



## COMPANY UPDATE / ESTIMATE CHANGE

### Key Metrics

AWK - NYSE - as of	11/1/17	\$87.21
Price Target		\$110.00
52-Week Range	\$69.41 -	\$88.20
Shares Outstanding (mm)		178.28
Market Cap. (\$mm)		\$15,548.0
1-Mo. Average Daily Volume		922,137
Institutional Ownership		84.3%
LT Debt / Total Cap	Q3'17	54.8%
ROE	TTM	9.7%
Book Value / Share	Q3'17	\$30.83
Price / Book Value		2.8x
Dividend Yield		1.9%
EBITDA Margin	TTM	50.5%

### EPS (Cont'd Ops) FY 12/31

		Prior	Current		Prior	Current
	2016A	2017E	2017E	A	2018E	2018E
1Q	\$0.46	--	\$0.52	A	--	--
2Q	\$0.77	--	\$0.73	A	--	--
3Q	\$1.05	--	\$1.08	A	--	--
4Q	\$0.57	\$0.61	\$0.66		--	--
Year	\$2.85	\$2.98	\$3.00		\$3.39	\$3.37
P/E	30.6x		29.1x			25.9x

\*Adjusted for Special Items

### Revenue (\$MM)

		Prior	Current		Prior	Current
	2016A	2017E	2017E	A	2018E	2018E
1Q	\$743	--	\$756	A	--	--
2Q	\$827	--	\$844	A	--	--
3Q	\$930	--	\$936	A	--	--
4Q	\$802	\$829	\$834		--	--
Year	\$3,302	\$3,413	\$3,370		\$3,614	\$3,572

**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

Analyst: Spencer E. Joyce, CFA  
502.588.8402 // sjoyce@hilliard.com  
Institutional Sales Desk: George Moorin  
502.588.9141 // gmoorin@hilliard.com  
J.J.B. Hilliard, W.L. Lyons, LLC  
November 2, 2017

## American Water Works Co.

AWK – NYSE – Long-term Buy-1

**Benign Q3'17 Supports Optimistic View to 2018/2019;  
Reiterating Long-term Buy Rating.**

### Investment Highlights

- AWK reported adjusted Q3'17 EPS of \$1.08 versus \$1.05 in Q2'17; results fell short of our target of \$1.12, but met consensus. Core improvement/growth at both the regulated and market-based segments aided Q3.
- GAAP EPS were \$1.13, which is inclusive of a \$0.07/share benefit from an insurance recovery related to the 2014 chemical spill in WV and a \$0.02/share charge from a debt extinguishment.
- Revenue grew fractionally in Q3, falling ~\$50MM short of both our target and consensus. Non-reg drove about 40% of our miss, although profits for the group still doubled; we should have better anticipated a tougher weather comp from Q3'16. Sewer sales grew 29%; Scranton Sewer should boost results through Q4.
- GAAP Operations & Maintenance (O&M) yr/yr is not meaningful due to special items; however, adjusted TTM regulated efficiency sits at 34.2%, down 30bps sequentially; the 2021 goal remains 32.5%.
- Closing activity was minimal in Q3, but AWK maintains that McKeesport (~22k sewer customers) should be added in Q4; our model assumes 12/1/17. Deals covering ~45k customer equivalents remain pending.
- A \$62MM net revenue award in PA is awaiting final approval from an administrative law judge; requests for \$129.3MM (NJ) and \$74.6MM (MO) dominate the current regulatory calendar at this juncture.
- Management narrowed 2017 adjusted EPS guidance to \$3.00-\$3.06. Our 2017 estimate rises to \$3.00; our 2018E/19E EPS move -\$0.02/-0.03 to \$3.37/\$3.63.
- We are reiterating our LTB rating and 2 to 3-yr price target of \$110, which is ~30x our 2019E EPS. AWK shares have traded at this valuation in the past, and we believe they are likely to again given fundamentals.

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

**ADDITIONAL DISCUSSION—MULTIPLE ITEMS**

During the third quarter, AWK completed the largest debt offering in its history as a public company, placing a total of \$1.35B as follows: \$600MM of 2025 Notes @ 2.95%, \$750MM of 2047 Notes @ 3.75%. Perhaps of interest, a couple of years ago the company placed similar 10 and 30-year obligations at 3.4% and 4.3%. Proceeds are being used to both re-finance existing long-term obligations, and term out existing short-term obligations. Interest savings will primarily accrue to ratepayers, although not exclusively; AWK elected to pre-pay several hundred million of LTD that was set to come due in 2018 and 2020.

We are increasingly of the opinion that operational strength in 2017 will be somewhat obfuscated by financial results. The military services group faced a tough comparison this year, although in light of AWK's recent 50-year \$490MM agreement to operate assets on Wright Patterson AF Base, we view the business line as quite healthy. As alluded to prior, weather for the regulated businesses is situated to be a yr/yr headwind to 2017 EPS of about \$0.04 (split between Q2/Q3), which is really only noteworthy with 2017 also marking somewhat of a lull in the regulatory calendar. Additive to that, two separate discrete tax items (included in adjusted results) in NY and IL shave \$0.04 from FY EPS, which should return next year.

We are pleased with the firmed guidance from AWK management, which effectively adds conviction to our 2018/2019 model years as we close out what should be a constructive base year from which to grow; we expect sentiment to remain constructive into AWK's 2018 guidance release on Monday, December 11.

**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	\$22,370	\$22,370	\$48,680	\$104,760
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	297,740	306,180
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	761,420	761,420	832,660	915,190
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	16,810,040	17,568,160
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	\$19,732,270	\$19,732,270	\$20,762,010	\$21,792,340
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	1,073,000	1,238,000
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	2,452,000	2,605,760
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	5,430,530	5,430,530	5,757,020	6,110,840
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	\$19,732,270	\$19,732,270	\$20,762,010	\$21,792,340
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	\$604,380	\$651,220
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	541,210	566,880
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	(10,600)	19,400	10,020	21,800
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	296,680	1,395,680	1,478,610	1,562,900
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)	(1,300,000)	(1,300,000)
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)	(316,290)	(341,820)
Free Cash Flow	(40,809)	(431,618)	(208,000)	(96,000)	28,000	(450,000)	(726,000)	(143,000)	(140,000)	102,000	(326,630)	(407,630)	(187,680)	(128,920)
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	195,000	165,000
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	(70,630)	194,370	26,320	56,080
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	1,863,000	1,960,370
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%	52.2%	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	12.7x	12.7x	11.9x	11.3x
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	\$ 30.33	\$ 30.33	\$ 32.11	\$ 34.04
Tangible BV	\$ 20.58	\$ 20.82	\$ 21.06	\$ 21.57	\$ 22.05	\$ 21.76	\$ 21.76	\$ 22.02	\$ 22.41	\$ 23.16	\$ 22.24	\$ 22.24	\$ 23.90	\$ 25.70
Price / Book	2.0x	2.1x	2.4x	2.9x	2.5x	2.5x	2.5x	2.6x	2.6x	2.6x	2.9x	2.9x	2.7x	2.6x
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%	51.9%
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%	58.6%	58.6%	57.7%	56.6%
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%	10.7%	10.9%

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	39	32%	8%	92%
Hold/Neutral	74	60%	9%	91%
Sell	8	7%	0%	100%
Restriction	2	2%	100%	0%

As of 5 October 2017

**Other Disclosures**

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