



# American Water Works Company, Inc. (AWK)

Updated April 27<sup>th</sup>, 2023 by Nikolaos Sismanis

## Key Metrics

|                             |       |                                            |       |                                  |            |
|-----------------------------|-------|--------------------------------------------|-------|----------------------------------|------------|
| <b>Current Price:</b>       | \$146 | <b>5 Year CAGR Estimate:</b>               | 6.4%  | <b>Market Cap:</b>               | \$28.5 B   |
| <b>Fair Value Price:</b>    | \$124 | <b>5 Year Growth Estimate:</b>             | 8.0%  | <b>Ex-Dividend Date:</b>         | 05/08/2023 |
| <b>% Fair Value:</b>        | 118%  | <b>5 Year Valuation Multiple Estimate:</b> | -3.3% | <b>Dividend Payment Date:</b>    | 06/01/2023 |
| <b>Dividend Yield:</b>      | 1.9%  | <b>5 Year Price Target</b>                 | \$182 | <b>Years Of Dividend Growth:</b> | 15         |
| <b>Dividend Risk Score:</b> | B     | <b>Retirement Suitability Score:</b>       | D     | <b>Rating:</b>                   | Hold       |

## 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 53,500 miles of pipe, 490 water treatment plants, 175 wastewater facilities, 1110 wells, and 73 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 \$3.8 billion in annual revenues and based in Camden, New Jersey.

On April 27<sup>th</sup>, 2023, American Water Works increased its dividend by 8% to a quarterly rate of \$0.7075.

On the same day, the company reported its Q1 results for the period ending March 31<sup>st</sup>, 2023. Revenues rose by 11.4% year-over-year to \$938 million. The increase was primarily a result of authorized revenue increases from completed general rate cases and infrastructure proceedings for the recovery of incremental capital and acquisition investments. EPS came in at \$0.91 compared to \$0.87 last year, driven by a 7.8% increase in net income as a result of higher revenues, partially offset by a higher share count.

The company invested \$538 million in its infrastructure during the quarter, adding 4,000 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 \$144 million. For FY2023, management still expects EPS to land between \$4.72 and \$4.82, the midpoint of which we have utilized in our estimates. They also affirmed the long-term EPS growth outlook of between 7% and 9%.

## Growth on a Per-Share Basis

| Year                      | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   | 2020   | 2021   | 2022   | 2023          | 2028          |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| <b>EPS</b>                | \$2.07 | \$2.36 | \$2.66 | \$2.63 | \$2.39 | \$3.15 | \$3.43 | \$3.91 | \$6.96 | \$4.51 | <b>\$4.77</b> | <b>\$7.01</b> |
| <b>DPS</b>                | \$1.09 | \$1.21 | \$1.33 | \$1.47 | \$1.62 | \$1.78 | \$1.96 | \$2.15 | \$2.36 | \$2.57 | <b>\$2.83</b> | <b>\$4.16</b> |
| <b>Shares<sup>1</sup></b> | 179    | 180    | 180    | 179    | 179    | 180    | 181    | 181    | 182    | 182    | <b>186</b>    | <b>195</b>    |

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 nine years, the company expects to invest approximately \$30 billion in renewing its infrastructure, achieving operational efficiencies through new technologies, ensuring water quality, and expanding its overall operations. Management continues to expect EPS to grow by approximately 7%-9% annually through 2027, powered by 5%-7% from regulated investment CAPEX, 1.5%-2.5% from regulated acquisitions, and <1% from military services. 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 of management's guidance. Due to the company's predictable cash flows, the dividend has grown

<sup>1</sup> Share count is in millions.

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annually, displaying at 5 and 10-year CAGR of 10.1% and 10.5%, respectively. Management intends to grow the dividend between a rate of 7% and 10% through 2027. We have set our expected growth rate at 8% through 2028.

## Valuation Analysis

| Year      | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | Now  | 2028 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E  | 19.3 | 20.3 | 19.2 | 28.5 | 32.2 | 27.3 | 33.8 | 32.7 | 24.4 | 34.4 | 30.7 | 26.0 |
| Avg. Yld. | 2.7% | 2.5% | 2.6% | 2.0% | 2.1% | 2.1% | 1.7% | 1.7% | 1.4% | 1.7% | 1.9% | 2.3% |

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 yields stand below those of government bonds even in a rising-rates environment. To be prudent, we forecast the stock's yield to increase and the valuation to contract modestly. Accordingly, we have set our medium-term fair P/E at humbler 26.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

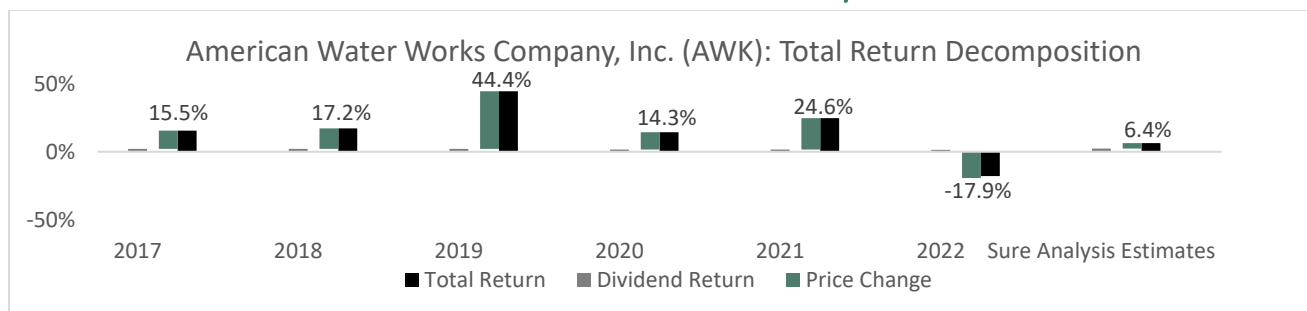
| Year   | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 53%  | 51%  | 50%  | 56%  | 68%  | 57%  | 57%  | 55%  | 34%  | 57%  | 59%  | 59%  |

American Water's dividend can be viewed as extremely safe. The payout ratio stands at 59%, 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 2020-2021 despite COVID-19.

## Final Thoughts & Recommendation

American Water Works comes with several attractive characteristics. That being said, the company's secure business model and incredibly predictable cash flows and growth trajectory have caused the stock's valuation to remain elevated. Hence, current investors are subject to overpaying while also buying into a relatively thin yield, which translates to softer tangible returns. Based on management's reaffirmed medium-term guidance and our valuation compression forecast, we estimate annualized returns of around 6.4% through 2028. Accordingly, we have assigned a hold rating to the stock. Nevertheless, we highlight that AWK offers one of the most predictable future total return-return profiles amongst dividend-paying stocks.

## Total Return Breakdown by Year



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## Income Statement Metrics

| Year             | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  | 2021  | 2022   |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|
| Revenue          | 2,879 | 3,011 | 3,159 | 3,302 | 3,357 | 3,440 | 3,610 | 3,777 | 3,930 | 3,792  |
| Gross Profit     | 1,590 | 1,661 | 1,755 | 1,803 | 1,988 | 1,961 | 2,066 | 2,155 | 2,153 | 2,203  |
| Gross Margin     | 55.2% | 55.2% | 55.6% | 54.6% | 59.2% | 57.0% | 57.2% | 57.1% | 54.8% | 58.1%  |
| D&A Exp.         | 407   | 424   | 440   | 470   | 492   | 545   | 582   | 604   | 636   | 649    |
| Operating Profit | 949   | 1,001 | 1,072 | 1,075 | 1,237 | 1,139 | 1,204 | 1,248 | 1,196 | 1,273  |
| Operating Margin | 33.0% | 33.2% | 33.9% | 32.6% | 36.8% | 33.1% | 33.4% | 33.0% | 30.4% | 33.6%  |
| Net Profit       | 369   | 423   | 476   | 468   | 426   | 567   | 621   | 709   | 1,263 | 820    |
| Net Margin       | 12.8% | 14.0% | 15.1% | 14.2% | 12.7% | 16.5% | 17.2% | 18.8% | 32.1% | 21.6   |
| Free Cash Flow   | (149) | 63    | (72)  | (106) | (61)  | (287) | (375) | (502) | (432) | (1312) |
| Income Tax       | 237   | 280   | 306   | 302   | 486   | 222   | 212   | 215   | 377   | 188    |

## Balance Sheet Metrics

| Year                 | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   | 2020   | 2021   | 2022   |
|----------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Total Assets         | 15,088 | 16,038 | 17,241 | 18,482 | 19,482 | 21,223 | 22,682 | 24,766 | 26,080 | 28     |
| Cash & Equivalents   | 27     | 23     | 45     | 75     | 55     | 130    | 60     | 547    | 116    | 85     |
| Accounts Receivable  | 208    | 232    | 255    | 269    | 272    | 301    | 294    | 321    | 271    | 334    |
| Inventories          | 33     | 37     | 38     | 39     | 41     | 41     | 44     | 47     | 57     | 98     |
| Goodwill & Int. Ass. | 1,208  | 1,208  | 1,302  | 1,345  | 1,388  | 1,659  | 1,568  | 1,559  | 1,139  | 1,143  |
| Total Liabilities    | 10,360 | 11,123 | 12,192 | 13,264 | 14,097 | 15,359 | 16,561 | 18,312 | 18,780 | 20,090 |
| Accounts Payable     | 264    | 100    | 126    | 154    | 195    | 175    | 203    | 189    | 235    | 254    |
| Long-Term Debt       | 5,857  | 5,938  | 6,544  | 7,172  | 7,717  | 8,604  | 9,453  | 10,940 | 10,980 | 12,380 |
| Shareholder's Equity | 4,728  | 4,915  | 5,049  | 5,218  | 5,385  | 5,864  | 6,121  | 6,454  | 7,298  | 7,693  |
| LTD/E Ratio          | 1.24   | 1.21   | 1.30   | 1.37   | 1.43   | 1.47   | 1.54   | 1.70   | 1.51   | 1.61   |

## Profitability & Per Share Metrics

| Year             | 2013   | 2014  | 2015   | 2016   | 2017   | 2018   | 2019   | 2020   | 2021   | 2022   |
|------------------|--------|-------|--------|--------|--------|--------|--------|--------|--------|--------|
| Return on Assets | 2.5%   | 2.7%  | 2.9%   | 2.6%   | 2.2%   | 2.8%   | 2.8%   | 3.0%   | 5.0%   | 3.0%   |
| Return on Equity | 8.0%   | 8.8%  | 9.6%   | 9.1%   | 8.0%   | 10.1%  | 10.4%  | 11.3%  | 18.4%  | 10.9%  |
| ROIC             | 3.6%   | 3.9%  | 4.2%   | 3.9%   | 3.3%   | 4.1%   | 4.1%   | 4.3%   | 7.1%   | 4.3%   |
| Shares Out.      | 179    | 180   | 180    | 179    | 179    | 180    | 181    | 182    | 182    | 182    |
| Revenue/Share    | 16.08  | 16.73 | 17.55  | 18.45  | 18.75  | 19.11  | 19.94  | 20.75  | 21.59  | 20.84  |
| FCF/Share        | (0.83) | 0.35  | (0.40) | (0.59) | (0.34) | (1.59) | (2.07) | (2.76) | (2.37) | (7.21) |

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

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