highlights

Cash and cash equivalents amounted to \$60 million as of Dec 31, 2019, down from \$130 million on Dec 31, 2018.

Long-term debt was \$8,639 million as of Dec 31, 2019, higher than \$7,576 million at 2018-end.

Cash flow from operating activities in 2019 was \$1,383 million compared with \$1,386 million in 2018.

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 capital over the next 10 years.

Recent News

American Water Arm Acquires Town of Glasgow Water System - Jan 30,2020

American Water Works Company announced that its subsidiary, West Virginia American Water has completed the acquisition of Town of Glasgow water system. This acquisition will add 300 customers to its existing customer base in West Virginia.

This acquisition will ensure that the aging water system of Town of Glasgow is provided with the much needed investments. American Water Works will assist in leak detection and system repairs of water systems of the utility, which has historically experienced water loss of nearly 66%.

Post-acquisition, the previous customer rate of \$30.35 per 3,000 gallons will increase to \$34.56. The rate will continue to increase annually until December 31, 2023, when customers will reach the company's standard rates as set by the Public Service Commission.

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 10.1% in the last six months period, and up 35.9% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Utility sector was up 11.7% and 10.9% in the last six months period, respectively. Over the past year, the Zacks sub-industry and sector was up 34.2% and 1.5% respectively

The S&P 500 index is up 16% in the last six months period and 20% in the past year.

The stock is currently trading at 34.96X of forward 12 months earnings, which compares to 20.25X for the Zacks sub-industry, 14.51X for the Zacks sector and 19.31X for the S&P 500 index.

Over the past five years, the stock has traded as high as 35.54X and as low as 17.97X, with a 5-year median of 25.4X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$146 price target reflects 36.98X 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	34.96	20.25	14.51	19.31
	5-Year High	35.54	25.84	15.36	19.34
	5-Year Low	17.97	16.38	12.58	15.18
	5-Year Median	25.4	18.92	13.84	17.47
P/S F12M	Current	6.58	9.29	3.09	3.56
	5-Year High	6.68	9.29	3.31	3.56
	5-Year Low	2.7	2.86	1.71	2.54
	5-Year Median	4.08	3.45	1.98	3
P/B TTM	Current	4.01	4.18	4.32	4.67
	5-Year High	4.07	4.25	4.35	4.68
	5-Year Low	1.73	1.87	2.02	2.85
	5-Year Median	2.68	3.01	2.58	3.62

As of 2/20/2020

Industry Analysis Zacks Industry Rank: Top 25% (65 out of 255)



Top Peers

AquaVenture Holdings Ltd. (WAAS)	Outperform
American States Water Company (AWR)	Neutral
Consolidated Water Co. Ltd. (CWCO)	Neutral
California Water Service Group (CWT)	Neutral
Global Water Resources, Inc. (GWRS)	Neutral
Middlesex Water Company (MSEX)	Neutral
SJW Group (SJW)	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	SJW Neutral
VGM Score	D	-	-	D	F	D
Market Cap	24.85 B	1.61 B	24.34 B	3.32 B	1.18 B	2.04 B
# of Analysts	6	2	13	1	3	2
Dividend Yield	1.46%	1.61%	1.78%	1.35%	1.52%	1.79%
Value Score	D	-	-	D	D	D
Cash/Price	0.00	0.07	0.04	0.00	0.00	0.20
EV/EBITDA	19.90	21.69	14.18	26.03	25.25	16.32
PEG Ratio	4.41	4.81	2.09	5.22	NA	7.71
Price/Book (P/B)	4.05	2.65	3.30	5.58	4.06	2.27
Price/Cash Flow (P/CF)	20.10	18.92	13.49	31.72	23.06	17.74
P/E (F1)	35.60	33.96	19.28	41.77	32.87	30.84
Price/Sales (P/S)	6.88	6.88	2.68	7.04	8.72	5.18
Earnings Yield	2.82%	2.92%	5.17%	2.39%	3.05%	3.24%
Debt/Equity	1.43	0.77	0.70	0.82	0.85	0.57
Cash Flow (\$/share)	6.83	1.94	7.03	2.84	2.93	4.03
Growth Score	D	-	-	D	F	D
Hist. EPS Growth (3-5 yrs)	7.80%	6.60%	10.84%	4.32%	13.44%	1.15%
Proj. EPS Growth (F1/F0)	7.06%	9.09%	7.09%	3.35%	3.52%	66.91%
Curr. Cash Flow Growth	8.43%	5.97%	6.72%	2.05%	27.71%	13.41%
Hist. Cash Flow Growth (3-5 yrs)	7.29%	7.01%	8.25%	0.17%	11.04%	13.36%
Current Ratio	0.63	1.04	1.22	1.11	0.34	3.52
Debt/Capital	58.79%	43.60%	42.37%	44.97%	45.73%	36.31%
Net Margin	17.20%	18.02%	11.56%	17.26%	24.23%	9.59%
Return on Equity	10.79%	9.00%	16.80%	13.23%	12.57%	5.27%
Sales/Assets	0.16	0.20	0.55	0.30	0.17	0.20
Proj. Sales Growth (F1/F0)	3.99%	3.99%	3.90%	0.63%	5.63%	27.06%
Momentum Score	D	-	-	C	B	B
Daily Price Chg	-1.01%	-0.17%	0.01%	-1.39%	-0.40%	-0.38%
1 Week Price Chg	3.62%	1.55%	1.65%	3.95%	1.63%	1.46%
4 Week Price Chg	1.49%	1.43%	0.36%	0.40%	1.36%	-4.11%
12 Week Price Chg	13.22%	9.98%	4.39%	5.61%	7.88%	1.56%
52 Week Price Chg	36.78%	34.17%	15.29%	28.17%	16.63%	16.82%
20 Day Average Volume	953,406	91,498	1,992,841	211,769	42,614	81,210
(F1) EPS Est 1 week change	-1.08%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-1.08%	0.00%	-0.02%	0.00%	2.32%	0.00%
(F1) EPS Est 12 week change	-2.09%	0.00%	-0.17%	0.00%	0.82%	0.00%
(Q1) EPS Est Mthly Chg	0.76%	0.00%	-0.48%	0.00%	0.00%	0.00%

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	D
Momentum Score	D
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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