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American States Water Company NYSE:AWR

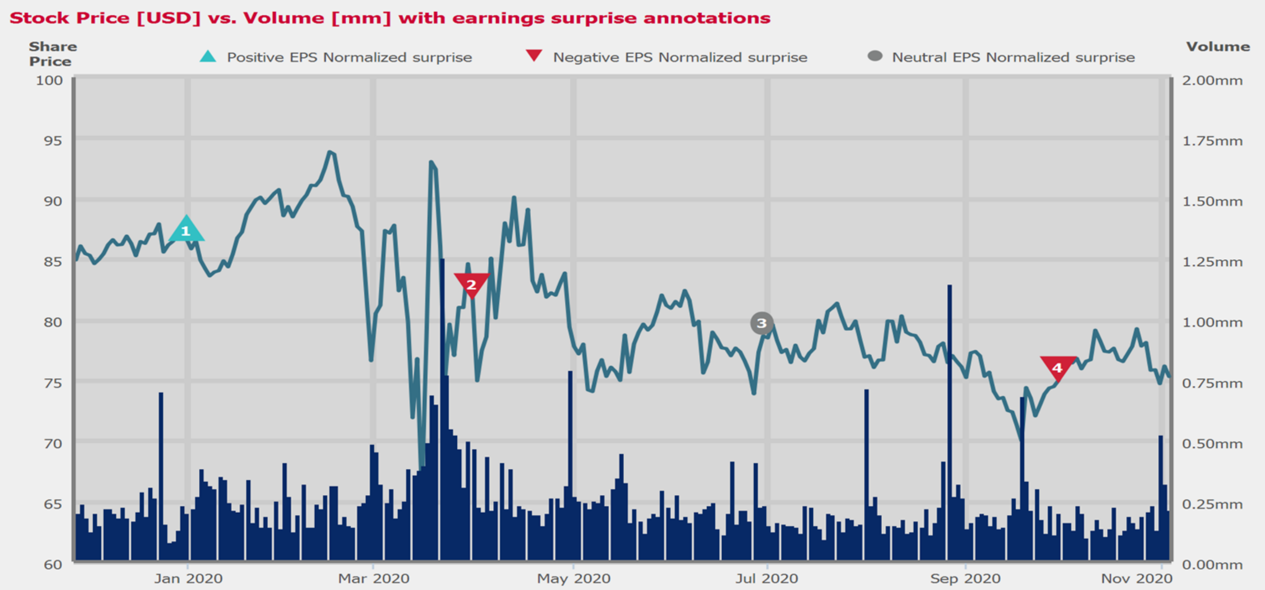
FQ3 2020 Earnings Call Transcripts

Tuesday, November 03, 2020 7:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2020-			-FQ4 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.75	0.72	(4.00 %)	0.46	2.29	NA
Revenue (mm)	152.09	133.69	(12.10 %)	94.06	483.41	NA

Currency: USD
Consensus as of Oct-15-2020 7:49 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2019	0.38	0.45	18.42 %
FQ1 2020	0.43	0.38	(11.63 %)
FQ2 2020	0.69	0.69	0.00 %
FQ3 2020	0.75	0.72	(4.00 %)

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Call Participants

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Robert J. Sprowls
CEO, President & Director

ANALYSTS

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Seaport Global Securities LLC, Research Division

Jonathan Garrett Reeder
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Ryan Michael Connors
Boenning and Scattergood, Inc., Research Division

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Presentation

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the American States Water Company conference call discussing the company's third quarter 2020 results. This call is being recorded. If you would like to listen to a replay of the call, it will begin this afternoon at approximately 5:00 p.m. Eastern Time and run through Tuesday, November 10, 2020, on the company's website, www.aswater.com.

The slides of the company will be referring to are also available on this website. [Operator Instructions] This call will be limited to 1 hour. Presenting today from American States Water Company is Bob Sprowls, President and Chief Executive Officer; and Eva Tang, Senior Vice President of Finance and Chief Financial Officer.

As a reminder, certain matters discussed during this conference call may be forward-looking statements intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. Please review a description of the company's risks and uncertainties in our most recent 10-K and Form 10-Q on file with the Securities and Exchange Commission.

In addition, this conference call will include discussion of certain measures that are not prepared in accordance with generally accepted accounting principles or GAAP in the United States and constitute non-GAAP financial measures under SEC rules. These non-GAAP financial measures are derived from consolidated financial information but are not presented in our financial statements that are prepared in accordance with GAAP.

For more details, please refer to the press release. At this time, I would like to turn the conference over to Bob Sprowls, President and Chief Executive Officer of American States Water Company.

Robert J. Sprowls
CEO, President & Director

Thank you, Keith. Welcome, everyone, and thank you for joining us today. I'll begin with a few highlights for the quarter, Eva will review some financial details, and then I'll wrap it up with some updates on regulatory activity, ASUS and dividends, and then we will take your questions.

I would like to start by thanking our employees. Through these uncertain times, the employees of American States Water once again delivered solid results. Our consolidated results for the third quarter were $0.72 per share as compared to adjusted earnings of $0.69 per share for the third quarter of 2019, an increase of $0.03 per share or 4.3%.

The adjusted earnings for the third quarter of 2019 exclude a $0.07 per share retroactive adjustment booked in that quarter for the August 2019 electric general rate case decision for periods prior to the third quarter of 2019. I'm pleased to report that in July of this year, the company's Board of Directors approved a 9.8% increase in the quarterly cash dividend from $0.305 per share to $0.335 per share. This increase is in addition to dividend increases of 10.9% in 2019 and 7.8% in 2018. Along with providing essential services and assistance to our customers and communities to get through the pandemic, we are working our way through some regulatory processes with the California Public Utilities Commission, or CPUC, which I'll discuss later on.

In addition, we continue to pursue new military-based contracts and our service levels remain high for all 3 of our subsidiaries. Now that we're going on month 8 of the COVID-19 pandemic, I wanted to reflect on the achievements of our personnel across the United States, both customer-facing and those who provide support in a remote working environment. Since March, our field personnel have worked tirelessly to keep the water, electricity and wastewater services operating smoothly for over 1 million customers, including 11 military bases.

They've embraced more stringent safety protocols as we look to keep our employees and customers healthy. While doing this, we've kept our commitments to strengthen our infrastructure for the short and long-term benefit of our customers. For the 9 months ended September 30, 2020, our water and electric utility segments spent $82.3 million in company-funded capital expenditures, on track to spend $105 million to $120 million for the year, barring any scheduling delays resulting from COVID-19.

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This would be about 3.5x our expected annual depreciation expense. While we hope for a return to normal sooner rather than later, I'm proud of the resiliency that our people have shown. I will now turn the call over to Eva to review the financial results for the quarter.

Eva G. Tang
Senior VP of Finance, CFO, Corporate Secretary & Treasurer

Thank you, Bob. And hello, everyone. Let me start with a more detailed look at our third quarter financial results on Slide 7.

As Bob mentioned, consolidated earnings for the quarter were $0.72 per share compared to $0.69 per share as adjusted for the same period in 2019. Earnings at our water segment increased $0.04 per share for the quarter. There continues to be volatility in the financial markets due at least in part to COVID-19 pandemics. This volatility resulted in an increase in gains on investments held to fund one of Golden State Water's retirement plan, contributing a $0.02 per share increase in the water segment's earnings for the quarter.

The remaining increase in the water segment's earnings for the third quarter of 2020 was due to a higher water gross margin from new water rates, partially offset by an increase in operating expenses, interest expense and the effective income tax rate as well as lower interest income earned on regulatory assets. Excluding the $0.07 per share retracted impact from August 2019 CPUC decision, our electric segment's earnings for the third quarter were $0.04 per share as compared to $0.03 per share as adjusted for the third quarter of 2019.

Largely due to an increase in the electric gross margin, resulting from new rates authorized by the CPUC, partially offset by increases in legal and other outside service costs. The final August 2019 decision also approved the recovery of previously incurred incremental tree treating costs totaling $302,000, which resulted in a reduction in maintenance expense that was recorded in the third quarter of last year. There was no equivalent item in 2020.

Earnings from our contracted services segment were $0.10 per share for the third quarter of 2020 as compared to $0.12 per share for the same period in 2019. There was an overall decrease in construction activity, resulting from weather delays and slowdowns in permitting for construction projects and government funding for new capital upgrades, caused in part by the impact of COVID-19. The company expect construction activity to pick up during the fourth quarter relative to the first 3 quarters, barring any further delays due to the weather conditions.

This decrease was partially offset by an increase in maintenance fee revenue and lower travel-related costs. While the revenues increased $3.5 million during the third quarter of 2020 due to full second -- full second year step increases for 2020 as a result of passing earnings tests. The decrease in electric revenues were largely due to $3.7 million in retroactive revenues recorded in the third quarter of 2019 for periods prior to that. Contracted services revenue for the quarter decreased $500,000 for reasons previously discussed.

The decrease was partially offset by increases in maintenance fees due to the successful resolution of various economic price adjustments.

Looking at Slide 9. Our water and electric supply costs were $32.3 million for the third quarter of 2020 as compared to $31.8 million for the third quarter of 2019. Any changes in the supply cost as compared to the adopted supply cost are tracked in balancing count for both the water and electric segments.

Total operating expenses, excluding supply costs, increased $1.5 million versus the third quarter of 2019. There was an increase in construction costs at our contracted services business, American States Utility Services, or ASUS, due to higher costs incurred on certain projects as well as increases in depreciation expense and property and other taxes, as a result of additions of utility plant and fixed assets at all of our business segments. There was also a $302,000 reduction to maintenance costs to reflect CPUC's approval in August of 2019 for recovery of previously incurred tree trimming cost, as previously mentioned. There was no similar reductions in 2020.

Interest expense, net of interest income and other, including investments held in a trust to fund the retirement benefit plan decreased $1.1 million due to higher gains because of the recent market conditions. This was partially offset by lower interest income on regulatory assets and lower interest income earned on certain U.S. construction projects.

Slide 10 shows the EPS Bridge comparing the third quarter of 2020 with the same quarter of 2019. The slides reflect our year-to-date earnings per share by segment. Fully diluted earnings for the first 9 months of 2020 were $1.79 per share

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as compared to $1.79 per share as adjusted for the same period of 2019. The 2019 adjusted earnings exclude a $0.04 per share retroactive impact, booked the last year resulting from the August 2019 electric GRC decision for the full year of 2018, which is shown on a separate line in the table on this slide. For more details, please refer to yesterday's press release and our Form 10-Q. In terms of the company's liquidity, net cash provided by operating activities for the first 9 months of 2020 was $87.8 million as compared to $84.3 million for the same period in 2019.

The increase was largely due to a $7.2 million refund to the water customers in 2019 related to the 2017 tax law changes, partially offset by a decrease in cash flow from higher accounts receivable from utility customers due to the economic impact of COVID-19 and the suspension of service disconnections of customers for nonpayment. Our regulated utilities invested $82.3 million in company-funded capital projects during the first 9 months of 2020.

The water utilities capital program has been somewhat affected by COVID-19, resulting in certain project delays. However, our regulated utilities still plan to spend $105 million to $120 million in company-funded capital expenditures for the year, barring further delays due to the pandemic. As we mentioned in the last quarter, Golden State Water issued unsecured private placement notes totaling $160 million in July. And repaid a large portion of its intercompany note issued to AWR parent.

Currently, American States Water has a credit facility of $200 million to support water and contracted services operations. We also put in place a separate 3-year $35 million revolving credit facility for the electric segment that is not guaranteed by the parent. At this time, we do not expect American States Water to issue additional equity.

With that, I'll turn the call back to Bob.

Robert J. Sprowls
CEO, President & Director

Thank you, Eva. I'd like to provide an update on our recent regulatory activity. In July, Golden State Water filed a general rate case application for all of its water regions and the general office. This general rate case will determine new water rates for the years 2022, 2023 and 2024. Among other things, Golden State Water requested capital budgets in this application of approximately $450.6 million for the 3-year rate cycle, and another $11.4 million of capital projects to be filed for revenue recovery through advice letters when those projects are completed.

A decision in the water general rate case is scheduled for the fourth quarter of 2021, with new rates to become effective January 1, 2022. On August 27, 2020, the CPUC issued a final decision in the first phase of the CPUC's order instituting rulemaking, evaluating the low-income rate-payer assistance and affordability objectives contained in the CPUC's 2010 water action plan, which also addressed other issues, including matters associated with the continued use of the water revenue adjustment mechanism or RAM by California water utilities.

The final decision also eliminates the modified supply-cost balancing account or MCBA, which is a full-cost balancing account used to track the difference between adopted and actual water supply costs, including the effects of changes in both rates and volume. Based on the language in the final decision, any general rate case application filed by Golden State Water and the other California water utilities after the August 27, 2020, effective data, the decision may not include a proposal to continue to the use of the RAM or MCBA, but may instead include a proposal to use a limited price adjustment mechanism, called the Monterey-Style RAM and an incremental supply cost balancing account.

This decision will not have any impact on Golden State Water's RAM or MCBA balances during the current rate cycle, which runs from 2019 through 2021. In addition, the language in the decision supports Golden State Water's position that it does not apply to its general rate case application filed in July of this year, which will set new rates for the years 2022 through 2024.

At this time, we cannot predict the potential impact of this decision, if any, on the pending water general rate case. On or prior to October 5, 2020, Golden State Water, 3 other California water utilities and the California Water Association filed separate applications for rehearing on the decision in the low-income proceeding. As you know, there are water utilities in the state that have been under the Monterey-Style RAM and incremental supply cost balancing account since 2008, and they seem to be able to successfully manage the effects of these mechanisms.

While we are disappointed by this PUC decision, we believe we are well positioned to strategize and adapt to the new requirements. As you'll see from this slide, the weighted average water rate base, as adopted by the CPUC, has grown from $717 million in 2017 to $916 million in 2020, which is a compound annual growth rate of 8.5%. The rate base

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amounts for 2020 do not include the $20.4 million of advice letter projects approved in Golden State Water's Class General Rate case.

Let's move on to ASUS on Slide 17. The ASUS' earnings contribution for the quarter was $0.10 per share versus $0.12 per share in the year prior. The decrease was mainly due to a reduction in construction activity due to weather delays as well as slowdowns in permitting for construction projects and in government funding for new capital upgrades that has occurred throughout 2020. Company expects construction activity to be stronger in the fourth quarter relative to the first 3 quarters, barring any further delays due to weather conditions.

But because of the previous delays, we now estimate ASUS' 2020 earnings contribution to be at the low end of the $0.46 to $0.50 per share range we have previously provided. In light of continued uncertainty associated with the effects of COVID-19, we project ASUS to contribute $0.45 to $0.49 per share for 2021. We are still involved in various stages of the proposal process at a number of military bases considering privatization of their water and wastewater systems.

The U.S. government is expected to release additional bases for bidding over the next several years. While we are disappointed that ASUS was not awarded with the most recent military-based water and wastewater privatization contract, we are confident that we will win a fair share of the future awards.

I would like to turn our attention to dividends outlined on Slide 18. We believe achieving strong and consistent financial results, along with providing a growing dividend allows the company to continue to attract capital to make necessary investments in the utility infrastructure for the communities and military bases that we serve and return value to our shareholders.

American States Water has paid dividends to shareholders every year since 1931, increasing the dividends received by shareholders each calendar year for 66 consecutive years, which places it in an exclusive group of companies on the New York Stock Exchange that have achieved that result. The company's current dividend policy is to achieve a compound annual growth rate and the dividend of more than 7% over the long term.

I'd like to conclude our prepared remarks by thanking you for your interest in American States Water.
I'll now turn the call over to the operator for questions.

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Question and Answer

Operator

[Operator Instructions] And the first question comes from Agnie Storozynski with Seaport Global.

Agnieszka Anna Storozynski
Seaport Global Securities LLC, Research Division

The first question about the military services business. So I understand the slowdown associated with COVID and permitting for this year. I'm a little bit surprised that you currently expect it to have a negative impact on '21 as well? Because I would have thought there's going to be like a catch-up of those projects which have -- which were delayed in 2020. So do you basically assume that COVID persists beyond the end of this year and has a negative impact and hence, that low guidance?

Robert J. Sprowls
CEO, President & Director

Yes. I mean, we do think it will continue past the end of this year and will continue to impact somewhat our ability to get new capital upgrades as well as permitting on effective permitting on our -- the jobs that we would like to do. Not fairly sure -- I mean, it's difficult to look into the crystal ball and see when this will all end. But we're not really back to normal yet.

Agnieszka Anna Storozynski
Seaport Global Securities LLC, Research Division

But does it mean that there will be a year like just some 2022 where you are -- where you have a disproportionate number of those upgrades. And so then the step-up in earnings would be above the trend for that business in 2022?

Robert J. Sprowls
CEO, President & Director

It's difficult to predict. It's possible. I mean, it's because we have a number of projects in front of the government to do on the basis we currently serve. And just the funding of these projects has slowed down a bit from what we've seen in the past years. Does that mean that in the future years, we'll make that up? It's possible, but we're kind of unchartered territory at this point. So it's hard to really predict.

Agnieszka Anna Storozynski
Seaport Global Securities LLC, Research Division

Great. And then on the change to the decoupling mechanism and the request for rehearing, so could you give us a sense when we will know if the commission will rehear the case and or a decision on the case? And then what are the other options if the commission denies those requests?

Robert J. Sprowls
CEO, President & Director

Yes. So I believe the commission has some flexibility in terms of deciding whether the decision needs to be reheard. So it's -- don't know if there's any hard and fast deadlines that they have to decide by. In terms of the second part of your question, the company has the company or companies, the water utility -- water utilities have the ability to take this issue directly to the California Supreme Court. Currently, in the legislation, we are -- we do not have the ability to go to the appellate court on this. But we do have the ability to go to the California Supreme Court, the California Supreme Court has to first decide whether they're willing to hear the case.

Agnieszka Anna Storozynski
Seaport Global Securities LLC, Research Division

Okay. And you are, in a sense, hedging on potential changes to the full RAM in your current pending rate case because you're being conservative? Or is it because you have heard something from the commission that might suggest that they would enact those changes earlier than the decision would require, meaning the decision would suggest that on the cases

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following the -- I think the August 2020, the filing after August 2020 would be impacted by that RAM change. But I'm just wondering why you're being so cautious about the potential impact on your pending rate case?

Robert J. Sprowls
CEO, President & Director

Well, Angie, we're pretty conservative around here. So that -- this is really just -- we're just being cautious. The -- in the proposed decision in the low-income proceeding, public advocates put forth comments suggesting that it should apply to our rate case. In their protest of our rate case filing, they did put forth comments that it should apply to the rate case. But I will tell you that their comments on the proposed decision, I think the language in the final decision was actually clear that it doesn't apply than it was in the proposed decision. So that was an improvement.

At this point, we don't have anything further than that to sort of base our caution on. We understand that California Water received a proposed decision that said that the ruling and the low-income decision did not apply to their rate case. So that's a good fact. Another good fact is we have not had a pre-hearing conference yet in the rate case. It would be quite difficult for our company to have to pull our rate case filing and refile it, we've already noticed our customers on the proposed rate increase. So there's a number of things that are stacking up in favor of it not applying to the 2022 through 2024 rate case. But we -- there is still a chance. And so we want to make sure that the folks that we speak to know that.

Operator

And the next question comes from Ryan Corners with Boenning and Scattergood.

Ryan Michael Connors
Boenning and Scattergood, Inc., Research Division

So at risk of beating the dead horse here, obviously, it's a hot topic with the decoupling. But wanted to get your take on the other side of this, which is cost of capital and ROE. I mean, obviously, the ORA has strenuously argued over the years that decoupling reduces risk, and that's why they argue for a lower ROE, seems based on the ROEs that they have successfully argued that. You kind of more or less affirm that concept when you say you think your earnings will be more volatile going forward. So how do you see this all impacting the cost of capital side going forward?

Robert J. Sprowls
CEO, President & Director

Well, I think -- I think we and maybe the other RAM companies will make an argument for the fact that it perhaps increases the risk of utility in future cost of capital proceedings. Now for us, just to sort of line up the periods a little bit here, we are -- we and the 3 other large water utilities in California are required to file our next cost of capital in -- on May 1, 2021. And that's for the -- that is typically for the period 2022 through 2024, given that it's impacting year cost of capital. We don't think that the elimination of the RAM applies to our 2022 through 2024 rate cycle.

So it makes it a little difficult for us to then use it in the cost of capital proceedings. Because it really -- the period doesn't fit. However, I'm sure that others will think about and we'll think about it as well in terms of it being something that we perhaps could argue in the cost of capital perceived.

Ryan Michael Connors
Boenning and Scattergood, Inc., Research Division

Okay. Okay. Well, I mean, I think you could maybe educate them that we and others are going to value your stock-based on the long term. Volatility profile of the earnings. So it actually is relevant to the day it takes hold, right? But anyway, the other question I had was, you noted that the peer companies that do use the Monterey-Style RAM have adapted pretty well to that, so it can be done. And so my question is, even if there's a chance that you could enhance your negotiating position on the cost of capital side, why would you not welcome the elimination of decoupling, if in fact, you do believe, as you said, that ultimately, Monterey is workable. And especially, why would you choose to -- you're talking about California's Supreme Court.

I mean these are some pretty nuclear options in terms of spending political capital, taking it that far. Why would you want to do that if, in fact, you think the system is workable and do get a little bump on the ROE?

Robert J. Sprowls
CEO, President & Director

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Well, first of all, I didn't say we were going to take it to the California Supreme Court. It is an option. We'd have to think through that depending upon how the commission decides. I think for us, we're just used to the full RAM at this point. The Monterey RAM, like we said, other companies have done well with that. And we'll -- we're just a bit unfamiliar, but we have plenty of years to get our arms around it. And I'm sure we'll do as well with it as we have with the full RAM, there potentially could be a little more volatility is what we're saying.

Operator

[Operator Instructions] And the next question comes from Jonathan Reeder with Wells Fargo.

Jonathan Garrett Reeder
Wells Fargo Securities, LLC, Research Division

We got a little summer weather.

Eva G. Tang
Senior VP of Finance, CFO, Corporate Secretary & Treasurer

Good presentation at the CWA though.

Jonathan Garrett Reeder
Wells Fargo Securities, LLC, Research Division

That was a curveball thrown in there and stuck out some time. So having gotten the chance to dig as deep in your earnings as I want. So I got 2 softballs for you, you'll like that.

Robert J. Sprowls
CEO, President & Director

That's true.

Eva G. Tang
Senior VP of Finance, CFO, Corporate Secretary & Treasurer

That's the whole purpose.

Jonathan Garrett Reeder
Wells Fargo Securities, LLC, Research Division

Can you all comment how Q3 utility results compared to your internal expectations heading into the corner? Were there any like headwinds, perhaps COVID-related that prevented quarterly EPS growth from being higher than you anticipated, but perhaps are not expected to impact your longer-term EPS growth trajectory on the regulated segments?

Robert J. Sprowls
CEO, President & Director

Yes. No, it was not. I mean we weren't taken by surprise or anything, if that's what you're asking about.

Jonathan Garrett Reeder
Wells Fargo Securities, LLC, Research Division

Yes. No, I mean, just trying to get a sense of where things came in for the quarter on the regulated side. Obviously, excluding the market gains related to the benefit plan, like if everything else was kind of right where you were expecting it to be?

Or were there some COVID expense pressures or anything like that, that may be shaved a couple of pennies off?

Eva G. Tang
Senior VP of Finance, CFO, Corporate Secretary & Treasurer

I don't believe so for the regulated utilities. They're pretty much on target on their expenses. To the expenses that's incremental due to the COVID-19, we do book to the CMA account. So not much impact to the utility side of it. We do incur some more treatment costs, but the other expenses decrease, offset each other. So I don't think there are surprises to our utilities earnings for the quarter.

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Jonathan Garrett Reeder
Wells Fargo Securities, LLC, Research Division

Okay. And then I know as kind of already brought up earlier, but when and how do you expect to gain the clarity with regards to whether that August decoupling order will be applied to the 2022, '24 GRC. Obviously, it'd be going against the date specified in the order. Does the ALJ respond specifically to PAO's protests that were filed, like when ALJ issues the scoping order? Or is there a specific date? Or those just kind of linger out there until you get a proposed decision?

Robert J. Sprowls
CEO, President & Director

We believe that we'll get some clarity on this when there's a prehearing conference and when a scoping memo is issued by the administrative law judge.

Eva G. Tang
Senior VP of Finance, CFO, Corporate Secretary & Treasurer

He has not done that yet.

Robert J. Sprowls
CEO, President & Director

Right. We haven't had the prehearing conference yet. I will tell you, we do have the same administrative law judge that Cal Water has in their case. And the case has been assigned to commissioner Shiroma.

Jonathan Garrett Reeder
Wells Fargo Securities, LLC, Research Division

Okay. When is the prehearing conference and scoping memo do? Is there like a due date on that? Or when do you expect it?

Robert J. Sprowls
CEO, President & Director

Well, it is behind schedule.

Jonathan Garrett Reeder
Wells Fargo Securities, LLC, Research Division

Right. You are already behind schedule?

Robert J. Sprowls
CEO, President & Director

Well, the prehearing conference, I mean, I believe it's behind schedule. I mean, I think we were thinking it was going to perhaps it's not significantly behind schedule, but I think we were perhaps expecting it in October and the commission, of course, has got their hands full with a lot of issues these days.

Jonathan Garrett Reeder
Wells Fargo Securities, LLC, Research Division

Sure, sure. Okay. So -- but something perhaps later this month or certainly by the end of the year, you would hope to have the clarity to figure out whether or not you need to kind of pull the case and refile it or something like that?

Robert J. Sprowls
CEO, President & Director

That's my understanding. It's likely to happen before year-end.

Operator

And this concludes our question-and-answer session. So I'd like to return the conference back to Bob Sprowls for any closing remarks.

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Robert J. Sprowls
CEO, President & Director

Thank you, Keith. Well, I just want to thank you all for your participation today. And let you know, we look forward to speaking with you next quarter. And just want to wish everyone a happy holiday season. Well, thank you very much.

Operator
Thank you. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.

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