

## American Water Works(AWK)

**\$140.90** (As of 08/26/20)

Price Target (6-12 Months): **\$148.00**

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: D

Growth: C

Momentum: D

### Summary

American Water Works' second-quarter earnings and revenues were better than expected. The company is benefiting from new rates, ongoing investments and planned capital expenditure 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. The company's ample current liquidity will enable it to meet near-term obligations. Shares of American Water Works have outperformed the industry in the past 12 months. However, fluctuating weather conditions, lower demand for water and the pandemic-led decline in demand will adversely impact profitability. Its operations are subject to stringent regulations, risk of accidents and contamination due to soiling of old pipelines.

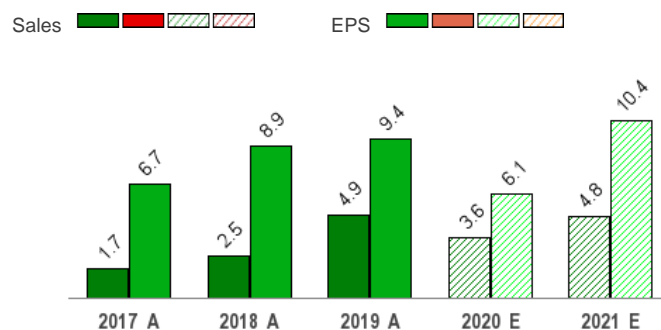
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	<b>\$150.47 - \$92.00</b>
20 Day Average Volume (sh)	<b>592,419</b>
Market Cap	<b>\$25.5 B</b>
YTD Price Change	<b>14.7%</b>
Beta	<b>0.24</b>
Dividend / Div Yld	<b>\$2.20 / 1.6%</b>
Industry	<b><u>Utility - Water Supply</u></b>
Zacks Industry Rank	<b>Bottom 30% (176 out of 252)</b>

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



Last EPS Surprise	<b>1.0%</b>
Last Sales Surprise	<b>1.5%</b>
EPS F1 Est- 4 week change	<b>-0.0%</b>
Expected Report Date	<b>11/04/2020</b>
Earnings ESP	<b>-1.1%</b>

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	865 E	965 E	1,079 E	966 E	3,920 E
2020	844 A	931 A	1,034 E	926 E	3,739 E
2019	813 A	882 A	1,013 A	902 A	3,610 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.72 E	\$1.08 E	\$1.51 E	\$0.95 E	\$4.23 E
2020	\$0.67 A	\$0.97 A	\$1.38 E	\$0.81 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>38.1</b>
P/E F1	<b>36.8</b>
PEG F1	<b>4.6</b>
P/S TTM	<b>6.9</b>

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/26/2020. The reports text is as of 08/27/2020.

## Overview

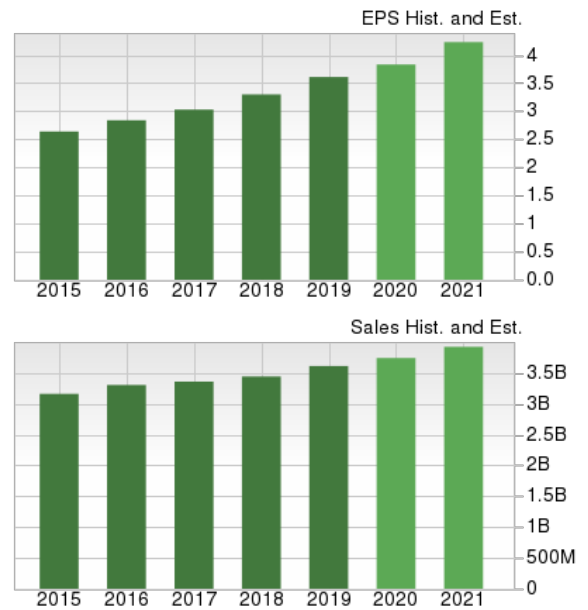
Water supply and wastewater service provider American Water Works Company was founded in 1886. The company provides essential water services to over 15 million customers in 47 states, the District of Columbia and Ontario, Canada. It has employee strength of 6,800. The company also intermittently acquires small water service providers to expand its customer base. In 2019, the company added 53,100 water and wastewater customer connections 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 the 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 12.6% in the past 12 months against the Zacks Utility Water Supply industry's 1.1% decline.

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. Remaining performance obligations associated with contracts with the U.S. government were nearly \$5.5 billion as of Jun 30, 2020, 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 also working on its Environment Social Responsibility and Governance principles, as well as aims to lower greenhouse gas emissions to 40% by 2025 from 2007 levels. The company was involved in more than 5,000 hours of community services in 2019.

- ▲ It has been benefiting from rate increase since the beginning of 2020. The new water rates (effective Jan 1, 2020) will increase American Water Works' total revenues by \$80 million. It still has rate cases worth \$294 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 from 46.1% in 2010 to 35.6% in 2018. For the past 12-month period ended Jun 30, 2020, the company's adjusted regulated O&M efficiency improved to 34.3% from 35.2% 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. It targets to lower O&M efficiency to 31.3% in 2024.

- ▲ 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 Jul 31, it added 17,700 customers to the existing customer base, out of which 6,900 customers were added through the organic route. The company continues to make regular investments to strengthen the 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. The 28 pending acquisitions as of Jul 3, 2020 — on completion — are expected to add 43,600 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 Jun 30, 2020, the company had a total liquidity of \$2,323 million, which is enough to meet near-term obligations. Long-term debt as of Jun 30, 2020 was \$9,589 million, up from \$8,733 million on Dec 31, 2019. Total debt to capital was 60.6% at second quarter-end, up from 58.9% at the end of 2019.

The times interest earned ratio at second 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 COVID-19 outbreak, 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.

Moreover, in this adverse economic condition caused by the COVID-19 outbreak, the loss of one or more large industrial or commercial customers could have a material adverse impact on the results of operations. In first six months of 2020, the company witnessed \$10 million decline in revenues, primarily due to lower demand from commercial and industrial customers.

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

- ▼ It envisions improving the quality of buried water pipelines and for that, the utilities need in excess of \$1 trillion to fund their systems in the next 25 years. Any disruption in capital markets and change in the company's credit ratings might make it difficult for American Water 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.

## Last Earnings Report

### American Water Q2 Earnings & Revenues Beat Estimates

American Water Works Company posted first-quarter 2020 earnings of 97 cents per share, which beat the Zacks Consensus Estimate by a penny.

The bottom line also improved 3.2% year over year on the back of strong contributions from Regulated and Market-based businesses. Second-quarter 2020 earnings figure reflects a 5 cents per share unfavorable impact due to the COVID-19 pandemic.

Quarter Ending **06/2020**

Report Date	Aug 05, 2020
Sales Surprise	1.54%
EPS Surprise	1.04%
Quarterly EPS	0.97
Annual EPS (TTM)	3.70

### Total Revenues

Total revenues of \$931 million beat the Zacks Consensus Estimate of \$917 million by 1.5% and improved 5.7% from the year-ago figure of \$882 million.

### Highlights of the Release

Total operating expenses for the quarter were \$618 million, up 6.6% from the year-ago period. The increase was due to higher operation and maintenance expenses.

Operating income was \$313 million, 3.6% higher than the year-ago figure. New water rates effective January 2020 increased revenues by \$80 million from a year ago.

Year to date, the company added 17,700 customers to the existing customer base through closed acquisitions and organic means. Its pending acquisitions, when completed, will add another 43,600 customers to the customer base.

For the 12 months period ended Jun 30, O&M efficiency improved to 34.3% from 35.2% in the year-ago period. The improvement was due to persistent focus on operating costs, and an increase in operating revenues for Regulated businesses.

Interest expenses for the reported quarter totaled \$101 million, up 7.5% from \$94 million in the prior-year period.

### Segment Details

**Regulated businesses'** net income was \$177 million compared with \$156 million in the year-ago quarter. Till Jul 31, 2020, this segment added 10,800 customers through 13 acquisitions in six states. Acquisitions, organic growth and additional authorized revenues to support infrastructure investments boosted income.

**Market-Based businesses'** net income was \$23 million compared with \$21 million in the year-ago quarter.

### Financial Highlights

Cash and cash equivalents amounted to \$569 million as of Jun 30, 2020, up from \$60 million on Dec 31, 2019.

Total long-term debt was \$9,593 million as of Jun 30, 2020, higher than \$8,644 million at 2019-end.

Cash flow from operating activities for first-half 2020 was \$531 million compared with \$480 million in the comparable year-ago period. For first-half 2020, capital expenditure of the company was \$870 million compared with \$712 million in the corresponding year-ago period.

### Guidance

American Water reaffirmed its guidance for 2020 earnings in the range \$3.79-\$3.89, taking into consideration a 6-cent impact of depreciation not recorded as required by assets held for sale accounting and an estimated 5-8 cents per share unfavorable impact from the COVID-19 pandemic.

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 Upgrades Wastewater System, Invests \$3.7M – Aug 12, 2020

American Water Works announced that its subsidiary, Illinois American Water has invested \$3.7 million in the past 12 months to upgrade and maintain the Alton Regional Wastewater System. Last June, Illinois American Water acquired this system and made a commitment to improve the quality of sewer services for customers.

A significant portion of the first-year investment included completion of the design phase for separating the combined sewer system in the Turner Tract, Piasa Valley and Shields Valley service areas. In addition, new sewer mains were installed, wastewater treatment plants were replaced and other necessary changes were made to provide quality services to clients.

### American Water Unit Gets \$5.1M Deal to Improve Sewer System – Jul 17, 2020

American Water Works announced that its unit Contract Services Group has received a \$5.1-million contract from the City of Camden to rehabilitate 28 combined sewer regulators. Through this sewer regulator project, American Water's unit will engage in replacing, repairing, chamber cleaning and coating, and jetting of the adjoining sewer.

Proper maintenance of the sewer system will significantly lower the possibility of flooding experienced throughout the City of Camden. The selection of American Water's unit for the sewer upgrade project is not surprising as the company has an expertise and knowledge of maintaining thousands of miles of water as well as wastewater pipelines that efficiently serves 15 million people across the United States.

### American Water Arm & Flo by Moen Unite to Stop Water Wastage – Jul 7, 2020

American Water Works announced that its unit, American Water Resources has entered into a partnership with Flo by Moen. The primary objective of the partnership is to offer its customers the all-in-one water leak detection system, Flo by Moen Smart Water Shutoff.

The Smart Water Shutoff is a tool that will assist customers to detect water leaks within their home's plumbing, avoid over usage that can result in unexpected increase in water bills and conserve freshwater resources that may be wasted due to undetected leaks.

## Valuation

American Water Works Company, shares are up 14.7% in the year to date period, and up 12.6% over the trailing 12-month period. Stocks in the Zacks sub-industry is down 5.9% but the Zacks Utility sector was down 15.1% in the year to date period. Over the past year, the Zacks sub-industry is down 1.1% and sector was down 10.7%.

The S&P 500 index is up 8.1% in the year to date period but up 20.9% in the past year.

The stock is currently trading at 34.42X of forward 12 months earnings, which compares to 17.2X for the Zacks sub-industry, 12.46X for the Zacks sector and 23.37X for the S&P 500 index.

Over the past five years, the stock has traded as high as 36.79X and as low as 18.62X, with a 5-year median of 25.77X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$148 price target reflects 36.18X 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	34.42	17.2	12.46	23.37
	5-Year High	36.79	25.47	15.28	23.37
	5-Year Low	18.62	16.94	11.3	15.25
	5-Year Median	25.77	19.05	13.72	17.58
P/S F12M	Current	6.62	7.4	2.64	3.81
	5-Year High	7.06	7.91	3.29	3.81
	5-Year Low	2.81	2.55	1.75	2.53
	5-Year Median	4.27	3.54	2.07	3.05
P/B TTM	Current	4.02	4.04	4.14	4.71
	5-Year High	4.28	4.4	4.29	4.71
	5-Year Low	1.82	1.97	2.01	2.83
	5-Year Median	2.75	3.01	2.64	3.76

As of 8/26/2020

## Industry Analysis Zacks Industry Rank: Bottom 30% (176 out of 252)



## Top Peers

Company (Ticker)	Rec	Rank
Artesian Resources Corporation (ARTNA)	Neutral	3
American States Water Company (AWR)	Neutral	2
Consolidated Water Co. Ltd. (CWCO)	Neutral	3
Global Water Resources, Inc. (GWRG)	Neutral	3
Middlesex Water Company (MSEX)	Neutral	3
SJW Group (SJW)	Neutral	3
The York Water Company (YORW)	Neutral	3
California Water Service Group (CWT)	Underperform	5

Industry Comparison Industry: Utility - Water Supply				Industry Peers		
	AWK	X Industry	S&P 500	AWR	MSEX	SJW
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	2	3	3
VGM Score	D	-	-	D	F	C
Market Cap	25.53 B	1.80 B	23.69 B	2.82 B	1.12 B	1.80 B
# of Analysts	6	2	14	2	3	3
Dividend Yield	1.56%	1.75%	1.65%	1.75%	1.60%	2.03%
Value Score	D	-	-	D	D	C
Cash/Price	0.02	0.04	0.07	0.00	0.01	0.01
EV/EBITDA	19.21	19.36	13.37	19.51	24.46	23.33
PEG Ratio	4.54	4.54	3.04	6.81	NA	2.25
Price/Book (P/B)	4.02	2.25	3.17	4.55	3.35	2.00
Price/Cash Flow (P/CF)	20.63	15.03	12.78	24.59	21.85	15.03
P/E (F1)	36.67	32.80	21.63	33.38	30.28	31.57
Price/Sales (P/S)	6.92	5.90	2.50	5.90	8.14	3.57
Earnings Yield	2.72%	3.05%	4.44%	3.00%	3.31%	3.16%
Debt/Equity	1.51	0.94	0.75	0.79	0.73	1.47
Cash Flow (\$/share)	6.83	1.95	6.94	3.11	2.93	4.19
Growth Score	C	-	-	D	F	C
Hist. EPS Growth (3-5 yrs)	8.11%	6.42%	10.41%	6.42%	14.16%	-1.43%
Proj. EPS Growth (F1/F0)	6.19%	6.03%	-4.92%	7.51%	5.31%	11.98%
Curr. Cash Flow Growth	8.43%	6.31%	5.22%	9.54%	6.31%	7.88%
Hist. Cash Flow Growth (3-5 yrs)	7.49%	5.46%	8.50%	2.18%	10.78%	5.46%
Current Ratio	0.90	0.83	1.34	0.86	0.52	0.56
Debt/Capital	60.22%	48.48%	44.18%	44.25%	42.03%	59.52%
Net Margin	17.29%	17.29%	10.25%	17.66%	26.57%	5.20%
Return on Equity	10.79%	8.83%	14.66%	13.51%	11.60%	5.01%
Sales/Assets	0.16	0.17	0.50	0.29	0.15	0.17
Proj. Sales Growth (F1/F0)	3.58%	3.54%	-1.45%	2.77%	3.49%	28.41%
Momentum Score	D	-	-	C	B	B
Daily Price Chg	-1.83%	-1.53%	-0.18%	-2.08%	-0.88%	-1.43%
1 Week Price Chg	-1.15%	-3.79%	-1.45%	-2.83%	-3.92%	-7.56%
4 Week Price Chg	-4.79%	-4.31%	2.10%	-4.31%	-4.85%	-3.54%
12 Week Price Chg	6.46%	-2.24%	3.61%	-6.20%	-8.10%	-3.01%
52 Week Price Chg	11.79%	-3.14%	3.61%	-16.38%	6.89%	-5.68%
20 Day Average Volume	592,419	87,056	1,883,291	259,856	34,159	87,056
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.04%	0.57%	0.93%	0.88%	1.44%	0.57%
(F1) EPS Est 12 week change	-0.12%	0.00%	3.41%	0.88%	1.44%	-2.13%
(Q1) EPS Est Mthly Chg	-0.36%	0.00%	0.00%	2.74%	0.00%	1.11%



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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	D
Growth Score	C
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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