American Water Works Company, Inc. (AWK)

Updated November 4th, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	$169	**5 Year CAGR Estimate:**	5.0%	**Market Cap:**	$30.6 B
Fair Value Price:	$136	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	11/09/2021
% Fair Value:	124%	**5 Year Valuation Multiple Estimate:**	-4.2%	**Dividend Payment Date:**	12/01/2021
Dividend Yield:	1.4%	**5 Year Price Target**	$200	**Years Of Dividend Growth:**	13
Dividend Risk Score:	B	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	9.5%

Overview & Current Events

American Water Works is the largest and most geographically diverse, publicly traded water and wastewater utility company in the United States, as measured by both operating revenues and population served. The company provides drinking water, wastewater, and other related services to over 15 million people in 46 states. Its regulated business includes 53,000 miles of pipe, 609 water treatment plants, 150 wastewater facilities, 110 wells, and 75 dams. The company also provides water and related services to the U.S. government and U.S. military through 17 installations. American Water Works generates around $4 billion in annual revenues and based in Camden, New Jersey.

On November 2nd, 2021, American Water Works reported its Q3 results for the period ending September 30th, 2021. Revenues increased by 1.2% year-over-year, to $1.09 billion, with overall operations remaining rather stable. EPS grew by 4.8% to $1.53 amid a smaller provision for income taxes. The company has invested $1.2 billion in its infrastructure during year-to-date, adding approximately 7,450 customer connections through closed acquisitions and organic growth. The company now has general rate cases in progress in three jurisdictions and filed for infrastructure surcharges in two jurisdictions, reflecting a total annualized revenue request of approximately $77 million. Management affirmed its EPS guidance range of $4.18 to $4.28. We continue to expect FY2021 EPS of $4.25, slightly higher than the midpoint. Management also expects to pay DPS of $2.41 throughout the year, which we have embedded in our calculations. Amid great cash flow visibility, the company established an FY-2022 diluted EPS guidance in the range of $4.39 to $4.49.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$1.76	$2.03	$2.07	$2.36	$2.66	$2.63	$2.39	$3.15	$3.43	$3.92	***$4.25***	***$6.24***
DPS	$0.90	$0.96	$1.09	$1.21	$1.33	$1.47	$1.62	$1.78	$1.96	$2.15	***$2.41***	***$3.71***
Shares[1]	176	177	179	180	180	179	179	180	181	182	***182***	***190***

American Water Works has a highly stable and robust track record both in terms of its profitability and its dividend payments. The company enjoys an extremely resilient business model due to water being a necessity both for residential and industrial usage, as well as a mission-critical asset for the military. As a result, American Water has been able to grow its network and operations with limited risks. Over the next 5 years, the company expects to invest approximately $10.4 billion in renewing its infrastructure, achieving operational efficiencies through new technologies, ensuring water quality, and expanding its overall operations. Management now expects EPS to grow by approximately 7%-9% annually, powered by 5%-6% from regulated investment CAPEX, 1.5%-2.5% from regulated acquisitions, and ~1% market-based businesses. EPS growth includes rate base increases which the company estimates to grow by a CAGR of 8%-9% through 2031. We have utilized an EPS CAGR of 8.0% in our calculations, which is the mid-point AWK's narrowed guidance.

Due to the company's predictable cash flows, the dividend had grown annually, displaying at 5 and 10-year CAGR of 10.4% and 10.2%, respectively. We expect solid DPS increases moving forward, easily supported by the company's underlying profitability. We have set our expected growth rate at 9%, which the company can comfortably afford.

[1] Share count is in millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	15.9	16.7	19.3	20.3	19.2	28.5	32.2	27.3	33.8	32.7	***39.7***	***32.0***
Avg. Yld.	3.2%	2.8%	2.7%	2.5%	2.6%	2.0%	2.1%	2.1%	1.7%	1.7%	***1.4%***	***1.9%***

American Water Works' valuation has greatly expanded over the past decade. This has also been the case with all of the company's industry peers, who have also seen their multiples expand considerably. This is due to the market treating water stocks (along with their dividends) as ultra-safe investments amid their high operational predictability. Due to their payouts being some of the safest in the market, investors have been flocking to water stocks, whose yield declines have been mimicking the decline in the rate of T-bills very closely. With rates expected to remain quite low in the medium-term, we expect both the stock's yield and valuation to remain quite low and quite hefty, respectively. That being said, we forecast a potential valuation compression to a P/E of around 32, which in our view, reflects the company's qualities, while also making for a fairer earnings multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

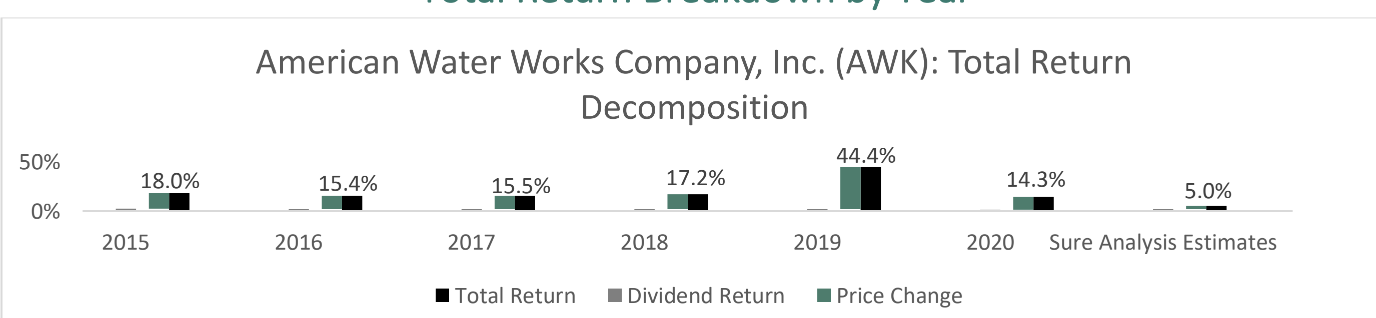
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	51%	47%	53%	51%	50%	56%	68%	57%	57%	55%	***57%***	***59%***

American Water's dividend can be viewed as extremely safe. The payout ratio is just over 55%, and the company has a very clear and predictable path towards growing its EPS. Its cash flows are of high quality due to water being an essential commodity, with much-anticipated consumption rates and robust pricing power. Additionally, the company enjoys a rock-solid competitive advantage, operating in an oligopolistic industry, which is also very capital intensive and hence almost forbids new market participants. The company is the biggest amongst its peers, while its relationship with the government also adds to its already great moat. We expect American Water to deliver resilient results even through a prolonged recession. The company is not meaningfully correlated to the underlying economy. Hence the excellent results during 2020, despite COVID-19.

Final Thoughts & Recommendation

American Water Works has managed to reward its investors with rich returns with great consistency. The stock, similar to its underlying results, should see little to no trading volatility. That being said, the company's secure business model and incredibly predictable cash flows and growth trajectory have caused the stock's valuation to expand significantly. Hence, current investors are subject to overpaying while also buying into a very thin yield, which translates to lower tangible returns. Combined with the possibility for a strong potential valuation headwind, we project annualized returns of around 5%. The stock could manage retain its premium, which would lead to higher returns. However, we remain prudent. Shares earn a hold rating. The stock displays a low-risk profile and solid growth prospects, nonetheless.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	2,666	2,854	2,879	3,011	3,159	3,302	3,357	3,440	3,610	3,777
Gross Profit	1,364	1,524	1,590	1,661	1,755	1,803	1,988	1,961	2,066	2,155
Gross Margin	51.2%	53.4%	55.2%	55.2%	55.6%	54.6%	59.2%	57.0%	57.2%	57.1%
D&A Exp.	352	382	407	424	440	470	492	545	582	604
Operating Profit	802	923	949	1,001	1,072	1,075	1,237	1,139	1,204	1,248
Operating Margin	30.1%	32.4%	33.0%	33.2%	33.9%	32.6%	36.8%	33.1%	33.4%	33.0%
Net Profit	310	358	369	423	476	468	426	567	621	709
Net Margin	11.6%	12.5%	12.8%	14.0%	15.1%	14.2%	12.7%	16.5%	17.2%	18.8%
Free Cash Flow	(170)	(30)	(149)	63	(72)	(106)	(61)	(287)	(375)	(502)
Income Tax	199	257	237	280	306	302	486	222	212	215

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	14,776	14,719	15,088	16,038	17,241	18,482	19,482	21,223	22,682	24,766
Cash & Equivalents	14	24	27	23	45	75	55	130	60	547
Accounts Receivable	181	195	208	232	255	269	272	301	294	321
Inventories	29	30	33	37	38	39	41	41	44	47
Goodwill & Int. Ass.	1,195	1,207	1,208	1,208	1,302	1,345	1,388	1,659	1,568	1,559
Total Liabilities	10,536	10,274	10,360	11,123	12,192	13,264	14,097	15,359	16,561	18,312
Accounts Payable	244	280	264	100	126	154	195	175	203	189
Long-Term Debt	5,884	5,576	5,857	5,938	6,544	7,172	7,717	8,604	9,453	10,940
Shareholder's Equity	4,236	4,443	4,728	4,915	5,049	5,218	5,385	5,864	6,121	6,454
D/E Ratio	1.39	1.25	1.24	1.21	1.30	1.37	1.43	1.47	1.54	1.70

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	2.1%	2.4%	2.5%	2.7%	2.9%	2.6%	2.2%	2.8%	2.8%	3.0%
Return on Equity	7.4%	8.3%	8.0%	8.8%	9.6%	9.1%	8.0%	10.1%	10.4%	11.3%
ROIC	3.1%	3.6%	3.6%	3.9%	4.2%	3.9%	3.3%	4.1%	4.1%	4.3%
Shares Out.	176	177	179	180	180	179	179	180	181	182
Revenue/Share	15.10	16.06	16.08	16.73	17.55	18.45	18.75	19.11	19.94	20.75
FCF/Share	(0.96)	(0.17)	(0.83)	0.35	(0.40)	(0.59)	(0.34)	(1.59)	(2.07)	(2.76)

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.