



COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics

AWK - NYSE - as of	12/8/17	\$91.52
Price Target		\$110.00
52-Week Range	\$69.96 -	\$91.97
Shares Outstanding (mm)		178.38
Market Cap. (\$mm)		\$16,324.9
1-Mo. Average Daily Volume		821,308
Institutional Ownership		85.8%
LT Debt / Total Cap	Q3'17	54.8%
ROE	TTM	9.7%
Book Value / Share	Q3'17	\$30.83
Price / Book Value		3.0x
Dividend Yield		1.8%
EBITDA Margin	TTM	50.5%

EPS (Cont'd Ops) FY 12/31

	Prior 2016A	Current 2017E	Current 2017E	Prior 2018E	Current 2018E
1Q	\$0.46	--	\$0.52	A --	--
2Q	\$0.77	--	\$0.73	A --	--
3Q	\$1.05	--	\$1.08	A --	--
4Q	\$0.57	\$0.66	\$0.66	--	--
Year	\$2.85	\$3.00	\$3.00	\$3.37	\$3.34
P/E	32.1x		30.5x		27.4x

*Adjusted for Special Items

Revenue (\$MM)

	Prior 2016A	Current 2017E	Current 2017E	Prior 2018E	Current 2018E
1Q	\$743	--	\$756	A --	--
2Q	\$827	--	\$844	A --	--
3Q	\$930	--	\$936	A --	--
4Q	\$802	\$834	\$834	--	--
Year	\$3,302	\$3,370	\$3,370	\$3,572	\$3,569

Company Description: *Founded in 1886, American Water is the largest investor-owned U.S. water and wastewater utility company. With headquarters in Voorhees, NJ, the company employs more than 7,000 professionals who provide drinking water, wastewater and other related services to approximately 15 million people in more than 30 states.*

Water Utilities

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December 11, 2017

American Water Works Co.

AWK – NYSE – Long-term Buy-1

Soft Guide for 2018 Offset by Positive Tweaks to the 5-Year Plan; Reiterating Long-term Buy.

Investment Highlights

- AWK initiated 2018 EPS guidance in the range of \$3.22 to \$3.32 this morning, indicating yr/yr growth of 7.9% over reiterated 2017 adjusted EPS guidance for \$3.00 to \$3.06 (calculated at mid-points).
- EPS guidance for 2018 bracketed current consensus for \$3.30, but was somewhat disappointing versus our prior estimate for \$3.37. Our 2018E EPS shades a few cents lower; however, we still view the year-ahead guide as somewhat conservative with major rate cases still pending in NJ, CA and MO.
- AWK reiterated its 5-year expected EPS CAGR of 7% to 10%, moving its base year forward to 2016 (from 2015). Expected contribution from Market-based growth was lowered to 1% (from 2%), offset by greater contribution from regulated Cap Ex (now 5% to 7% per year from 4% to 6%). Substantially compelling this shift is a \$1.3B increase to the 5-yr capital budget, which suggests \$7.2B of organic spend.
- A positive surprise for us, AWK lowered its stretch target for Operations & Maintenance (O&M) efficiency by 50bps to 32.0% (attained by 2022). No new equity is expected under the current tax and regulatory framework with the current Cap Ex budget.
- M&A activity will continue to be lumpy and carry long lead times; however, management cited a deal pipeline of ~330k customers that is comparable to a year-ago tally of ~145k.
- We are reiterating our Long-term Buy-rating and price target of \$110; our timeframe shortens a bit (to 2 years) as we move to the close of 2017. Our target remains based on ~30x our 2019E EPS, which suggests AWK holds its current trailing valuation alongside earnings growth over the next couple of years. Any material adjustments to our fundamental outlook are positive.

Note Important Disclosures on Pages 5-6
Note Analyst Certification on Page 5

ADDITIONAL DISCUSSION—MULTIPLE ITEMS

Some near-term disappointment for us is more than offset by positive revisions that hold longer-lasting implications. We expected EPS guidance for the year-ahead to be a bit stronger (i.e. a mid-point closer to consensus at \$3.30); however, with the 5-year CAGR intact, any given year is of lesser importance. Furthermore, in our opinion, the stretch EPS goals were actually strengthened due to a growing contribution from same-system organic Cap Ex (where the company has the best ability to drive its own results), which in turn drives a positive shift in terminal earnings mix. We assumed AWK would again lower its O&M target at some point, but thought next December was the more likely timeframe.

AWK spent several minutes discussing implications of tax reform, but in our view, likely did not surprise many investors. Benefit from tax cuts will ultimately accrue to the ratepayer across utility subsidiaries, although this is not necessarily to the detriment of AWK or its investors as this scenario could afford the ability to deploy capital without needing to raise customer rates. AWK's market-based businesses benefit from a lower tax rate, but losses would widen at the parent (a cost center) on reduced tax shield value.

Most interesting for us in regard to taxes is that deferred assets and liabilities must be re-measured in the period that tax legislation is enacted. This could drive very large single-period adjustments across the utility sector (AWK included). Although we will make individual assessments as-needed, we will likely be inclined to take the other side of any overly bullish or bearish waves of sentiment driven by tax items.

SUITABILITY

We assign AWK a suitability rating of '1.' Recently added to the S&P 500 Index, we view American Water as a large-cap core holding in the Utility sector. We believe substantial regional diversification helps mitigate regulatory/environment/disaster risks, while exposing the firm to broad secular growth opportunities in water and wastewater infrastructure. Despite a relatively recent IPO (late-2000s), sector-appropriate leverage, long-tenured individual franchises and a predominantly regulated business mix keep AWK above our more aggressive '2' rating.

CONSIDERATIONS AND RISKS

We view all companies in the Water Utilities industry as being subject to significant regulatory and political risks. Utility operations are heavily regulated; negative rate-making climates and/or new environmental restrictions may affect the company's ability to earn a sufficient return on invested capital. Weather, natural disaster, and availability of water supplies could negatively impact sources of water, demand for water services, and a utility's ability to supply water to customers. Risks associated with the collection, treatment, and disposal of wastewater could also impose significant costs.

Continued growth in non-traditional water distribution, including the Keystone Clearwater purchase, could bring uncertainties associated with costs, liabilities, operational efficiencies and managerial expertise. Furthermore this could alter the market opinion toward fair valuation multiples and metrics.

Significant Cap Ex is required to maintain infrastructure and expand rate base. Should AWK lack the ability to secure funding, or if delays occur, results could be impacted. Water assets can be subject to condemnation through eminent domain. The company's non-regulated businesses provide guarantees and have long-term contracts. AWK is subject to all other risks that result from being a public company.

Our Suitability rating is 1 on a 1-to-4 scale (1 = most conservative, 4 = most aggressive).

Additional information is available upon request.

American Water Works Co.

Summary Balance Sheet (\$000's)	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17	Q4'17E	FY'17E	FY'18E	FY'19E
Cash	\$23,080	\$45,000	\$66,000	\$52,000	\$46,000	\$75,000	\$75,000	\$78,000	\$64,000	\$93,000	\$19,810	\$19,810	\$14,210	\$880
A/R	267,053	255,000	220,000	240,000	302,000	269,000	269,000	250,000	288,000	312,000	279,720	279,720	297,750	306,190
Unbilled Utility Rev	220,538	267,000	247,000	286,000	285,000	263,000	263,000	227,000	236,000	234,000	273,480	273,480	291,100	299,350
Other Current Assets	150,698	90,000	105,000	113,000	168,000	177,000	177,000	212,000	220,000	221,000	185,850	185,850	195,140	204,900
Total CAs	661,369	657,000	638,000	691,000	801,000	784,000	784,000	767,000	808,000	860,000	758,860	758,860	798,200	811,320
Net PP&E	13,029,296	13,933,000	14,098,000	14,317,000	14,559,000	14,992,000	14,992,000	15,128,000	15,391,000	15,681,000	16,026,250	16,026,250	16,908,810	17,762,460
Goodwill	1,208,043	1,302,000	1,313,000	1,313,000	1,313,000	1,345,000	1,345,000	1,345,000	1,373,000	1,373,000	1,447,500	1,447,500	1,472,500	1,497,500
Other LT Assets	1,232,248	1,349,000	1,368,000	1,385,000	1,298,000	1,361,000	1,361,000	1,370,000	1,394,000	1,447,000	1,497,100	1,497,100	1,646,810	1,811,490
Total Assets	\$16,130,956	\$17,241,000	\$17,417,000	\$17,706,000	\$17,971,000	\$18,482,000	\$18,482,000	\$18,610,000	\$18,966,000	\$19,361,000	\$19,729,710	\$19,729,710	\$20,826,320	\$21,882,770
ST Debt	449,959	628,000	839,000	950,000	951,000	849,000	849,000	980,000	1,117,000	103,000	878,000	878,000	1,148,000	1,343,000
CP of LTD	61,132	54,000	54,000	54,000	53,000	574,000	574,000	574,000	686,000	687,000	310,000	310,000	310,000	249,000
A/P	285,800	126,000	116,000	146,000	135,000	154,000	154,000	108,000	134,000	144,000	160,140	160,140	170,460	175,290
Other	444,107	725,000	605,000	590,000	789,000	815,000	815,000	756,000	724,000	813,000	855,750	855,750	898,540	943,470
Total CLs	1,240,998	1,533,000	1,614,000	1,740,000	1,928,000	2,392,000	2,392,000	2,418,000	2,661,000	1,747,000	2,203,890	2,203,890	2,527,000	2,710,760
LTD	5,448,245	5,874,000	5,850,000	5,861,000	5,853,000	5,759,000	5,759,000	5,744,000	5,659,000	6,681,000	6,534,000	6,534,000	6,534,000	6,595,000
Deferred Income Tax	2,120,739	2,310,000	2,358,000	2,430,000	2,524,000	2,596,000	2,596,000	2,629,000	2,723,000	2,862,000	2,921,000	2,921,000	3,244,000	3,567,000
Other	2,405,383	2,475,000	2,513,000	2,522,000	2,428,000	2,517,000	2,517,000	2,532,000	2,539,000	2,553,000	2,642,850	2,642,850	2,774,990	2,913,740
Common Shareholders' Equity	4,915,591	5,049,000	5,082,000	5,153,000	5,238,000	5,218,000	5,218,000	5,287,000	5,384,000	5,518,000	5,427,970	5,427,970	5,746,330	6,096,270
Total Liabilities & SE	\$16,130,956	\$17,241,000	\$17,417,000	\$17,706,000	\$17,971,000	\$18,482,000	\$18,482,000	\$18,610,000	\$18,966,000	\$19,361,000	\$19,729,710	\$19,729,710	\$20,826,320	\$21,882,770
Summary Cash Flow (\$000's)	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17	Q4'17E	FY'17E	FY'18E	FY'19E
Net Income	\$423,109	\$476,000	\$82,000	\$137,000	\$148,000	\$101,000	\$468,000	\$93,000	\$131,000	\$203,000	\$119,030	\$546,030	\$598,040	\$645,790
D&A	424,084	440,000	116,000	115,000	119,000	120,000	470,000	124,000	126,000	128,000	129,250	507,250	542,440	571,350
Deferred Tax	255,573	296,000	52,000	82,000	89,000	59,000	282,000	64,000	73,000	127,000	59,000	323,000	323,000	323,000
(Inc) / Dec in Wrk Cap	23,992	(52,618)	(90,000)	(52,000)	72,000	(109,000)	(179,000)	(85,000)	(61,000)	76,000	(13,160)	16,840	8,180	23,310
Operating CF	1,126,758	1,159,382	160,000	282,000	428,000	171,000	1,041,000	196,000	269,000	534,000	294,120	1,393,120	1,471,660	1,563,450
Cap Ex	(956,119)	(1,160,000)	(284,000)	(313,000)	(331,000)	(383,000)	(1,311,000)	(270,000)	(332,000)	(362,000)	(400,000)	(1,364,000)	(1,400,000)	(1,400,000)
Acquisitions	(8,935)	(197,000)	(22,000)	(2,000)	(5,000)	(175,000)	(204,000)	(2,000)	(7,000)	(1,000)	(149,000)	(159,000)	(50,000)	(50,000)
Asset/Securities Sales	13,841	5,000	(1,000)	3,000	3,000	4,000	9,000	-	4,000	5,000	-	9,000	-	-
Dividends	(216,354)	(239,000)	(61,000)	(66,000)	(67,000)	(67,000)	(261,000)	(67,000)	(74,000)	(74,000)	(74,310)	(289,310)	(316,270)	(341,780)
Free Cash Flow	(40,809)	(431,618)	(208,000)	(96,000)	28,000	(450,000)	(726,000)	(143,000)	(140,000)	102,000	(329,190)	(410,190)	(294,610)	(228,330)
Adv & Contribs for Construct	26,295	26,000	7,000	11,000	(2,000)	-	16,000	7,000	5,000	11,000	-	23,000	-	-
LTD Proceeds	500,497	565,000	-	2,000	-	551,000	553,000	-	20,000	1,362,000	-	1,382,000	290,000	-
LTD (Repaid)	(238,371)	(130,000)	(11,000)	(2,000)	(7,000)	(124,000)	(144,000)	(4,000)	(2,000)	(328,000)	(524,000)	(858,000)	(291,000)	-
ST Debt Drawn (Repaid)	(180,348)	180,000	211,000	110,000	1,000	(101,000)	221,000	131,000	137,000	(1,014,000)	775,000	29,000	270,000	195,000
Anti-Dilutive Repurch	-	(126,000)	(62,000)	(3,000)	-	-	(65,000)	(54,000)	-	-	-	-	-	-
Stock Issued	20,913	39,000	10,000	8,000	4,000	4,000	26,000	10,000	6,000	5,000	5,000	26,000	20,000	20,000
Net Cash Flow	88,177	122,382	(53,000)	30,000	24,000	(120,000)	(119,000)	(53,000)	26,000	138,000	(73,190)	191,810	(5,610)	(13,330)
EBITDA	1,424,732	1,512,000	329,000	412,000	433,000	366,000	1,540,000	351,000	432,000	551,000	402,160	1,736,160	1,857,580	1,956,930
EBITDA margin--period	47.3%	47.9%	44.3%	49.8%	46.6%	45.6%	46.6%	46.4%	51.2%	58.9%	48.2%	51.5%	52.1%	52.8%
EV / TTM EBITDA	10.5x	11.0x	11.8x	13.4x	12.6x	12.1x	12.1x	12.5x	12.4x	12.4x	13.2x	13.2x	12.3x	11.8x
Selected Financial Statistics	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17	Q4'17E	FY'17E	FY'18E	FY'19E
Book Value	\$ 27.29	\$ 28.05	\$ 28.39	\$ 28.95	\$ 29.43	\$ 29.31	\$ 29.31	\$ 29.54	\$ 30.08	\$ 30.83	\$ 30.31	\$ 30.31	\$ 32.05	\$ 33.96
Tangible BV	\$ 20.58	\$ 20.82	\$ 21.06	\$ 21.57	\$ 22.05	\$ 21.76	\$ 21.76	\$ 22.02	\$ 22.41	\$ 23.16	\$ 22.23	\$ 22.23	\$ 23.84	\$ 25.62
Price / Book	2.0x	2.1x	2.4x	2.9x	2.5x	2.5x	2.5x	2.6x	2.6x	2.6x	3.0x	3.0x	2.9x	2.7x
LT Debt / Total Capital	52.6%	53.8%	53.5%	53.2%	52.8%	52.5%	52.5%	52.1%	51.2%	54.8%	54.6%	54.6%	53.2%	52.0%
Net Total Debt / Total Capital	54.7%	56.3%	56.8%	56.9%	56.5%	57.7%	57.7%	57.7%	57.9%	57.2%	58.7%	58.7%	58.1%	57.3%
ROE (TTM)--Adj for Freedom Spill	8.7%	9.5%	9.4%	9.6%	9.8%	9.9%	9.9%	10.0%	9.0%	9.7%	10.0%	10.0%	10.6%	10.8%

Source: Company reports and Hilliard Lyons estimates

Analyst Certification

I, Spencer E. Joyce, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Suitability Ratings

- 1** - A large cap, core holding with a solid history
- 2** - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
- 3** - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
- 4** - Speculative, due to small size, inconsistent profitability, erratic revenues, volatility, low trading volume or a narrow customer or product base

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.

Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

Underperform - We believe the stock is vulnerable to a price setback in the next 12 months.



Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.		
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	31	28%	13%	87%
Hold/Neutral	74	66%	9%	91%
Sell	7	6%	0%	100%

As of 6 December 2017

Other Disclosures

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