

American Water Works Company, Inc.
Form 10-Q
October 31, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 001-34028

AMERICAN WATER WORKS COMPANY, INC.
(Exact name of registrant as specified in its charter)

| | |
|--|--------------------------------------|
| Delaware | 51-0063696 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 1 Water Street, Camden, NJ | 08102-1658 |
| (Address of principal executive offices) | (Zip Code) |
| (856) 955-4001 | |
| (Registrant's telephone number, including area code) | |
| 1025 | |

Laurel
Oak Road,
Voorhees,
NJ 08043

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

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Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding as of October 25, 2018 |
|--|---|
| Common Stock, \$0.01 par value per share | 180,598,794 shares (excludes 4,683,156 treasury shares as of October 25, 2018) |

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FORWARD-LOOKING STATEMENTS

We have made statements in Part I, Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations and in other sections of this Quarterly Report on Form 10-Q (“Form 10-Q”), that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and the Private Securities Litigation Reform Act of 1995. In some cases, these forward-looking statements can be identified by words with prospective meanings such as “intend,” “plan,” “estimate,” “believe,” “anticipate,” “expect,” “predict,” “project,” “propose,” “assume,” “forecast,” “likely,” “outlook,” “future,” “pending,” “goal,” “objective,” “potential,” “continue,” “seek to,” “may,” “can,” “should,” “will” and “could,” or other variations or similar expressions. Forward-looking statements may relate to, among other things, our future financial performance, including our operation and maintenance (“O&M”) efficiency ratio, our cash flows, our growth and portfolio optimization strategies, our projected capital expenditures and related funding requirements, our ability to repay debt, our projected strategy to finance current operations and growth initiatives, the impact of legal proceedings and potential fines and penalties, business process and technology improvement initiatives, trends in our industry, regulatory, legislative, tax policy or legal developments or rate adjustments, including rate case filings, filings for infrastructure surcharges and filings to address regulatory lag, and impacts that the Tax Cuts and Jobs Act (the “TCJA”) may have on us and our business, results of operations, cash flows and liquidity.

Forward-looking statements are predictions based on our current expectations and assumptions regarding future events. They are not guarantees or assurances of any outcomes, financial results or levels of activity, performance or achievements, and you are cautioned not to place undue reliance upon them. These forward-looking statements are subject to a number of estimates and assumptions, and known and unknown risks, uncertainties and other factors. Our actual results may vary materially from those discussed in the forward-looking statements included herein as a result of the following important factors:

- the decisions of governmental and regulatory bodies, including decisions to raise or lower customer rates;
- the timeliness and outcome of regulatory commissions’ actions concerning rates, capital structure, authorized return on equity, capital investment, system acquisitions, taxes, permitting and other decisions;
- changes in customer demand for, and patterns of use of, water, such as may result from conservation efforts;
- limitations on the availability of our water supplies or sources of water, or restrictions on our use thereof, resulting from allocation rights, governmental or regulatory requirements and restrictions, drought, overuse or other factors;
- changes in laws, governmental regulations and policies, including with respect to environmental, health and safety, water quality and emerging contaminants, public utility and tax regulations and policies, and impacts resulting from U.S., state and local elections;
- weather conditions and events, climate variability patterns, and natural disasters, including drought or abnormally high rainfall, prolonged and abnormal ice or freezing conditions, strong winds, coastal and intercoastal flooding, earthquakes, landslides, hurricanes, tornadoes, wildfires, electrical storms and solar flares;
- the outcome of litigation and similar governmental and regulatory proceedings, investigations or actions;
- our ability to appropriately maintain current infrastructure, including our operational and information technology (“IT”) systems, and manage the expansion of our business;
- exposure or infiltration of our critical infrastructure, operational technology and IT systems, including the disclosure of sensitive or confidential information contained therein, through physical or cyber attacks or other means;
- our ability to obtain permits and other approvals for projects;
- changes in our capital requirements;
- our ability to control operating expenses and to achieve efficiencies in our operations;
- the intentional or unintentional actions of a third party, including contamination of our water supplies or water provided to our customers;
- our ability to obtain adequate and cost-effective supplies of chemicals, electricity, fuel, water and other raw materials that are needed for our operations;
- our ability to successfully meet growth projections for our regulated and market-based businesses, either individually or in the aggregate, and capitalize on growth opportunities, including our ability to, among other things:

- acquire, close and successfully integrate regulated operations and market-based businesses;
- enter into contracts and other agreements with, or otherwise obtain, new customers in our market-based businesses;
- and

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• realize anticipated benefits and synergies from new acquisitions;

• risks and uncertainties associated with contracting with the U.S. government, including ongoing compliance with applicable government procurement and security regulations;

- cost overruns relating to improvements in or the expansion of our operations;

• our ability to maintain safe work sites;

• our exposure to liabilities related to environmental laws and similar matters resulting from, among other things, water and wastewater service provided to customers, including, for example, our water transfer solutions that are focused on customers in the shale natural gas exploration and production market;

• changes in general economic, political, business and financial market conditions;

• access to sufficient capital on satisfactory terms and when and as needed to support operations and capital expenditures;

• fluctuations in interest rates;

• restrictive covenants in or changes to the credit ratings on us or our current or future debt that could increase our financing costs or funding requirements or affect our ability to borrow, make payments on debt or pay dividends;

• fluctuations in the value of benefit plan assets and liabilities that could increase our cost and funding requirements;

• changes in federal or state general, income and other tax laws, including any further rules, regulations, interpretations and guidance by the U.S. Department of the Treasury and state or local taxing authorities related to the enactment of the TCJA, the availability of tax credits and tax abatement programs, and our ability to utilize our U.S. federal and state income tax net operating loss (“NOL”) carryforwards;

• migration of customers into or out of our service territories;

• the use by municipalities of the power of eminent domain or other authority to condemn our systems, or the assertion by private landowners of similar rights against us;

• our difficulty or inability to obtain insurance, our inability to obtain insurance at acceptable rates and on acceptable terms and conditions, or our inability to obtain reimbursement under existing insurance programs for any losses sustained;

• the incurrence of impairment charges related to our goodwill or other assets;

• labor actions, including work stoppages and strikes;

• our ability to retain and attract qualified employees;

• civil disturbances or terrorist threats or acts, or public apprehension about future disturbances or terrorist threats or acts; and

• the impact of new, and changes to existing, accounting standards.

These forward-looking statements are qualified by, and should be read together with, the risk factors and other statements contained in our Annual Report on Form 10-K for the year ended December 31, 2017 (“Form 10-K”), and in this Form 10-Q, and you should refer to such risks, uncertainties and risk factors in evaluating such forward-looking statements. Any forward-looking statements we make speak only as of the date this Form 10-Q was filed with the U.S. Securities and Exchange Commission (“SEC”). Except as required by the federal securities laws, we do not have any obligation, and we specifically disclaim any undertaking or intention, to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or otherwise. New factors emerge from time to time, and it is not possible for us to predict all such factors. Furthermore, it may not be possible to assess the impact of any such factor on our businesses, either viewed independently or together, or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement. The foregoing factors should not be construed as exhaustive.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

American Water Works Company, Inc. and Subsidiary Companies

Consolidated Balance Sheets (Unaudited)

(In millions, except share and per share data)

| | September 30, 2018 | December 31, 2017 |
|---|-----------------------|----------------------|
| ASSETS | | |
| Property, plant and equipment | \$ 22,734 | \$ 21,716 |
| Accumulated depreciation | (5,671) | (5,470) |
| Property, plant and equipment, net | 17,063 | 16,246 |
| Current assets: | | |
| Cash and cash equivalents | 86 | 55 |
| Restricted funds | 29 | 27 |
| Accounts receivable, net | 347 | 272 |
| Unbilled revenues | 203 | 212 |
| Materials and supplies | 42 | 41 |
| Other | 93 | 113 |
| Total current assets | 800 | 720 |
| Regulatory and other long-term assets: | | |
| Regulatory assets | 1,086 | 1,061 |
| Goodwill | 1,571 | 1,379 |
| Postretirement benefit asset | 193 | — |
| Intangible assets | 91 | 9 |
| Other | 76 | 67 |
| Total regulatory and other long-term assets | 3,017 | 2,516 |
| Total assets | \$ 20,880 | \$ 19,482 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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American Water Works Company, Inc. and Subsidiary Companies
 Consolidated Balance Sheets (Unaudited)
 (In millions, except share and per share data)

| | September 30, 2018 | December 31, 2017 |
|---|-----------------------|----------------------|
| CAPITALIZATION AND LIABILITIES | | |
| Capitalization: | | |
| Common stock (\$0.01 par value, 500,000,000 shares authorized, 185,279,397 and 182,508,564 shares issued, respectively) | \$ 2 | \$ 2 |
| Paid-in-capital | 6,647 | 6,432 |
| Accumulated deficit | (432) | (723) |
| Accumulated other comprehensive loss | (60) | (79) |
| Treasury stock, at cost (4,683,156 and 4,064,010 shares, respectively) | (297) | (247) |
| Total common stockholders' equity | 5,860 | 5,385 |
| Long-term debt | 7,570 | 6,490 |
| Redeemable preferred stock at redemption value | 7 | 8 |
| Total long-term debt | 7,577 | 6,498 |
| Total capitalization | 13,437 | 11,883 |
| Current liabilities: | | |
| Short-term debt | 564 | 905 |
| Current portion of long-term debt | 263 | 322 |
| Accounts payable | 141 | 195 |
| Accrued liabilities | 455 | 630 |
| Taxes accrued | 67 | 33 |
| Interest accrued | 89 | 73 |
| Other | 169 | 167 |
| Total current liabilities | 1,748 | 2,325 |
| Regulatory and other long-term liabilities: | | |
| Advances for construction | 259 | 271 |
| Deferred income taxes, net | 1,670 | 1,551 |
| Deferred investment tax credits | 21 | 22 |
| Regulatory liabilities | 1,962 | 1,664 |
| Accrued pension expense | 393 | 384 |
| Accrued postretirement benefit expense | — | 40 |
| Other | 78 | 66 |
| Total regulatory and other long-term liabilities | 4,383 | 3,998 |
| Contributions in aid of construction | 1,312 | 1,276 |
| Commitments and contingencies (See Note 12) | | |
| Total capitalization and liabilities | \$ 20,880 | \$ 19,482 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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American Water Works Company, Inc. and Subsidiary Companies
 Consolidated Statements of Operations (Unaudited)
 (In millions, except per share data)

| | For the Three Months Ended September 30, 2018 | | For the Nine Months Ended September 30, 2017 | |
|--|--|---------|---|---------|
| Operating revenues | \$976 | \$936 | \$2,590 | \$2,536 |
| Operating expenses: | | | | |
| Operation and maintenance | 390 | 322 | 1,085 | 1,003 |
| Depreciation and amortization | 141 | 128 | 404 | 378 |
| General taxes | 71 | 61 | 210 | 192 |
| Gain on asset dispositions and purchases | (18) | (7) | (20) | (9) |
| Impairment charge | 57 | — | 57 | — |
| Total operating expenses, net | 641 | 504 | 1,736 | 1,564 |
| Operating income | 335 | 432 | 854 | 972 |
| Other income (expense): | | | | |
| Interest, net | (89) | (89) | (259) | (259) |
| Non-operating benefit costs, net | 5 | (2) | 10 | (7) |
| Loss on early extinguishment of debt | (2) | (6) | (2) | (6) |
| Other, net | 6 | 5 | 14 | 11 |
| Total other income (expense) | (80) | (92) | (237) | (261) |
| Income before income taxes | 255 | 340 | 617 | 711 |
| Provision for income taxes | 70 | 137 | 164 | 284 |
| Consolidated net income | 185 | 203 | 453 | 427 |
| Net loss attributable to noncontrolling interest | (2) | — | (2) | — |
| Net income attributable to common stockholders | \$187 | \$203 | \$455 | \$427 |
| Basic earnings per share: (a) | | | | |
| Net income attributable to common stockholders | \$1.04 | \$1.14 | \$2.54 | \$2.39 |
| Diluted earnings per share: (a) | | | | |
| Net income attributable to common stockholders | \$1.04 | \$1.13 | \$2.53 | \$2.39 |
| Weighted-average common shares outstanding: | | | | |
| Basic | 181 | 178 | 179 | 178 |
| Diluted | 181 | 179 | 180 | 179 |
| Dividends declared per common share | \$0.455 | \$0.415 | \$0.91 | \$0.83 |

(a) Amounts may not calculate due to rounding.

The accompanying notes are an integral part of these Consolidated Financial Statements.

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American Water Works Company, Inc. and Subsidiary Companies
 Consolidated Statements of Comprehensive Income (Unaudited)
 (In millions)

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|--|---|-------|---|-------|
| | 2018 | 2017 | 2018 | 2017 |
| Net income attributable to common stockholders | \$187 | \$203 | \$455 | \$427 |
| Other comprehensive income (loss), net of tax: | | | | |
| Pension amortized to periodic benefit cost: | | | | |
| Actuarial loss, net of tax of \$1 and \$1 for the three months and \$2 and \$3 for the nine months ended September 30, 2018 and 2017, respectively | 2 | 1 | 6 | 5 |
| Foreign currency translation adjustment | — | — | — | (1) |
| Unrealized gain (loss) on cash flow hedges, net of tax of \$2 and \$(3) for the three months ended and \$4 and \$(4) for the nine months ended September 30, 2018 and 2017, respectively | 7 | (3) | 13 | (5) |
| Net other comprehensive income (loss) | 9 | (2) | 19 | (1) |
| Comprehensive income attributable to common stockholders | \$196 | \$201 | \$474 | \$426 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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American Water Works Company, Inc. and Subsidiary Companies
 Consolidated Statements of Cash Flows (Unaudited)
 (In millions)

| | For the Nine Months Ended September 30, 2018 2017 | |
|--|--|---------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$453 | \$427 |
| Adjustments to reconcile to net cash flows provided by operating activities: | | |
| Depreciation and amortization | 404 | 378 |
| Deferred income taxes and amortization of investment tax credits | 142 | 264 |
| Provision for losses on accounts receivable | 22 | 21 |
| Gain on asset dispositions and purchases | (20) | (9) |
| Impairment charge | 57 | — |
| Pension and non-pension postretirement benefits | 19 | 44 |
| Other non-cash, net | 27 | (39) |
| Changes in assets and liabilities: | | |
| Receivables and unbilled revenues | (70) | (34) |
| Pension and postretirement benefit contributions | (11) | (36) |
| Accounts payable and accrued liabilities | (23) | (22) |
| Other assets and liabilities, net | 32 | 48 |
| Impact of Freedom Industries settlement activities | (40) | (22) |
| Net cash provided by operating activities | 992 | 1,020 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Capital expenditures | (1,136) | (964) |
| Acquisitions, net of cash acquired | (381) | (10) |
| Proceeds from sale of assets | 33 | 9 |
| Removal costs from property, plant and equipment retirements, net | (61) | (51) |
| Net cash used in investing activities | (1,545) | (1,016) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from long-term debt | 1,355 | 1,382 |
| Repayments of long-term debt | (330) | (334) |
| Net short-term borrowings with maturities less than three months | (341) | (746) |
| Proceeds from issuance of common stock | 183 | — |
| Proceeds from issuances of employee stock plans and direct stock purchase plan | 15 | 21 |
| Advances and contributions for construction, net of refunds of \$20 and \$16 for the nine months ended September 30, 2018 and 2017, respectively | 15 | 23 |
| Debt issuance costs | (12) | (13) |
| Make-whole premium on early debt redemption | (10) | (34) |
| Dividends paid | (237) | (215) |
| Anti-dilutive share repurchases | (45) | (54) |
| Taxes paid related to employee stock plans | (7) | (11) |
| Net cash provided by financing activities | 586 | 19 |
| Net increase in cash and cash equivalents and restricted funds | 33 | 23 |
| Cash and cash equivalents and restricted funds at beginning of period | 83 | 99 |
| Cash and cash equivalents and restricted funds at end of period | \$116 | \$122 |

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Non-cash investing activity:

| | | |
|---|-------|-------|
| Capital expenditures acquired on account but unpaid as of end of period | \$187 | \$175 |
| Acquisition financed by treasury stock | \$— | \$33 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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American Water Works Company, Inc. and Subsidiary Companies
 Consolidated Statements of Changes in Stockholders' Equity (Unaudited)
 (In millions)

| | Common Stock Shares | Par Value | Paid-in-Capital | Accumulated Deficit | Accumulated Other Comprehensive Loss | Treasury Stock Shares | At Cost | Total Stockholders' Equity |
|--|---------------------------|--------------|-----------------|------------------------|---|-----------------------------|------------|----------------------------------|
| Balance as of December 31, 2017 | 182.5 | \$ 2 | \$ 6,432 | \$ (723) | \$ (79) | (4.1) | \$(247) | \$ 5,385 |
| Net income attributable to common stockholders | — | — | — | 455 | — | — | — | 455 |
| Direct stock reinvestment and purchase plan | 0.1 | — | 5 | — | — | — | — | 5 |
| Employee stock purchase plan | 0.1 | — | 6 | — | — | — | — | 6 |
| Stock-based compensation activity | 0.3 | — | 21 | (1) | — | (0.1) | (5) | 15 |
| Issuance of common stock | 2.3 | — | 183 | — | — | — | — | 183 |
| Repurchases of common stock | — | — | — | — | — | (0.5) | (45) | (45) |
| Net other comprehensive income | — | — | — | — | 19 | — | — | 19 |
| Dividends | — | — | — | (163) | — | — | — | (163) |
| Balance as of September 30, 2018 | 185.3 | \$ 2 | \$ 6,647 | \$ (432) | \$ (60) | (4.7) | \$(297) | \$ 5,860 |

| | Common Stock Shares | Par Value | Paid-in-Capital | Accumulated Deficit | Accumulated Other Comprehensive Loss | Treasury Stock Shares | At Cost | Total Stockholders' Equity |
|---|---------------------------|--------------|-----------------|------------------------|---|-----------------------------|------------|----------------------------------|
| Balance as of December 31, 2016 | 181.8 | \$ 2 | \$ 6,388 | \$ (873) | \$ (86) | (3.7) | \$(213) | \$ 5,218 |
| Cumulative effect of change in accounting principle | — | — | — | 21 | — | — | — | 21 |
| Net income attributable to common stockholders | — | — | — | 427 | — | — | — | 427 |
| Direct stock reinvestment and purchase plan | 0.1 | — | 6 | — | — | — | — | 6 |
| Employee stock purchase plan | — | — | 5 | — | — | — | — | 5 |
| Stock-based compensation activity | 0.5 | — | 18 | — | — | (0.1) | (7) | 11 |
| Acquisitions via treasury stock | — | — | 6 | — | — | 0.4 | 27 | 33 |
| Repurchases of common stock | — | — | — | — | — | (0.7) | (54) | (54) |
| Net other comprehensive loss | — | — | — | — | (1) | — | — | (1) |
| Dividends | — | — | — | (148) | — | — | — | (148) |
| Balance as of September 30, 2017 | 182.4 | \$ 2 | \$ 6,423 | \$ (573) | \$ (87) | (4.1) | \$(247) | \$ 5,518 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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American Water Works Company, Inc. and Subsidiary Companies

Notes to Consolidated Financial Statements (Unaudited)

(Unless otherwise noted, in millions, except per share data)

Note 1: Basis of Presentation

The unaudited Consolidated Financial Statements provided in this report include the accounts of American Water Works Company, Inc. and all of its subsidiaries (collectively, “American Water” or the “Company”), in which a controlling interest is maintained after the elimination of intercompany balances and transactions. The unaudited Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial reporting, and with the rules and regulations for reporting on Quarterly Reports on Form 10-Q (“Form 10-Q”). Accordingly, they do not contain certain information and disclosures required by GAAP for comprehensive financial statements. In the opinion of management, all adjustments necessary for a fair statement of the financial position as of September 30, 2018, and the results of operations and cash flows for all periods presented have been made. All adjustments are of a normal, recurring nature, except as otherwise disclosed.

The unaudited Consolidated Financial Statements and Notes included in this report should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 (“Form 10-K”), which provides a more complete discussion of the Company’s accounting policies, financial position, operating results and other matters. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the year, primarily due to the seasonality of the Company’s operations.

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Note 2: Significant Accounting Policies

New Accounting Standards

The Company adopted the following accounting standards in 2018:

| Standard | Description | Date of Adoption | Application | Effect on the Consolidated Financial Statements |
|---|--|------------------|---|--|
| Revenue from Contracts with Customers | Changes the criteria for recognizing revenue from a contract with a customer. Replaces existing guidance on revenue recognition, including most industry-specific guidance. The objective is to provide a single, comprehensive revenue recognition model for all contracts with customers to improve comparability within industries, across industries and across capital markets. The underlying principle is that an entity will recognize revenue to depict the transfer of goods and services to customers at an amount the entity expects to be entitled to in exchange for those goods or services. The guidance also requires a number of disclosures regarding the nature, amount, timing and uncertainty of revenue and the related cash flows. | January 1, 2018 | Modified retrospective | The adoption had no material impact on the Consolidated Financial Statements. Additional disclosures were added in the Notes to Consolidated Financial Statements. For additional information, see Note 3—Revenue Recognition. |
| Clarifying the Definition of a Business | Updated the accounting guidance to clarify the definition of a business, with the objective of assisting entities with evaluating whether transactions should be accounted for as acquisitions, or disposals, of assets or businesses. | January 1, 2018 | Prospective | The adoption had no material impact on the Consolidated Financial Statements. |
| Improving the Presentation of Net Periodic Pension Cost and Net Periodic Post-retirement Benefit Cost | Updated authoritative guidance to require the service cost component of net periodic benefit cost to be presented in the same income statement line item(s) as other employee compensation costs arising from services rendered during the period. The remaining | January 1, 2018 | Retrospective for the presentation of the service cost component and the other components of net periodic benefit costs on the Consolidated Statements of | The Company presented in the current period, and reclassified in the prior periods, net periodic benefit costs, other than the service cost component, in non-operating benefit costs, net on the |

| | | | | |
|--|--|---------------------------|---|--|
| | <p>components of net periodic benefit cost are required to be presented separately from the service cost component, in an income statement line item outside of operating income. Also, the guidance only allows for the service cost component to be eligible for capitalization. The updated guidance does not impact the accounting for net periodic benefit costs as regulatory assets or liabilities. Updated authoritative guidance to simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Under the amendments in the update, an entity should perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying value exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary.</p> | | <p>Operations; prospective for the limitation of capitalization to only the service cost component of net periodic benefit costs in total assets.</p> | <p>Consolidated Statements of Operations.</p> |
| <p>Simplification of Goodwill Impairment Testing</p> | <p>Updated the accounting and disclosure guidance for cloud computing arrangements that are service contracts. Under this guidance, implementation costs incurred in cloud computing arrangements and in developing or obtaining internal-use software follow the same capitalization requirements. The accounting for the service element of the arrangement remains unchanged.</p> | <p>August 31, 2018</p> | <p>Prospective</p> | <p>See Note 6—Goodwill and Other Intangible Assets.</p> |
| <p>Cloud Computing Service Arrangements</p> | <p>Updated the accounting and disclosure guidance for cloud computing arrangements that are service contracts. Under this guidance, implementation costs incurred in cloud computing arrangements and in developing or obtaining internal-use software follow the same capitalization requirements. The accounting for the service element of the arrangement remains unchanged.</p> | <p>September 30, 2018</p> | <p>Prospective</p> | <p>The adoption had no material impact on the Consolidated Financial Statements.</p> |

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The following recently issued accounting standards have not yet been adopted by the Company as of September 30, 2018:

| Standard | Description | Date of Adoption | Application | Estimated Effect on the Consolidated Financial Statements |
|-----------------------------------|--|---|--|---|
| Accounting for Leases | Updated the accounting and disclosure guidance for leasing arrangements. Under this guidance, a lessee will be required to recognize the following for all leases, excluding short-term leases, at the commencement date: (i) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (ii) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the guidance, lessor accounting is largely unchanged. A package of optional transition practical expedients allows an entity not to reassess under the new guidance: (i) whether any existing contracts are or contain leases; (ii) lease classification; and (iii) initial direct costs. Additional optional transition practical expedients are available which allow an entity not to evaluate existing land easements if the easements were not previously accounted for as leases, and to apply the new lease standard at the adoption date and recognize a cumulative-effect adjustment in the opening balance of retained earnings in the period of adoption. | January 1, 2019; early adoption permitted | Modified retrospective | The Company has not yet quantified the impact of recognizing right-of-use assets and lease liabilities, but is evaluating the impact on its Consolidated Financial Statements. The Company has defined a process and implemented software to meet the accounting and reporting requirements of the guidance and is assessing lease arrangements. The Company expects to elect all practical expedients available under the new lease accounting and disclosure guidance and will not elect early adoption for the standard. |
| Accounting for Hedging Activities | Updated the accounting and disclosure guidance for hedging activities, which allows for more financial and nonfinancial hedging strategies to be eligible for hedge accounting. Under this guidance, a qualitative effectiveness assessment is permitted for certain hedges if an entity can reasonably support an expectation of high effectiveness throughout the term of the hedge, | January 1, 2019; early adoption permitted | Modified retrospective for adjustments related to the measurement of ineffectiveness for cash flow hedges; prospective for the updated presentation and disclosure | The Company does not expect the adoption to have a material impact on its Consolidated Financial Statements based upon its hedging activities as of the balance sheet date. The Company is evaluating the timing of adoption. |

| | | | | |
|---|---|---|---|--|
| | provided that an initial quantitative test establishes that the hedge relationship is highly effective. Also, for cash flow hedges determined to be highly effective, all changes in the fair value of the hedging instrument will be recorded in other comprehensive income, with a subsequent reclassification to earnings when the hedged item impacts earnings. | | requirements. | |
| Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income | Permits an entity to reclassify tax effects stranded in accumulated other comprehensive income as a result of the Tax Cuts and Jobs Act (the "TCJA") to retained earnings. | January 1, 2019; early adoption permitted | In the period of adoption or retrospective. | The Company is evaluating any impact on its Consolidated Financial Statements, as well as the timing of adoption. |
| Measurement of Credit Losses | Updated the accounting guidance on reporting credit losses for financial assets held at amortized cost basis and available-for-sale debt securities. Under this guidance, expected credit losses are required to be measured based on historical experience, current conditions and reasonable and supportable forecasts that affect the collectability of the reported amount of financial assets. Also, this guidance requires that credit losses on available-for-sale debt securities be presented as an allowance rather than as a direct write-down. | January 1, 2020; early adoption permitted | Modified retrospective | The Company is evaluating any impact on its Consolidated Financial Statements, as well as the timing of adoption. |
| Disclosure Requirements for Fair Value Measurement | Updated the disclosure requirements for fair value measurement. The guidance removes the requirements to disclose transfers between Level 1 and Level 2 measurements, the timing of transfers between levels, and the valuation processes for Level 3 measurements. Disclosure of transfers into and out of Level 3 measurements will be required. The guidance adds disclosure requirements for the change in unrealized gains and losses in other comprehensive income for recurring Level 3 measurements, as well as the range and weighted average of significant unobservable inputs used to develop Level 3 measurements. | January 1, 2020; early adoption permitted | Prospective for added disclosures and for the narrative description of measurement uncertainty; retrospective for all other amendments. | The Company does not expect the adoption to have a material impact on its Consolidated Financial Statements, and the Company is evaluating the timing of adoption. |

| | | | | |
|--|---|--|----------------------|--|
| <p>Disclosure Requirements for Defined Benefit Plans</p> | <p>Updated the disclosure requirements for defined benefit plans. The guidance removes the requirement to disclose the amounts in accumulated other comprehensive income to be recognized as net periodic benefit cost, the effects of a one percent change in assumed healthcare costs and a number of other disclosures. The guidance clarifies that projected benefit obligations and accumulated benefit obligations should be disclosed, and adds disclosure requirements for the weighted-average interest crediting rates for promised interest crediting rates and an explanation of the reasons for significant gains and losses related to changes in the benefit obligation.</p> | <p>December 31, 2020; early adoption permitted</p> | <p>Retrospective</p> | <p>The Company is evaluating any impact on its Consolidated Financial Statements, as well as the timing of adoption.</p> |
|--|---|--|----------------------|--|

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Cash, Cash Equivalents and Restricted Funds

The following table provides a reconciliation of the cash, cash equivalents and restricted funds as presented on the Consolidated Balance Sheets, to the sum of such amounts presented on the Consolidated Statements of Cash Flows for the periods ended September 30:

| | 2018 | 2017 |
|--|-------|-------|
| Cash and cash equivalents | \$86 | \$93 |
| Restricted funds | 29 | 28 |
| Restricted funds included in other long-term assets | 1 | 1 |
| Cash and cash equivalents and restricted funds as presented on the Consolidated Statements of Cash Flows | \$116 | \$122 |
| Reclassifications | | |

Certain reclassifications have been made to prior periods in the accompanying Consolidated Financial Statements and Notes to conform to the current presentation.

Note 3: Revenue Recognition

On January 1, 2018, the Company adopted Accounting Standards Codification Topic 606, Revenue From Contracts With Customers, and all related amendments (collectively, “ASC 606” or the “standard”), using the modified retrospective approach, applied to contracts which were not completed as of January 1, 2018. Under this approach, periods prior to the adoption date have not been restated and continue to be reported under the accounting standards in effect for those periods. The Company’s revenue associated with alternative revenue programs and lease contracts is outside the scope of ASC 606 and accounted for under other existing GAAP.

Under ASC 606, a performance obligation is a promise within a contract to transfer a distinct good or service, or a series of distinct goods and services, to a customer. Revenue is recognized when performance obligations are satisfied and the customer obtains control of promised goods or services. The amount of revenue recognized reflects the consideration to which the Company expects to be entitled to receive in exchange for goods or services. Under the standard, a contract’s transaction price is allocated to each distinct performance obligation. To determine revenue recognition for arrangements that the Company determines are within the scope of ASC 606, the Company performs the following five steps: (i) identifies the contracts with a customer; (ii) identifies the performance obligations within the contract, including whether they are distinct and capable of being distinct in the context of the contract; (iii) determines the transaction price; (iv) allocates the transaction price to the performance obligations in the contract; and (v) recognizes revenue when, or as, the Company satisfies each performance obligation.

The Company’s revenues from contracts with customers are discussed below. Customer payments for contracts are generally due within 30 days of billing and none of the contracts with customers have payment terms that exceed one year; therefore, the Company elected to apply the significant financing component practical expedient and no amount of consideration has been allocated as a financing component. See Note 15—Segment Information for further discussion of the Company’s operating segments.

Regulated Businesses Revenue

Revenue from the Company’s Regulated Businesses is generated primarily from water and wastewater services delivered to customers. These contracts contain a single performance obligation, the delivery of water and wastewater services, as the promise to transfer the individual good or service is not separately identifiable from other promises within the contracts and, therefore, is not distinct. Revenues are recognized over time, as services are provided. There are generally no significant financing components or variable consideration. Revenues include amounts billed to customers on a cycle basis, and unbilled amounts calculated based on estimated usage from the date of the meter reading associated with the latest customer bill, to the end of the accounting period. The amounts that the Company has a right to invoice are determined by each customer’s actual usage, an indicator that the invoice amount corresponds directly to the value transferred to the customer. The Company elected to use the right to invoice and the disclosure of remaining performance obligations practical expedients for these revenues.

Market-Based Businesses Revenue

Through various protection programs, the Company provides fixed fee services to domestic homeowners and smaller commercial customers to protect against repair costs for interior and external water and sewer lines, interior electric and gas lines, heating and cooling systems, water heaters, power surge protection and other related services. Most of

the contracts have a one-year term and each service is a separate performance obligation, satisfied over time, as the customers simultaneously receive and consume the benefits provided from the service. Customers are obligated to pay for the protection programs ratably over 12 months or via a one-time, annual fee, with revenues recognized ratably over time for these services. Advances from customers are deferred until the performance obligation is satisfied. The Company elected to use the disclosure of remaining performance obligations practical expedients for these revenues.

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The Company's Market-Based Businesses also have long-term, fixed fee contracts to operate and maintain water and wastewater facilities with the U.S. government on various military bases and facilities owned by municipal and industrial customers, as well as shorter-term contracts that provide water management solutions for shale natural gas companies and customers in the water services market. Billing and revenue recognition for the fixed fee revenues occurs ratably over the term of the contract, as customers simultaneously receive and consume the benefits provided by the Company. Additionally, these contracts allow the Company to make capital improvements to underlying infrastructure, which are initiated through separate modifications or amendments to the original contract, whereby stand-alone, fixed pricing is separately stated for each improvement. The Company has determined that these capital improvements are separate performance obligations, with revenue recognized over time based on performance completed at the end of each reporting period. The Company elected to use the significant financing component practical expedient for these contract revenues. Losses on contracts are recognized during the period in which the losses first become probable and estimable. Revenues recognized during the period in excess of billings on construction contracts are recorded as unbilled revenues, with billings in excess of revenues recorded as other current liabilities until the recognition criteria are met. Changes in contract performance and related estimated contract profitability may result in revisions to costs and revenues, and are recognized in the period in which revisions are determined.

Disaggregated Revenues

The following table summarizes the Company's operating revenues disaggregated for the three months ended September 30, 2018:

| (In millions) | Revenues from Contracts with Customers | Other Revenues Not from Contracts with Customers (a) | Total Operating Revenues |
|-------------------------------|--|--|--------------------------------|
| Regulated Businesses: | | | |
| Water services: | | | |
| Residential | \$ 475 | \$ 7 | \$ 482 |
| Commercial | 180 | 3 | 183 |
| Industrial | 40 | — | 40 |
| Public and other | 86 | 2 | 88 |
| Total water services | 781 | 12 | 793 |
| Wastewater services: | | | |
| Residential | 29 | — | 29 |
| Commercial | 8 | — | 8 |
| Industrial | 3 | — | 3 |
| Public and other | 1 | — | 1 |
| Total wastewater services | 41 | — | 41 |
| Miscellaneous utility charges | 13 | — | 13 |
| Alternative revenue programs | — | 8 | 8 |
| Lease contract revenue | — | 2 | 2 |
| Total Regulated Businesses | 835 | 22 | 857 |
| Market-Based Businesses | 125 | — | 125 |
| Other | (5) | (1) | (6) |
| Total operating revenues | \$ 955 | \$ 21 | \$ 976 |

(a) Includes revenues associated with provisional rates, alternative revenue programs, lease contracts and intercompany rent which are outside the scope of ASC 606 and accounted for under other existing GAAP.

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The following table summarizes of the Company's operating revenues disaggregated for the nine months ended September 30, 2018:

| (In millions) | Revenues from Contracts with Customers | Other Revenues Not from Contracts with Customers (a) | Total Operating Revenues |
|-------------------------------|--|--|--------------------------------|
| Regulated Businesses: | | | |
| Water services: | | | |
| Residential | \$ 1,253 | \$ 7 | \$ 1,260 |
| Commercial | 465 | 3 | 468 |
| Industrial | 105 | — | 105 |
| Public and other | 251 | 2 | 253 |
| Total water services | 2,074 | 12 | 2,086 |
| Wastewater services: | | | |
| Residential | 83 | — | 83 |
| Commercial | 22 | — | 22 |
| Industrial | 10 | — | 10 |
| Public and other | 2 | — | 2 |
| Total wastewater services | 117 | — | 117 |
| Miscellaneous utility charges | 36 | — | 36 |
| Alternative revenue programs | — | 22 | 22 |
| Lease contract revenue | — | 6 | 6 |
| Total Regulated Businesses | 2,227 | 40 | 2,267 |
| Market-Based Businesses | 339 | — | 339 |
| Other | (14) | (2) | (16) |
| Total operating revenues | \$ 2,552 | \$ 38 | \$ 2,590 |

(a) Includes revenues associated with provisional rates, alternative revenue programs, lease contracts and intercompany rent which are outside the scope of ASC 606 and accounted for under other existing GAAP.

Contract Balances

Contract assets and contract liabilities are the result of timing differences between revenue recognition, billings and cash collections. In the Company's Market-Based Businesses, certain contracts are billed as work progresses in accordance with agreed-upon contractual terms, either at periodic intervals or upon achievement of contractual milestones. Contract assets are recorded when billing occurs subsequent to revenue recognition, and are reclassified to accounts receivable when billed and the right to consideration becomes unconditional. Contract liabilities are recorded when the Company receives advances from customers prior to satisfying contractual performance obligations, particularly for construction contracts and home warranty protection program contracts, and are recognized as revenue when the associated performance obligations are satisfied. Contract assets are included in unbilled revenues and contract liabilities are included in other current liabilities on the Consolidated Balance Sheets as of September 30, 2018.

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The following table summarizes the changes in contract assets and liabilities for the nine months ended September 30, 2018:

(In millions)

Contract assets:

| | |
|---|------|
| Balance at January 1, 2018 | \$35 |
| Additions | 20 |
| Transfers to accounts receivable, net (38) | |
| Balance at September 30, 2018 | \$17 |

Contract liabilities:

| | |
|---------------------------------------|------|
| Balance at January 1, 2018 | \$25 |
| Additions | 49 |
| Transfers to operating revenues (45) | |
| Balance at September 30, 2018 | \$29 |

Remaining Performance Obligations

Remaining performance obligations (“RPOs”) represent revenues the Company expects to recognize in the future from contracts that are in progress. As of September 30, 2018, the Company’s operation and maintenance and capital improvement contracts in the Market-Based Businesses have RPOs. Contracts with the U.S. government for work on various military bases expire between 2051 and 2068 and have RPOs of \$4.4 billion as of September 30, 2018, as measured by estimated remaining contract revenue. Such contracts are subject to customary termination provisions held by the U.S. government, prior to the agreed-upon contract expiration. Contracts with municipalities and commercial customers expire between 2018 and 2038 and have RPOs of \$612 million as of September 30, 2018, as measured by estimated remaining contract revenue. Approximately \$61 million of RPOs were eliminated in conjunction with the sale of 20 of the Company’s Contract Services Group’s contracts to subsidiaries of Veolia Environnement S.A. See Note 4—Acquisitions and Divestitures for further discussion of this transaction.

Note 4: Acquisitions and Divestitures

Regulated Acquisitions

During the nine months ended September 30, 2018, the Company closed on seven acquisitions of various regulated water and wastewater systems for a total aggregate purchase price of \$18 million. Assets acquired in these acquisitions, principally utility plant, totaled \$19 million. Liabilities assumed, primarily contributions in aid of construction, totaled \$1 million.

Market-Based Businesses Acquisitions

Pivotal Home Solutions Acquisition

On June 4, 2018, the Company, through its subsidiary American Water Enterprises, LLC, completed the acquisition of Pivotal Home Solutions (“Pivotal”) for a total purchase price of \$365 million, net of cash received and including \$9 million in working capital. Pivotal is headquartered in Naperville, Illinois, and is a provider of home warranty protection products and services, operating in 18 states, with approximately 1.2 million customer contracts at the time of acquisition. Pivotal is complementary to the Company’s Homeowner Services Group product offerings, and enhances its presence in the home warranty solutions markets through utility partnerships. The results of Pivotal have been consolidated into the Homeowner Services Group non-reportable operating segment.

This acquisition was funded through the issuance of common stock, as described below, and from borrowings through the Company’s commercial paper program, which were subsequently refinanced with the issuance of long-term debt during the third quarter of 2018. This acquisition is being accounted for as a business combination which requires, among other things, the assets acquired and the liabilities assumed to be recognized at their fair values at the acquisition date. The purchase price allocation is based upon preliminary information and is subject to change upon the completion of formal valuations and other reviews and assessments, which will occur no later than one year after the acquisition date.

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The following table provides the preliminary purchase price allocation for the Pivotal acquisition as of June 4, 2018, and the adjustments that have been made through September 30, 2018:

| | June 4, 2018 (as initially reported) | Measurement Period Adjustments | June 4, 2018 (as adjusted) |
|--|--|--------------------------------------|-------------------------------------|
| Identifiable assets: | | | |
| Accounts receivable | \$ 23 | \$ (1) | \$ 22 |
| Other current assets | 1 | 1 | 2 |
| Property, plant and equipment | 21 | 1 | 22 |
| Intangible assets | 96 | (4) | 92 |
| Total identifiable assets | 141 | (3) | 138 |
| Liabilities assumed: | | | |
| Accounts payable and accrued liabilities | (5) | — | (5) |
| Other current liabilities | (14) | 2 | (12) |
| Long-term liabilities | (1) | — | (1) |
| Total liabilities assumed | (20) | 2 | (18) |
| Net identifiable assets acquired | 121 | (1) | 120 |
| Goodwill | 242 | 3 | 245 |
| Net assets acquired | \$ 363 | \$ 2 | \$ 365 |

Customer relationships, which comprise the majority of the preliminary intangible assets balance, are amortized based on historical attrition rates over their estimated useful lives of up to 21 years, with a weighted average life of approximately six years, as the assets are expected to contribute to the cash flows of the Company. The remaining intangible assets are amortized over their expected benefit periods of up to six years, with a weighted average life of approximately three years. Goodwill was calculated as the excess of the consideration transferred over the net assets recognized, and represents the expected revenue and cost synergies of the combined business and assembled workforce of Pivotal. The goodwill is included in the Company's Homeowner Services Group reporting unit, within the Market-Based Businesses, and is deductible for income tax purposes.

Pivotal's revenue and net income included in the Company's Consolidated Statements of Operations for the three and nine months ended September 30, 2018, did not have a material impact on the overall consolidated results of operations of the Company.

Equity Forward Transaction and Common Stock Issuance

On April 11, 2018, the Company effected an equity forward transaction by entering into a forward sale agreement with each of two forward purchasers in connection with a public offering of 2,320,000 shares of the Company's common stock. In the equity forward transaction, the forward purchasers, or an affiliate, borrowed an aggregate of 2,320,000 shares of the Company's common stock from third parties and sold them to the underwriters in the public offering. On June 7, 2018, the Company elected to fully and physically settle both forward sale agreements, resulting in the issuance of a total of 2,320,000 shares of its common stock at a price of \$79.01 per share, for aggregate net proceeds of \$183 million. The net proceeds of the transaction were used to finance a portion of the purchase price of the Pivotal acquisition described above.

Highlighted Pending Acquisitions

On April 13, 2018, the Company's Illinois subsidiary entered into an agreement to acquire the City of Alton, Illinois' regional wastewater system for approximately \$54 million. This system currently serves approximately 23,000 customer equivalents, comprised of approximately 11,000 direct connections in Alton and service to an additional 12,000 customers under bulk contracts in the nearby communities of Bethalto and Godfrey. The Company is expecting to close this acquisition by the end of the first quarter of 2019, pending regulatory approval.

On May 30, 2018, the Company's Pennsylvania subsidiary entered into an agreement to acquire the wastewater assets of Exeter Township, Pennsylvania for approximately \$96 million. This system currently serves nearly 9,000

customers, and the Company is expecting to close this acquisition during the second quarter of 2019, pending regulatory approval.

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Divestitures

On July 5, 2018, the Company entered into an agreement for the sale of the majority of its Contract Services Group to subsidiaries of Veolia Environnement S.A. for \$27 million. The Company closed on the sale of 20 of the 22 contracts associated with this agreement during the third quarter of 2018, and expects to close on the remaining two contracts, subject to customer consents, by the end of 2018. As part of the sale, the Company recognized a pre-tax gain of \$14 million for the three and nine months ended September 30, 2018.

Note 5: Regulatory Liabilities

Tax Cuts and Jobs Act

On December 22, 2017, the TCJA was signed into law, which, among other things, enacted significant and complex changes to the Internal Revenue Code of 1986, including a reduction in the federal corporate income tax rate from 35% to 21% as of January 1, 2018. During the nine months ended September 30, 2018, the Company's 14 regulatory jurisdictions began to consider the impacts of the TCJA. The Company has adjusted customer rates to reflect the lower income tax rate in eight states. In one state, a portion of the tax savings is being used to offset additional capital investment and to reduce certain regulatory assets. One additional state is using a portion of the tax savings to reduce certain regulatory assets. Proceedings in the other five jurisdictions remain pending. With respect to excess accumulated deferred income taxes, regulators in five states have agreed with the Company's overall timeline of passing the excess back to customers beginning no earlier than 2019, when the Company is able to produce the normalization schedule using the average rate assumption method. In one of those states we entered into a stipulated settlement that, if approved, would authorize the amortization of the re-measured deferred income taxes to offset future infrastructure investments.

The Company generally expects its regulated customers to benefit from the tax savings resulting from the TCJA. As a result, the Company has recorded a \$55 million reserve on revenue during the nine months ended September 30, 2018, for the estimated tax savings resulting from the TCJA, with a corresponding regulatory liability, of which the current portion is \$22 million (recorded in Other Current Liabilities), and the long-term portion is \$33 million (recorded in regulatory liabilities). We cannot predict how each jurisdiction may calculate the amount of credits due to customers. If any of the Company's regulatory jurisdictions determines the credits due to customers are higher than the expected reduction to income tax expense, this would result in an adverse impact to results of operations and cash flows.

Other Postretirement Benefit Plan Remeasurement

On August 31, 2018, the other postretirement benefit plan was remeasured to reflect an announced plan amendment which changed benefits for certain union and non-union plan participants. As a result of the remeasurement, the Company recorded a \$227 million reduction to the net accumulated postretirement benefit obligation, with a corresponding regulatory liability. See Note 11—Pension and Other Post-Retirement Benefits for further discussion.

Note 6: Goodwill and Other Intangible Assets

The following table summarizes changes in the carrying amount of goodwill for the nine months ended September 30, 2018:

| | Regulated Businesses | | Market-Based Businesses | | Consolidated | | |
|----------------------------------|-------------------------|---------------------------|----------------------------|---------------------------|--------------|---------------------------|--------------|
| | Cost | Accumulated Impairment | Cost | Accumulated Impairment | Cost | Accumulated Impairment | Total Net |
| Balance as of December 31, 2017 | \$3,492 | \$ (2,332) | \$327 | \$ (108) | \$3,819 | \$ (2,440) | \$1,379 |
| Goodwill from acquisitions | — | — | 245 | — | 245 | — | 245 |
| Goodwill impairment charge | — | — | — | (53) | — | (53) | (53) |
| Balance as of September 30, 2018 | \$3,492 | \$ (2,332) | \$572 | \$ (161) | \$4,064 | \$ (2,493) | \$1,571 |

During the nine months ended September 30, 2018, the Company recorded goodwill of \$245 million as part of the acquisition of Pivotal. Goodwill acquired from this acquisition was allocated to the Homeowner Services Group reporting unit, within the Market-Based Businesses. See Note 4—Acquisitions and Divestitures for further discussion. The Company allocates goodwill at the reporting unit level and evaluates goodwill for impairment on an annual basis, as of November 30, or on an interim basis, if an event occurs or circumstances change that would more likely than not, reduce the fair value of a reporting unit below its carrying value. As a result of operational and financial

challenges encountered in the construction business of Keystone Clearwater Solutions, LLC (“Keystone”), the Company substantially exited this business line during the third quarter of 2018. This action, along with the exit of the water trucking business line during the first half of 2018, narrowed the scope of the Keystone business going forward, focusing solely on providing water transfer services.

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Based on the factors discussed above, the Company concluded there were indicators that the Keystone reporting unit may be impaired. Accordingly, impairment testing was performed as part of the preparation of the Company's Consolidated Financial Statements, resulting in an aggregate, non-cash, pre-tax impairment charge of \$57 million, of which, \$54 million was attributable to the Company, after adjustment for noncontrolling interest.

In terms of the process followed for the impairment, the Company first completed an impairment test of the Keystone reporting unit's customer relationship intangible asset at September 30, 2018. The results of this impairment test showed that the fair value of the intangible asset was lower than its carrying value, resulting in a non-cash, pre-tax impairment charge of \$4 million, which is recorded in Impairment charge on the Consolidated Statement of Operations for the three and nine months ended September 30, 2018.

The Company then completed an interim goodwill impairment test for the Keystone reporting unit at September 30, 2018. The results of this impairment test showed the fair value of the Keystone reporting unit was lower than its carrying value, resulting in a non-cash, pre-tax impairment charge of \$53 million, which is recorded in Impairment charge on the Consolidated Statement of Operations for the three and nine months ended September 30, 2018. The Company estimated the fair value of the Keystone reporting unit using an income approach valuation technique which estimates the amount and timing of future discounted cash flows from operations of the Keystone reporting unit, relying on multiple projected scenarios. Significant assumptions used in estimating the fair value included, but was not limited to, forecasts of future operating results, including revenue per well, well completions and gross profit margin; capital expenditures; tax rates; working capital; weighted average cost of capital; and long-term growth rates. See Note 14—Fair Value of Financial Assets and Liabilities for further discussion.

Note 7: Stockholders' Equity

Accumulated Other Comprehensive Loss

The following table presents changes in accumulated other comprehensive loss by component, net of tax, for the nine months ended September 30, 2018 and 2017, respectively:

| | Defined Benefit Plans | | | | Gain | Accumulated |
|--|-----------------------|--------------|--------------|-------------|--------|---------------|
| | Employee | Amortization | Amortization | Foreign | on | Other |
| | Benefit | of Prior | of | Currency | Cash | Comprehensive |
| | Funded | Plan | Actuarial | Translation | Flow | Loss |
| | Status | Service | (Gain) | | Hedges | |
| | Cost | Cost | Loss | | | |
| Beginning balance as of December 31, 2017 | \$(140) | \$ 1 | \$ 49 | \$ 1 | \$ 10 | \$ (79) |
| Other comprehensive income before reclassifications | — | — | — | — | 13 | 13 |
| Amounts reclassified from accumulated other comprehensive loss | — | — | 6 | — | — | 6 |
| Net other comprehensive income | — | — | 6 | — | 13 | 19 |
| Ending balance as of September 30, 2018 | \$(140) | \$ 1 | \$ 55 | \$ 1 | \$ 23 | \$ (60) |
| Beginning balance as of December 31, 2016 | \$(147) | \$ 1 | \$ 42 | \$ 2 | \$ 16 | \$ (86) |
| Other comprehensive loss before reclassifications | — | — | — | (1) | (5) | (6) |
| Amounts reclassified from accumulated other comprehensive loss | — | — | 5 | — | — | 5 |
| Net other comprehensive income (loss) | — | — | 5 | (1) | (5) | (1) |
| Ending balance as of September 30, 2017 | \$(147) | \$ 1 | \$ 47 | \$ 1 | \$ 11 | \$ (87) |

The Company does not reclassify the amortization of defined benefit pension cost components from accumulated other comprehensive loss directly to net income in its entirety, as a portion of these costs have been capitalized as a regulatory asset. These accumulated other comprehensive income loss components are included in the computation of net periodic pension cost. See Note 11—Pension and Other Post-Retirement Benefits for further discussion.

The amortization of the gain on cash flow hedges is reclassified to net income during the period incurred and is included in interest, net in the accompanying Consolidated Statements of Operations.

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Anti-dilutive Stock Repurchase Program

During the nine months ended September 30, 2018, the Company repurchased 0.6 million shares of common stock in the open market at an aggregate cost of \$45 million under the anti-dilutive stock repurchase program authorized by the Company's Board of Directors in 2015. As of September 30, 2018, there were 5.5 million shares of common stock available for repurchase under the program.

Equity Forward Transaction

See Note 4—Acquisitions and Divestitures for discussion relating to the forward sale agreements entered into by the Company on April 11, 2018, and the subsequent settlement of these agreements on June 7, 2018.

Note 8: Long-Term Debt

The following long-term debt was issued during the nine months ended September 30, 2018:

| Company | Type | Rate | Maturity | Amount |
|------------------------------|--|-------------|-----------|----------|
| American Water Capital Corp. | Senior Notes—fixed rate | 3.75%-4.20% | 2028-2048 | \$ 1,325 |
| American Water Capital Corp. | Private activity bonds and government funded debt—fixed rate (a) | 0.00%-5.00% | 2020-2048 | 30 |
| Total issuances | | | | \$ 1,355 |

(a) Approximately \$26 million of this debt relates to the New Jersey Environmental Infrastructure Financing Program. The following long-term debt was retired through sinking fund provisions, optional redemptions or payment at maturity during the nine months ended September 30, 2018:

| Company | Type | Rate | Maturity | Amount |
|-----------------------------------|--|-------------|-----------|--------|
| American Water Capital Corp. | Senior Notes—fixed rate | 5.62%-6.25% | 2018-2022 | \$ 310 |
| American Water Capital Corp. | Private activity bonds and government funded debt—fixed rate | 1.79%-2.90% | 2021-2031 | 1 |
| Other American Water subsidiaries | Private activity bonds and government funded debt—fixed rate | 0.00%-5.40% | 2018-2047 | 15 |
| Other American Water subsidiaries | Mortgage bonds—fixed rate | 9.13% | 2021 | 1 |
| Other American Water subsidiaries | Term Loan | 4.83%-5.69% | 2021 | 2 |
| Other American Water subsidiaries | Mandatorily redeemable preferred stock | 8.49% | 2036 | 1 |
| Total retirements and redemptions | | | | \$ 330 |

On August 9, 2018, American Water Capital Corp. (“AWCC”) completed a \$1.325 billion debt offering which included the sale of \$625 million aggregate principal amount of its 3.75% Senior Notes due in 2028, and \$700 million aggregate principal amount of its 4.20% Senior Notes due in 2048. At the closing of the offering, AWCC received, after deduction of underwriting discounts and before deduction of offering expenses, net proceeds of approximately \$1.3 billion. AWCC used proceeds from the offering to: (i) lend funds to American Water and its regulated operating subsidiaries; (ii) repay \$191 million principal amount of AWCC's 5.62% Senior Notes due 2018 upon maturity on December 21, 2018; (iii) prepay \$100 million aggregate principal amount of AWCC's outstanding 5.62% Series E Senior Notes due March 29, 2019 (the “Series E Notes”) and \$100 million aggregate principal amount of AWCC's outstanding 5.77% Series F Senior Notes due March 29, 2022 (the “Series F Notes”, and, together with the Series E Notes, the “Series Notes”); and (iv) repay AWCC's commercial paper obligations and for general corporate purposes.

As a result of AWCC's prepayment of the Series Notes, a make-whole premium of \$10 million was paid to the holders thereof on September 11, 2018. Substantially all of the early debt extinguishment costs were allocable to the Company's utility subsidiaries and recorded as regulatory assets, as the Company believes they are probable of recovery in future rates.

On August 6, 2018, the Company terminated four forward starting swap agreements with an aggregate notional amount of \$400 million, realizing a net gain of \$9 million, to be amortized through interest, net over 10 and 30 year periods, in correlation with the terms of the new debt issued on August 9, 2018.

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On August 17, 2018, the Company entered into two forward starting swap agreements, each with a notional amount of \$80 million, to reduce interest rate exposure on debt expected to be issued in 2019. These forward starting swap agreements terminate in August 2019, and have an average fixed rate of 2.98%. On October 11, 2018, the Company entered into two additional forward starting swap agreements, each with a notional amount of \$100 million, to reduce interest rate exposure on debt expected to be issued in 2019. These forward starting swap agreements terminate in December 2019, and have an average fixed rate of 3.31%. The Company has designated these forward starting swap agreements as cash flow hedges, with their fair value recorded in accumulated other comprehensive gain or loss. Upon termination, the cumulative gain or loss recorded in accumulated other comprehensive gain or loss will be amortized through interest, net over the term of the new debt.

The Company has employed interest rate swaps to fix the interest cost on a portion of its variable-rate debt with an aggregate notional amount of \$5 million. The Company has designated these interest rate swaps as economic hedges, accounted for at fair value with gains or losses deferred as a regulatory asset or regulatory liability. The net gain recognized by the Company for the three and nine months ended September 30, 2018 and 2017 was de minimis. No ineffectiveness was recognized on hedging instruments for the three and nine months ended September 30, 2018 and 2017.

The following table provides a summary of the gross fair value for the Company's derivative assets and liabilities, as well as the location of the asset and liability balances on the Consolidated Balance Sheets:

| Derivative Instruments | Derivative Designation | Balance Sheet Classification | September 30, 2018 | December 31, 2017 |
|------------------------|------------------------|------------------------------|--------------------|-------------------|
| Asset derivative: | | | | |
| Forward starting swaps | Cash flow hedge | Other current assets | \$ 5 | \$ — |
| Liability derivative: | | | | |
| Forward starting swaps | Cash flow hedge | Other current liabilities | \$ — | \$ 3 |

Note 9: Short-Term Debt

On March 21, 2018, AWCC and certain lenders amended and restated the credit agreement with respect to AWCC's revolving credit facility to increase the maximum commitments under the facility from \$1.75 billion to \$2.25 billion, and to extend the expiration date of the facility from June 2020 to March 2023. The facility is used principally to support AWCC's commercial paper program and to provide a sub-limit of up to \$150 million for letters of credit. Subject to satisfying certain conditions, the credit agreement also permits AWCC to increase the maximum commitment under the facility by up to an aggregate of \$500 million, and to request extensions of its expiration date for up to two one-year periods. As of September 30, 2018, AWCC had no outstanding borrowings and \$88 million of outstanding letters of credit under the revolving credit facility, with \$2.16 billion available to fulfill our short-term liquidity needs and to issue letters of credit. The financial covenants with respect to the facility remained unchanged from the credit agreement in effect on December 31, 2017.

On March 21, 2018, AWCC increased the maximum aggregate principal amount of borrowings authorized for issuance under its commercial paper program from \$1.60 billion to \$2.10 billion. As of September 30, 2018, AWCC had \$564 million in commercial paper outstanding. The weighted-average interest rate on AWCC short-term borrowings was approximately 2.39% and 1.38% for the three months ended September 30, 2018 and 2017 respectively, and approximately 2.22% and 1.19% for the nine months ended September 30, 2018 and 2017, respectively.

Note 10: Income Taxes

The Company's effective income tax rate was 27.5% and 40.3% for the three months ended September 30, 2018 and 2017, respectively, and 26.6% and 39.9% for the nine months ended September 30, 2018 and 2017, respectively. The decrease in the Company's effective income tax rate primarily resulted from the reduction in the federal corporate income tax rate from 35% to 21% as of January 1, 2018, from the enactment of the TCJA. There were no significant adjustments recorded during the nine months ended September 30, 2018 pursuant to Staff Accounting Bulletin 118.

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Note 11: Pension and Other Post-Retirement Benefits

The following table provides the components of net periodic benefit (credit) costs:

| | For the Three Months Ended September 30, 2018 | | For the Nine Months Ended September 30, 2017 | |
|--|---|------|--|------|
| Components of net periodic pension benefit cost: | | | | |
| Service cost | \$8 | \$8 | \$25 | \$25 |
| Interest cost | 19 | 20 | 57 | 60 |
| Expected return on plan assets | (24) | (23) | (73) | (70) |
| Amortization of actuarial loss | 6 | 9 | 20 | 27 |
| Net periodic pension benefit cost | \$9 | \$14 | \$29 | \$42 |

Components of net periodic other post-retirement benefit (credit) cost:

| | | | | |
|--|-------|-----|--------|------|
| Service cost | \$2 | \$3 | \$7 | \$8 |
| Interest cost | 5 | 7 | 16 | 20 |
| Expected return on plan assets | (7) | (7) | (20) | (20) |
| Amortization of prior service credit | (7) | (5) | (16) | (14) |
| Amortization of actuarial loss | 1 | 3 | 3 | 8 |
| Net periodic other post-retirement benefit (credit) cost | \$(6) | \$1 | \$(10) | \$2 |

The Company made a contribution of \$11 million for the funding of its defined benefit pension plans for the three and nine months ended September 30, 2018, and made contributions of \$11 million and \$31 million for the three and nine months ended September 30, 2017, respectively. In addition, the Company made no contributions for the funding of its other post-retirement plans for the three and nine months ended September 30, 2018, and made contributions of \$2 million and \$5 million for the three and nine months ended September 30, 2017, respectively. The Company expects to make pension contributions to the plan trusts of up to \$11 million during the remainder of 2018.

On August 31, 2018, the other postretirement benefit plan was remeasured to reflect an announced plan amendment which changed benefits for certain union and non-union plan participants. The remeasurement included a \$175 million reduction in future benefits payable to plan participants, and resulted in a \$227 million reduction to the net accumulated postretirement benefit obligation. The plan amendment will be amortized over 10.2 years, the average future working lifetime to full eligibility age for all plan participants. The following table provides the significant assumptions related to the Company's other postretirement benefit plan:

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Weighted-average assumptions used to determine benefit obligations: | | |
| Discount rate | 4.23% | 3.73% |
| Expected return on plan assets | 4.77% | 4.77% |
| Medical trend | graded from 7.00% in 2018 to 4.50% in 2026+ | graded from 7.00% in 2018 to 4.50% in 2026+ |

Note 12: Commitments and Contingencies

Contingencies

The Company is routinely involved in legal actions incident to the normal conduct of its business. As of September 30, 2018, the Company has accrued approximately \$55 million of probable loss contingencies and has estimated that the maximum amount of losses associated with reasonably possible loss contingencies that can be reasonably estimated is \$25 million. For certain matters, claims and actions, the Company is unable to estimate possible losses. The Company believes that damages or settlements, if any, recovered by plaintiffs in such matters,

claims or actions, other than as described in this Note 12—Commitments and Contingencies, will not have a material adverse effect on the Company.

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West Virginia Elk River Freedom Industries Chemical Spill

Global Class Action Litigation Settlement

On June 8, 2018, the U.S. District Court for the Southern District of West Virginia granted final approval of a settlement class and global class action settlement (the “Settlement”) for all claims and potential claims by all putative class members (collectively, the “Plaintiffs”) arising out of the January 2014 Freedom Industries, Inc. chemical spill in West Virginia. The effective date of the Settlement is July 16, 2018.

Under the terms and conditions of the Settlement, West Virginia-American Water Company (“WVAWC”) and certain other Company affiliated entities (collectively, the “American Water Defendants”) have not admitted, and will not admit, any fault or liability for any of the allegations made by the Plaintiffs in any of the actions that were resolved. Under federal class action rules, claimants had the right, until December 8, 2017, to elect to opt out of the final Settlement. Less than 100 of the 225,000 estimated putative class members opted out from the Settlement, and these claimants will not receive any benefit from or be bound by the terms of the Settlement.

In June 2018, the Company and its remaining non-participating general liability insurance carrier settled for a payment to the Company of \$20 million, out of a maximum of \$25 million in potential coverage under the terms of the relevant policy, in exchange for a full release by the American Water Defendants of all claims against the insurance carrier related to the Freedom Industries chemical spill.

As a result, the aggregate pre-tax amount to be contributed by WVAWC of the \$126 million Settlement with respect to the Company, net of insurance recoveries, is \$23 million. As of September 30, 2018, \$40 million of the aggregate settlement amount of \$126 million, reflecting payments made by the Company under the terms of the Settlement, is reflected in Accrued Liabilities, and the offsetting insurance receivables are reflected in Other Current Assets on the Consolidated Balance Sheet. The Company has funded WVAWC’s contributions to the Settlement through existing sources of liquidity.

Other Related Proceedings

On March 16, 2017, the Lincoln County (West Virginia) Commission (the “LCC”) passed a county ordinance entitled the “Lincoln County, WV Comprehensive Public Nuisance Investigation and Abatement Ordinance.” The ordinance establishes a mechanism that Lincoln County believes will allow it to pursue criminal or civil proceedings for the “public nuisance” it alleges was caused by the Freedom Industries chemical spill. On April 20, 2017, the LCC filed a civil complaint in Lincoln County circuit court against WVAWC and certain other defendants not affiliated with the Company, alleging that the Freedom Industries chemical spill caused a public nuisance in Lincoln County. The complaint seeks an injunction against WVAWC that would require the creation of various databases and public repositories of documents related to the Freedom Industries chemical spill, as well as further study and risk assessments regarding the alleged exposure of Lincoln County residents to the released chemicals. On June 12, 2017, the West Virginia Mass Litigation Panel entered an order granting a motion to transfer this case to its jurisdiction and stayed the case consistent with the existing stay order. The LCC has elected to opt out of the Settlement. On January 26, 2018, the LCC filed a motion seeking to lift the stay imposed by the Mass Litigation Panel. On March 5, 2018, this motion was denied. On July 31, 2018, WVAWC filed a motion to dismiss the LCC’s complaint. On September 21, 2018, the Mass Litigation Panel heard arguments on this motion. This motion remains pending. WVAWC believes that this lawsuit is without merit and intends to vigorously contest the claims and allegations raised in the complaint. On September 28, 2018, the Mass Litigation Panel entered an order dismissing all of its pending cases except for two, one of which was the LCC’s complaint discussed above.

California Public Utilities Commission Residential Rate Design Proceeding

On July 12, 2018, the California Public Utilities Commission (the “CPUC”) adopted the April 9, 2018 presiding officer’s decision that resolved the CPUC’s residential tariff administration proceeding. The adoption provides for a waiver by California-American Water Company, a wholly owned subsidiary of the Company, of \$0.5 million of cost recovery for residential customers through the water revenue adjustment mechanism/modified cost balancing account, in lieu of a penalty.

Dunbar, West Virginia Water Main Break Class Action Litigation

On the evening of June 23, 2015, a 36-inch pre-stressed concrete transmission water main, installed in the early 1970s, failed. The water main is part of WVAWC’s West Relay pumping station located in the City of Dunbar. The failure of

the main caused water outages and low pressure to up to approximately 25,000 WVAWC customers. In the early morning hours of June 25, 2015, crews completed a repair, but that same day, the repair developed a leak. On June 26, 2015, a second repair was completed and service was restored that day to approximately 80% of the impacted customers, and to the remaining approximately 20% by the next morning. The second repair showed signs of leaking but the water main was usable until June 29, 2015 to allow tanks to refill. The system was reconfigured to maintain service to all but approximately 3,000 customers while a final repair was completed safely on June 30, 2015. Water service was fully restored by July 1, 2015 to all customers affected by this event.

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On June 2, 2017, a class action complaint was filed in West Virginia Circuit Court in Kanawha County against WVAWC on behalf of a purported class of residents and business owners who lost water service or pressure as a result of the Dunbar main break. The complaint alleges breach of contract by WVAWC for failure to supply water, violation of West Virginia law regarding the sufficiency of WVAWC's facilities and negligence by WVAWC in the design, maintenance and operation of the water system. The plaintiffs seek unspecified alleged damages on behalf of the class for lost profits, annoyance and inconvenience, and loss of use, as well as punitive damages for willful, reckless and wanton behavior in not addressing the risk of pipe failure and a large outage.

On October 12, 2017, WVAWC filed with the court a motion seeking to dismiss all of the plaintiffs' counts alleging statutory and common law tort claims. Furthermore, WVAWC asserted that the Public Service Commission of West Virginia, and not the court, has primary jurisdiction over allegations involving violations of the applicable tariff, the public utility code and related rules. On May 30, 2018, the court, at a hearing, denied WVAWC's motion to apply the primary jurisdiction doctrine, and on October 11, 2018, the court issued a written order to that effect. The court will issue a written order on the motion to dismiss, and has set a trial date of August 26, 2019.

The Company and WVAWC believe that WVAWC has valid, meritorious defenses to the claims raised in this class action complaint. WVAWC is vigorously defending itself against these allegations. Given the current stage of this proceeding, the Company cannot reasonably estimate the amount of any reasonably possible losses or a range of such losses related to this proceeding.

Note 13: Earnings per Common Share

The following table is a reconciliation of the numerator and denominator for basic and diluted earnings per share ("EPS") calculations:

| | For the | | For the | |
|--|-----------|-----------|-----------|-----------|
| | Three | Nine | Three | Nine |
| | Months | Months | Months | Months |
| | Ended | Ended | Ended | Ended |
| | September | September | September | September |
| | 30, | 30, | 30, | 30, |
| | 2018 | 2017 | 2018 | 2017 |
| Numerator: | | | | |
| Net income attributable to common stockholders | \$187 | \$203 | \$455 | \$427 |

Denominator:

| | | | | |
|--|-----|-----|-----|-----|
| Weighted-average common shares outstanding—Basic | 181 | 178 | 179 | 178 |
| Effect of dilutive common stock equivalents | — | 1 | 1 | 1 |
| Weighted-average common shares outstanding—Diluted | 181 | 179 | 180 | 179 |

The effect of dilutive common stock equivalents is related to outstanding stock options, restricted stock units and performance stock units granted under the 2007 and 2017 Omnibus Equity Compensation Plans, as well as estimated shares to be purchased under the Company's 2017 Nonqualified Employee Stock Purchase Plan. Less than one million share-based awards were excluded from the computation of diluted EPS for the three and nine months ended September 30, 2018 and 2017 because their effect would have been anti-dilutive under the treasury stock method.

Equity Forward Transaction and Common Stock Issuance

See Note 4—Acquisitions and Divestitures for discussion regarding the forward sale agreements entered into by the Company on April 11, 2018, and the physical settlement of these agreements on June 7, 2018.

Note 14: Fair Value of Financial Assets and Liabilities

Fair Values of Financial Instruments

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Current assets and current liabilities—The carrying amounts reported on the Consolidated Balance Sheets for current assets and current liabilities, including revolving credit debt, due to the short-term maturities and variable interest

rates, approximate their fair values.

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Preferred stock with mandatory redemption requirements and long-term debt—The fair values of preferred stock with mandatory redemption requirements and long-term debt are categorized within the fair value hierarchy based on the inputs that are used to value each instrument. The fair value of long-term debt classified as Level 1 is calculated using quoted prices in active markets. Level 2 instruments are valued using observable inputs and Level 3 instruments are valued using observable and unobservable inputs. The fair values of instruments classified as Level 2 and Level 3 are determined by a valuation model that is based on a conventional discounted cash flow methodology and utilizes assumptions of current market rates. As a majority of the Company's debt is not traded in active markets, the Company calculated a base yield curve using a risk-free rate (a U.S. Treasury securities yield curve) plus a credit spread that is based on the following two factors: an average of the Company's own publicly-traded debt securities and the current market rates for U.S. Utility A debt securities. The Company used these yield curve assumptions to derive a base yield for the Level 2 and Level 3 securities. Additionally, the Company adjusted the base yield for specific features of the debt securities, including call features, coupon tax treatment and collateral for the Level 3 instruments.

The following table presents the carrying amounts, including fair value adjustments previously recognized in acquisition purchase accounting and a fair value adjustment related to the Company's interest rate swap fair value hedge (which is classified as Level 2 in the fair value hierarchy), and the fair values of the financial instruments:

| | Carrying Amount | At Fair Value as of | | | |
|--|-----------------|---------------------|---------|---------|---------|
| | | September 30, 2018 | Level 1 | Level 2 | Level 3 |
| Preferred stock with mandatory redemption requirements | \$ 9 | \$ — | \$ — | \$ 11 | \$ 11 |
| Long-term debt (excluding capital lease obligations) | 7,831 | 5,708 | 1,703 | 8,125 | |

| | Carrying Amount | At Fair Value as of | | | |
|--|-----------------|---------------------|---------|---------|---------|
| | | December 31, 2017 | Level 1 | Level 2 | Level 3 |
| Preferred stock with mandatory redemption requirements | \$ 10 | \$ — | \$ — | \$ 14 | \$ 14 |
| Long-term debt (excluding capital lease obligations) | 6,809 | 4,876 | 1,821 | 7,643 | |

Recurring Fair Value Measurements

The following table presents assets and liabilities measured and recorded at fair value on a recurring basis and their level within the fair value hierarchy as of September 30, 2018 and December 31, 2017, respectively:

| | At Fair Value as of | | | |
|---------------------------------------|---------------------|---------|---------|-------|
| | September 30, 2018 | | | |
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Restricted funds | \$31 | \$ — | \$ — | \$ 31 |
| Rabbi trust investments | 16 | — | — | 16 |
| Deposits | 3 | — | — | 3 |
| Mark-to-market derivative assets | — | 5 | — | 5 |
| Other investments | 6 | — | — | 6 |
| Total assets | 56 | 5 | — | 61 |
| Liabilities: | | | | |
| Deferred compensation obligations | 18 | — | — | 18 |
| Mark-to-market derivative liabilities | — | — | — | — |
| Total liabilities | 18 | — | — | 18 |
| Total net assets (liabilities) | \$38 | \$ 5 | \$ — | \$ 43 |

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| | At Fair Value as of December 31, 2017 | | | |
|-------------------------|--|------------|------------|--------|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Restricted funds | \$28 | \$— | \$— | —\$ 28 |
| Rabbi trust investments | 15 | — | — | 15 |
| Deposits | 4 | — | — | 4 |
| Other investments | 3 | — | — | 3 |
| Total assets | 50 | — | — | 50 |

Liabilities:

| | | | | |
|---------------------------------------|------|---------|-----|--------|
| Deferred compensation obligations | 17 | — | — | 17 |
| Mark-to-market derivative liabilities | — | 3 | — | 3 |
| Total liabilities | 17 | 3 | — | 20 |
| Total net assets (liabilities) | \$33 | \$ (3) | \$— | —\$ 30 |

Restricted funds—The Company's restricted funds primarily represent proceeds received from financings for the construction and capital improvement of facilities and from customers for future services under operations, maintenance and repair projects. Long-term restricted funds of \$1 million and \$1 million were included in other long-term assets as of September 30, 2018 and December 31, 2017, respectively.

Rabbi trust investments—The Company's rabbi trust investments consist of equity and index funds from which supplemental executive retirement plan benefits and deferred compensation obligations can be paid. The Company includes these assets in other long-term assets.

Deposits—Deposits include escrow funds and certain other deposits held in trust. The Company includes cash deposits in other current assets.

Deferred compensation obligations—The Company's deferred compensation plans allow participants to defer certain cash compensation into notional investment accounts. The Company includes such plans in other long-term liabilities. The value of the Company's deferred compensation obligations is based on the market value of the participants' notional investment accounts. The notional investments are comprised primarily of mutual funds, which are based on observable market prices.

Mark-to-market derivative assets and liabilities—The Company utilizes fixed-to-floating interest-rate swaps, typically designated as fair-value hedges, to achieve a targeted level of variable-rate debt as a percentage of total debt. The Company also employs derivative financial instruments in the form of variable-to-fixed interest rate swaps and forward starting interest rate swaps, classified as economic hedges and cash flow hedges, respectively, in order to fix the interest cost on existing or forecasted debt. The Company uses a calculation of future cash inflows and estimated future outflows, which are discounted, to determine the current fair value. Additional inputs to the present value calculation include the contract terms, counterparty credit risk, interest rates and market volatility.

Other investments—Other investments primarily represent money market funds used for active employee benefits. The Company includes other investments in other current assets.

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Nonrecurring Fair Value Measurements

The following table presents assets measured and recorded at fair value on a nonrecurring basis and their level within the fair value hierarchy as of September 30, 2018:

At Fair Value as of
September 30, 2018

| Level | Level | Level | Total | Total Impairment Expense for the Nine Months Ended September 30, 2018 |
|-------|-------|-------|-------|--|
| 1 | 2 | 3 | | |

Assets:

| | | | | |
|-------------------------------|------------|---------------|--------------|--------------|
| Keystone goodwill (a) | \$— | —\$ 38 | \$ 38 | \$ 53 |
| Keystone intangible asset (a) | — | 3 | 3 | 4 |
| Total | \$— | —\$ 41 | \$ 41 | \$ 57 |

As of December 31, 2017, Keystone's goodwill balance was \$91 million and its intangible asset balance was \$8 (a) million. Subsequent to the impairment charge recorded in the third quarter of 2018, Keystone's goodwill and intangible asset balances were \$38 million and \$3 million, respectively, as of September 30, 2018.

The Company's estimation of the fair value of the Keystone reporting unit as part of evaluating its goodwill and intangible asset for impairment represents a Level 3 fair value measurement, due to the use of internal projections and unobservable measurement inputs. See Note 6—Goodwill and Other Intangible Assets for further discussion.

Note 15: Segment Information

The Company operates its businesses primarily through one reportable segment, the Regulated Businesses segment. The Company also operates businesses that provide a broad range of related and complementary water and wastewater services in non-regulated markets, which includes four operating segments that individually do not meet the criteria of a reportable segment. These four non-reportable operating segments are collectively presented as the "Market-Based Businesses." "Other" includes corporate costs that are not allocated to the Company's operating segments, eliminations of inter-segment transactions, fair value adjustments and associated income and deductions related to the acquisitions that have not been allocated to the operating segments for evaluation of performance and allocation of resource purposes. The following tables include the Company's summarized segment information:

| | As of or for the Three Months Ended September 30, 2018 | | | |
|--|---|----------------------------|---------|--------------|
| | Regulated Businesses | Market-Based Businesses | Other | Consolidated |
| Operating revenues | \$857 | \$ 125 | \$ (6) | \$ 976 |
| Depreciation and amortization | 128 | 9 | 4 | 141 |
| Impairment charge | — | 57 | — | 57 |
| Total operating expenses, net | 505 | 139 | (3) | 641 |
| Interest, net | (71) | — | (18) | (89) |
| Income before income taxes | 288 | (14) | (19) | 255 |
| Provision for income taxes | 76 | (5) | (1) | 70 |
| Net income attributable to common stockholders | 213 | (7) | (19) | 187 |
| Total assets | 18,415 | 973 | 1,492 | 20,880 |
| Capital expenditures | 373 | 2 | 22 | 397 |

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| | As of or for the Three Months Ended | | | |
|--|-------------------------------------|----------------------------|---------|--------------|
| | September 30, 2017 | | | |
| | Regulated Businesses | Market-Based Businesses | Other | Consolidated |
| Operating revenues | \$842 | \$ 100 | \$ (6) | \$ 936 |
| Depreciation and amortization | 121 | 5 | 2 | 128 |
| Total operating expenses, net | 429 | 80 | (5) | 504 |
| Interest, net | (67) | 1 | (23) | (89) |
| Income before income taxes | 347 | 21 | (28) | 340 |
| Provision for income taxes | 135 | 7 | (5) | 137 |
| Net income attributable to common stockholders | 212 | 14 | (23) | 203 |
| Total assets | 17,390 | 600 | 1,371 | 19,361 |
| Capital expenditures | 336 | 3 | 23 | 362 |
| | As of or for the Nine Months Ended | | | |
| | September 30, 2018 | | | |
| | Regulated Businesses | Market-Based Businesses | Other | Consolidated |
| Operating revenues | \$2,267 | \$ 339 | \$(16) | \$ 2,590 |
| Depreciation and amortization | 373 | 20 | 11 | 404 |
| Impairment charge | — | 57 | — | 57 |
| Total operating expenses, net | 1,420 | 323 | (7) | 1,736 |
| Interest, net | (209) | 3 | (53) | (259) |
| Income before income taxes | 656 | 20 | (59) | 617 |
| Provision for income taxes | 173 | 4 | (13) | 164 |
| Net income attributable to common stockholders | 484 | 18 | (47) | 455 |
| Total assets | 18,415 | 973 | 1,492 | 20,880 |
| Capital expenditures | 1,050 | 9 | 77 | 1,136 |
| | As of or for the Nine Months Ended | | | |
| | September 30, 2017 | | | |
| | Regulated Businesses | Market-Based Businesses | Other | Consolidated |
| Operating revenues | \$2,247 | \$ 306 | \$(17) | \$ 2,536 |
| Depreciation and amortization | 357 | 13 | 8 | 378 |
| Total operating expenses, net | 1,315 | 263 | (14) | 1,564 |
| Interest, net | (200) | 2 | (61) | (259) |
| Income before income taxes | 731 | 46 | (66) | 711 |
| Provision for income taxes | 285 | 17 | (18) | 284 |
| Net income attributable to common stockholders | 446 | 29 | (48) | 427 |
| Total assets | 17,390 | 600 | 1,371 | 19,361 |
| Capital expenditures | 878 | 7 | 79 | 964 |

Note 16: Subsequent Events

On October 10, 2018, pursuant to the exercise of a put option by the minority owner, the Company acquired an additional 3% membership interest in Water Solutions Holdings, LLC, which includes Keystone, its wholly owned subsidiary, bringing the Company's interest to 98%.

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ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read together with the unaudited Consolidated Financial Statements and Notes thereto included elsewhere in this Form 10-Q, and in our Form 10-K for the year ended December 31, 2017. This discussion contains forward-looking statements that are based on management’s current expectations, estimates and projections about our business, operations and financial performance. The cautionary statements made in this Form 10-Q should be read as applying to all related forward-looking statements whenever they appear in this Form 10-Q. Our actual results may differ materially from those currently anticipated and expressed in such forward-looking statements as a result of a number of factors, including those we discuss under “Forward-Looking Statements,” and elsewhere in this Form 10-Q.

Overview

Through its subsidiaries, American Water Works Company, Inc. is the largest and most geographically diverse, publicly-traded water and wastewater utility company in the United States, as measured by both operating revenue and population served. Our primary business involves the ownership of utilities that provide water and wastewater services to residential, commercial, industrial, public authority, fire service and sale for resale customers, collectively presented as our “Regulated Businesses.” Our utilities are generally subject to economic regulation by certain state utility commissions or other entities engaged in utility regulation, collectively referred to as public utility commissions (“PUCs” or “Regulators”). We also operate several market-based businesses, not subject to economic regulated by PUCs, that provide a broad range of related and complementary water and wastewater services to military bases, municipalities and shale natural gas exploration and production companies, as well as residential, commercial and industrial customers. Individually, these four operating segments do not meet the criteria of a reportable segment in accordance with generally accepted accounting principles in the United States (“GAAP”), and are collectively presented as our “Market-Based Businesses”. See Part I, Item 1—Business in our Form 10-K for further discussion.

Throughout this Form 10-Q, unless the context otherwise requires, references to “we”, “us”, “our”, the “Company” and “American Water” mean American Water Works Company, Inc. and its subsidiaries, taken together as a whole.

References to “parent company” mean American Water Works Company, Inc., without its subsidiaries.

Quarter Highlights

On July 5, 2018, we entered into an agreement for the sale of 22 of our Contract Services Group’s 33 operation and maintenance (“O&M”) contracts to subsidiaries of Veolia Environnement S.A. for \$27 million. During the third quarter of 2018, we closed on the sale of 20 of the 22 contracts associated with this agreement, recognizing an after-tax gain of \$10 million, or \$0.06 per share. We expect to close on the sale of the remaining two contracts, subject to customer consents, by the end of 2018.

As a result of operational and financial challenges encountered in the construction business of Keystone Clearwater Solutions, LLC (“Keystone”), the Company decided to exit this business line during the third quarter of 2018. This action, along with the exit of the water trucking business line during the first half of 2018, narrowed the scope of the Keystone business going forward, focusing solely on providing water transfer services. These factors prompted the impairment testing of Keystone’s goodwill and customer relationship intangible asset at September 30, 2018, resulting in a non-cash, after-tax, impairment charge of \$40 million, net of noncontrolling interest, or \$0.22 per share. See Note 6—Goodwill and Other Intangible Assets in the Notes to the Consolidated Financial Statements for further discussion.

On October 29, 2018, our New Jersey subsidiary received an order on its general rate case filing, authorizing additional annualized revenues of \$40 million, effective as of June 15, 2018. The order authorized a 9.6% return on equity and a capital structure of 46% debt and 54% equity. The order also approved the inclusion of \$35 million of infrastructure surcharges in base rates and remanded the regulatory treatment of certain acquisition adjustments to a separate proceeding.

On October 26, 2018, our West Virginia subsidiary, the staff of the Public Service Commission of West Virginia (“WVPSC”) and the Consumer Advocate Division filed a joint stipulation for the general rate case that would provide for \$23 million in additional annualized revenues and keep the current, 9.75% authorized return on equity. The joint stipulation would allow for our West Virginia subsidiary’s excess deferred income tax amortization to be used to offset future infrastructure surcharges, and for the implementation of a customer lead service line replacement program. This

joint stipulation is subject to the WVPSC's approval.

Our Military Services Group was awarded a contract for ownership, operation and maintenance of the water and wastewater systems at Fort Leonard Wood in Missouri, effective October 1, 2018. The contract award includes estimated revenues of approximately \$591 million over a 50-year period, subject to an annual economic price adjustment.

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On August 9, 2018, American Water Capital Corp. (“AWCC”), our wholly owned finance subsidiary, completed a \$1.325 billion debt offering which included the sale of \$625 million aggregate principal amount of its 3.75% Senior Notes due in 2028, and \$700 million aggregate principal amount of its 4.20% Senior Notes due in 2048. AWCC used proceeds from the offering to lend funds to American Water and its regulated subsidiaries, to repay various senior notes and commercial paper obligations, and for general corporate purposes. See Note 8—Long-Term Debt in the Notes to the Consolidated Financial Statements for further discussion.

Every five years, we negotiate national health and welfare benefits with our union-represented employees. On July 31, 2018, a new, five-year national benefits agreement was ratified, covering approximately 3,200 of our union-represented employees, which includes 17 labor unions and 69 collective bargaining agreements. Highlights of the new agreement include union-represented employees’ participation in the Company’s cash-based annual performance plan, changes to certain retiree medical benefits and additional medical plan options for our employees and their families.

Financial Results

The following table provides highlights of our diluted earnings per share and our adjusted diluted earnings per share (a non-GAAP measure) for the three and nine months ended September 30, 2018:

| | For the Three Months Ended September 30, 2018 | | For the Nine Months Ended September 30, 2017 | |
|--|--|---------|---|---------|
| Diluted earnings per share (GAAP): | | | | |
| Net income attributable to common stockholders | \$1.04 | \$1.13 | \$2.53 | \$2.39 |
| Non-GAAP adjustments: | | | | |
| Gain on sale of portion of Contract Services Group contracts | (0.08) | — | (0.08) | — |
| Income tax impact | 0.02 | — | 0.02 | — |
| Net non-GAAP adjustment | (0.06) | — | (0.06) | — |
| Impairment charge | 0.31 | — | 0.31 | — |
| Income tax impact | (0.08) | — | (0.08) | — |
| Net loss attributable to noncontrolling interest | (0.01) | — | (0.01) | — |
| Net non-GAAP adjustment | 0.22 | — | 0.22 | — |
| Impact of Freedom Industries settlement activities | — | (0.12) | (0.11) | (0.12) |
| Income tax impact | — | 0.05 | 0.03 | 0.05 |
| Net non-GAAP adjustment | — | (0.07) | (0.08) | (0.07) |
| Early debt extinguishment at the parent company | — | 0.03 | — | 0.03 |
| Income tax impact | — | (0.01) | — | (0.01) |
| Net non-GAAP adjustment | — | 0.02 | — | 0.02 |
| Total net non-GAAP adjustments | 0.16 | (0.05) | 0.08 | (0.05) |
| Adjusted diluted earnings per share (non-GAAP) | \$1.20 | \$1.08 | \$2.61 | \$2.34 |

For the three months ended September 30, 2018, net income attributable to common stockholders was \$1.04 per diluted share, a decrease of \$0.09 per diluted share, or 8.0%, as compared to the same period in 2017. Included in the 2018 amount was an after-tax benefit of \$10 million, or \$0.06 per diluted share, resulting from a gain recognized on the sale of the majority of our Contract Services Group’s O&M contracts to subsidiaries of Veolia Environnement S.A., and an after-tax charge of \$40 million, net of noncontrolling interest, or \$0.22 per diluted share, resulting from a goodwill and intangible asset impairment charge related to Keystone. Included in the 2017 amount was an after-tax benefit of \$13 million, or \$0.07 per diluted share, resulting from an insurance settlement with one of our general

liability insurance carriers related to the Freedom Industries matter in West Virginia, and an after-tax charge of \$4 million, or \$0.02 per diluted share, resulting from an early debt extinguishment charge at the parent company.

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Adjusted diluted earnings per share (a non-GAAP measure) was \$1.20 for the three months ended September 30, 2018, an increase of \$0.12 per diluted share, or 11.1%, as compared to the same period in 2017. This increase was primarily due to continued growth in our Regulated Businesses, largely driven by infrastructure investment, acquisitions and organic growth, combined with growth in our Market-Based Businesses, mainly from our Homeowner Services Group, with integration expenses from the acquisition of Pivotal Home Solutions (“Pivotal”) on June 4, 2018, lower than projected during the third quarter.

For the nine months ended September 30, 2018, net income attributable to common stockholders was \$2.53 per diluted share, an increase of \$0.14 per diluted share, or 5.9%, as compared to the same period in 2017. Included in the 2018 amount was: (i) an after-tax benefit of \$10 million, or \$0.06 per diluted share, resulting from a gain recognized on the sale of the majority of our Contract Services Group’s O&M contracts to subsidiaries of Veolia Environnement S.A.; (ii) an after-tax charge of \$40 million, net of noncontrolling interest, or \$0.22 per diluted share, resulting from a goodwill and intangible asset impairment charge related to Keystone; and (iii) an after-tax benefit of \$15 million, or \$0.08 per diluted share, resulting from an insurance settlement with one of our general liability insurance carriers related to the Freedom Industries matter in West Virginia. Included in the 2017 amount was an after-tax benefit of \$13 million, or \$0.07 per diluted share, resulting from an insurance settlement with one of our general liability insurance carriers related to the Freedom Industries matter, and an after-tax charge of \$4 million, or \$0.02 per diluted share, resulting from an early debt extinguishment charge at the parent company.

Adjusted diluted earnings per share (a non-GAAP measure) was \$2.61 for the nine months ended September 30, 2018, an increase of \$0.27 per diluted share, or 11.5%, as compared to the same period in 2017. This increase was primarily due to continued growth in our Regulated Businesses, largely driven by infrastructure investment, acquisitions and organic growth, combined with growth in our Market-Based Businesses, mainly from our Homeowner Services Group, with integration expenses from the acquisition of Pivotal, lower than projected mainly during the third quarter. Adjusted diluted earnings per share represents a non-GAAP financial measure and is calculated as GAAP diluted earnings per share, excluding the impact of one or more of the following events: (i) the gain recognized in the third quarter of 2018 on the sale of the majority of our Contract Services Group’s O&M contracts; (ii) a goodwill and intangible asset impairment charge related to narrowing of the scope of the Keystone business in the third quarter of 2018; (iii) the September 2017 and June 2018 insurance settlements related to the Freedom Industries chemical spill in West Virginia; and (iv) the early debt extinguishment charges incurred in September 2017 with respect to the prepayment of debt allocated to the parent company, each as quantified in the table above. We believe that this non-GAAP measure provides investors with useful information by excluding certain matters that may not be indicative of our ongoing operating results, and that providing this non-GAAP measure will allow investors to understand better our businesses’ operating performance and facilitate a meaningful year-to-year comparison of our results of operations. Although management uses this non-GAAP financial measure internally to evaluate our results of operations, we do not intend results excluding the adjustments to represent results as defined by GAAP, and the reader should not consider them as indicators of performance. This non-GAAP financial measure is derived from our consolidated financial information but is not presented in our financial statements prepared in accordance with GAAP, and thus it should be considered in addition to, and not as a substitute for, measures of financial performance prepared in accordance with GAAP. In addition, this non-GAAP financial measure as defined and used above may not be comparable to similarly titled non-GAAP measures used by other companies, and, accordingly, it may have significant limitations on its use.

Focusing on Central Themes

In 2018, our strategy, which is driven by our vision and core values, will continue to be anchored on our five central themes: (i) safety; (ii) customers; (iii) people; (iv) growth; and (v) technology and operational efficiency. We continue to focus on operating our business responsibly and managing our operating and capital costs in a manner that benefits our customers and produces long-term value for our stockholders. Additionally, we continue to execute on our ongoing strategy that ensures a safe workplace for our employees, emphasizes public safety for our customers and communities, and leverages our human resources, processes and technology innovation to make our business more effective and efficient. The progress that we have made during the first nine months of 2018 with respect to growth and improvement in our operational efficiency is described below.

Growth—Infrastructure investments and acquisitions

During the first nine months of 2018, we made capital investments of approximately \$1.5 billion, focused in three key areas:

\$1.1 billion, of which the majority was in our Regulated Businesses for infrastructure improvements;

\$365 million to acquire Pivotal, as discussed below; and

\$18 million for acquisitions in our Regulated Businesses, which added approximately 7,600 water and wastewater customers.

For the full year of 2018, our capital investment is expected to be in the range of \$2.0 billion to \$2.1 billion, which includes the acquisition of Pivotal in the second quarter of 2018.

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Our Military Services Group was awarded a contract for ownership, operation and maintenance of the water and wastewater systems at Fort Leonard Wood in Missouri, effective October 1, 2018. Designated as the U.S. Army's Maneuver Support Center of Excellence and the home to three U.S. Army schools, Fort Leonard Wood directly and indirectly supports 36,400 jobs across the state of Missouri. The contract award includes estimated revenues of approximately \$591 million over a 50-year period, subject to an annual economic price adjustment.

In the course of pursuing our long-term strategy and growth initiatives for our Market-Based Businesses, on July 5, 2018, we entered into an agreement for the sale of 22 of our Contract Services Group's 33 O&M contracts to subsidiaries of Veolia Environnement S.A. for \$27 million. We closed on the sale of 20 of the 22 contracts during the third quarter of 2018, and expect to close on the sale of the remaining two contracts associated with this agreement, subject to customer consents, by the end of 2018. We will retain four of our Contract Services Group's O&M contracts due to their proximity to our existing service areas, and expect the majority of the remaining contracts to be sold to other parties or expire within the next twelve months.

On June 4, 2018, American Water Enterprises, LLC, a wholly owned subsidiary of the Company, completed the acquisition of Pivotal for a purchase price of \$365 million, including \$9 million in working capital. Headquartered in Naperville, Illinois, Pivotal is a leading provider of home warranty protection products and services for gas, electric and other service lines inside and around a home, heating and cooling systems, and home appliances, operating in 18 states, with approximately 1.2 million customer contracts at the time of acquisition. Pivotal joins our Homeowner Services Group which provides similar home warranty protection products and services, primarily for external water and sewer lines. This transaction was financed with approximately 50% debt and 50% equity, and included the Company's election to physically settle the equity forward sale agreements entered into on April 11, 2018. See Note 4—Acquisitions and Divestitures in the Notes to the Consolidated Financial Statements for further discussion.

On May 30, 2018, our Pennsylvania subsidiary entered into an agreement to acquire the wastewater assets of Exeter Township, Pennsylvania, for approximately \$96 million. This system currently serves approximately 9,000 customers and we are expecting to close this acquisition during the second quarter of 2019, pending regulatory approval.

On April 13, 2018, our Illinois subsidiary entered into an agreement to acquire the City of Alton, Illinois' regional wastewater system for approximately \$54 million. This system currently serves approximately 23,000 customer equivalents, comprised of approximately 11,000 customer connections in Alton and an additional 12,000 customers under bulk contracts in the nearby communities of Bethalto and Godfrey. We are expecting to close this acquisition by the end of the first quarter of 2019, pending regulatory approval.

Technology & Operational Efficiency—Continued improvement in our Regulated Businesses' adjusted O&M efficiency ratio

Our adjusted O&M efficiency ratio, which we use as a measure of our operating performance, was 35.7% for the twelve months ended September 30, 2018, as compared to 35.9% for the twelve months ended September 30, 2017, with all periods prior to January 1, 2018, presented on a pro forma basis to include the estimated impact of the TCJA on operating revenues. The improvement in this ratio was primarily attributable to an increase in operating revenue in our Regulated Businesses.

Our adjusted O&M efficiency ratio is defined as the operation and maintenance expenses from our Regulated Businesses, divided by the pro forma operating revenues from our Regulated Businesses, where both operation and maintenance expenses and pro forma operating revenues were adjusted to eliminate purchased water expense. Additionally, from operation and maintenance expenses, we excluded the allocable portion of non-operation and maintenance support services costs, mainly depreciation and general taxes, that are reflected in our Regulated Businesses segment as operation and maintenance expenses, but for consolidated financial reporting purposes, are categorized within other line items in the accompanying Consolidated Statements of Operations.

In addition to the adjustments discussed above, for period-to-period comparability purposes, we have presented the estimated impact of the TCJA on operating revenues for our Regulated Businesses on a pro forma basis for all periods presented prior to January 1, 2018, as if the lower federal corporate income tax rate was in effect for these periods (see Note 5—Regulatory Liabilities in the Notes to the Consolidated Financial Statements for further discussion). We also excluded from operation and maintenance expenses the impact of certain Freedom Industries chemical spill settlement activities recognized in 2017 and 2018. We excluded the items discussed above from the calculation as we believe

such items are not reflective of management's ability to increase the efficiency of our Regulated Businesses. We evaluate our operating performance using this ratio because we believe it directly measures improvement in the efficiency of our Regulated Businesses. This information is intended to enhance an investor's overall understanding of our operating performance. Our adjusted O&M efficiency ratio is not an accounting measure that is based on GAAP, may not be comparable to other companies' operating measures and should not be used in place of the GAAP information provided elsewhere in this report.

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The following table provides the calculation of our adjusted O&M efficiency ratio and a reconciliation that compares operation and maintenance expenses and operating revenues, each as determined in accordance with GAAP, to those amounts utilized in the calculation of our adjusted O&M efficiency ratio:

| (In millions) | For the Twelve Months Ended September 30, | |
|--|---|---------|
| | 2018 | 2017 |
| Total operation and maintenance expenses (a) | \$1,451 | \$1,377 |
| Less: | | |
| Operation and maintenance expenses—Market-Based Businesses | 346 | 334 |
| Operation and maintenance expenses—Other (a) | (40) | (40) |
| Total operation and maintenance expenses—Regulated Businesses (a) | 1,145 | 1,083 |
| Less: | | |
| Regulated purchased water expenses | 134 | 124 |
| Allocation of non-operation and maintenance expenses | 30 | 29 |
| Impact of Freedom Industries settlement activities (b) | (20) | (22) |
| Adjusted operation and maintenance expenses—Regulated Businesses (i) | \$1,001 | \$952 |
| Total operating revenues | \$3,410 | \$3,338 |
| Less: | | |
| Pro forma adjustment for impact of the TCJA (c) | 40 | 165 |
| Total pro forma operating revenues | 3,370 | 3,173 |
| Less: | | |
| Operating revenues—Market-Based Businesses | 455 | 419 |
| Operating revenues—Other | (22) | (23) |
| Total pro forma operating revenues—Regulated Businesses | 2,937 | 2,777 |
| Less: | | |
| Regulated purchased water revenues (d) | 134 | 124 |
| Adjusted pro forma operating revenues—Regulated Businesses (ii) | \$2,803 | \$2,653 |
| Adjusted O&M efficiency ratio—Regulated Businesses (i) / (ii) | 35.7 % | 35.9 % |

NOTE The adjusted O&M efficiency ratio previously reported for the twelve months ended September 30, 2017 was 34.2%, which did not include the adjustments for the items discussed in footnotes (a) and (c) below.

(a) Includes the impact of the Company's adoption of ASU 2017-07 on January 1, 2018. See Note 2—Significant Accounting Policies in the Notes to the Consolidated Financial Statements for further discussion.

(b) Includes settlements with two of our general liability insurance carriers in connection with the Freedom Industries chemical spill.

(c) Includes the estimated impact of the TCJA on operating revenues for our Regulated Businesses for all periods presented prior to January 1, 2018, as if the lower federal corporate income tax rate was in effect for these periods.

See Note 5—Regulatory Liabilities in the Notes to the Consolidated Financial Statements for further discussion.

(d) The calculation assumes regulated purchased water revenues approximate regulated purchased water expenses.

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Regulatory Matters

The following table provides annualized incremental revenues resulting from rate authorizations that became effective during the three and nine months ended September 30, 2018, for general rate cases and infrastructure surcharges, assuming a constant water sales volume:

| (In millions) | For the Three Months Ended September 30, 2018 | For the Nine Months Ended September 30, 2018 |
|---------------|--|---|
|---------------|--|---|

General rate cases by state:

| | | |
|--|----|---------|
| Missouri (effective May 28, 2018) | \$ | —\$ 33 |
| New York (effective April 1, 2018) | — | 5 |
| Pennsylvania (effective January 1, 2018) | — | 62 |
| Total general rate cases | \$ | —\$ 100 |

Infrastructure surcharges by state:

| | | |
|---|----|--------|
| Tennessee (effective April 10, 2018) | \$ | —\$ 1 |
| Indiana (effective March 14, 2018) | — | 7 |
| Virginia (effective March 1, 2018) | — | 1 |
| Illinois (effective January 1, 2018) | — | 3 |
| West Virginia (effective January 1, 2018) | — | 3 |
| Total infrastructure surcharges | \$ | —\$ 15 |

On October 29, 2018, our New Jersey subsidiary received an order approving the settlement on its general rate case filing, authorizing additional annualized revenues of \$40 million, effective as of June 15, 2018. The order included an authorized return on equity of 9.6% and a capital structure of 46% debt and 54% equity. The order approved the inclusion of \$35 million of infrastructure surcharges in base rates and reset the Distribution System Investment Charge (“DSIC”) mechanism back to zero. Also, the regulatory treatment of certain acquisition adjustments was remanded to the Office of Administrative Law for a separate proceeding, with resolution anticipated in the first quarter of 2019. As part of the order, our New Jersey customers will receive refunds for the amount of provisional rates implemented as of June 15, 2018 and collected that exceeds the final rate increase, plus interest.

On March 22, 2018, our California subsidiary received a decision on its cost of capital filing, authorizing for 2018 through 2020, a 9.20% return on equity, a 5.63% cost of debt and a capital structure of 44.61% debt and 55.39% equity. The decision also approved continuation of the annual adjustment mechanism which could potentially adjust the authorized cost of capital in 2019 or 2020.

Pending General Rate Case and Infrastructure Surcharge Filings

On October 26, 2018, our West Virginia subsidiary, the staff of the WVPSC and the Consumer Advocate Division filed a joint stipulation with the WVPSC with respect to our West Virginia subsidiary’s general rate case and infrastructure surcharge filings. The joint stipulation would provide for \$23 million in additional annualized revenues, based on a return on equity of 9.75%, including \$4 million in base rates from 2017 and 2018 infrastructure surcharges. In addition, the joint stipulation agrees to offset the as-filed infrastructure surcharge revenue request for 2019 with our West Virginia subsidiary’s amortization of excess deferred income taxes. The joint stipulation would also implement a customer lead service line replacement program, with recovery through an infrastructure surcharge. This joint stipulation is subject to the WVPSC’s approval.

On September 14, 2018, our Indiana subsidiary filed a general rate case requesting \$18 million and \$21 million in additional annualized revenues in 2019 and 2020, respectively.

On August 20, 2018 our Missouri subsidiary filed for infrastructure surcharges requesting \$7 million in additional annualized revenues.

On June 28, 2018, our Maryland subsidiary filed a general rate case requesting \$2 million in additional annualized revenues.

Our California subsidiary filed a general rate case requesting \$19 million in additional annualized revenues for 2018, and increases of \$9 million and \$8 million in the escalation year of 2019 and the attrition year of 2020, respectively. These requests have been adjusted to reflect the reduction in the federal corporate income tax rate resulting from the TCJA and the impact of the recently approved cost of capital decision, as discussed above.

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There is no assurance that all or any portion of these requests will be granted.

Tax Matters

Tax Cuts and Jobs Act

On December 22, 2017, the TCJA was signed into law, which, among other things, enacted significant and complex changes to the Internal Revenue Code of 1986, including a reduction in the federal corporate income tax rate from 35% to 21% as of January 1, 2018, and certain other provisions related specifically to the public utility industry, including continuation of interest expense deductibility, the exclusion from utilizing bonus depreciation and the normalization of deferred income tax. The enactment of the TCJA required a re-measurement of our deferred income taxes that materially impacted our 2017 results of operations and financial position. The portion of this re-measurement related to our Regulated Businesses was substantially offset by a regulatory liability, as we believe it is probable that the deferred income tax excesses created by the TCJA will benefit our regulated customers in future rates. The remaining portion of this re-measurement of the net deferred income tax liability was recorded as a non-cash charge to earnings during the fourth quarter of 2017.

During the nine months ended September 30, 2018, our 14 regulatory jurisdictions began to consider the impacts of the TCJA. The Company has adjusted customer rates to reflect the lower income tax rate in eight states. In one state, a portion of the tax savings is being used to offset additional capital investment and to reduce certain regulatory assets. One additional state is using a portion of the tax savings to reduce certain regulatory assets. Proceedings in the other five jurisdictions remain pending. With respect to excess accumulated deferred income taxes, regulators in five states have agreed with the Company's overall timeline of passing the excess back to customers beginning no earlier than 2019, when the Company is able to produce the normalization schedule using the average rate assumption method. In one of those states we entered into a stipulated settlement that, if approved, would authorize the amortization of the re-measured deferred income taxes to offset future infrastructure investments.

On March 23, 2018, President Trump signed the Consolidated Appropriations Act of 2018 (the "Bill"). The Bill corrects and clarifies some aspects of the TCJA related to bonus depreciation eligibility. Specifically, property that was acquired, or the construction began prior to September 27, 2017, will be eligible for bonus depreciation. This clarification will allow the Company to benefit from additional bonus depreciation deductions resulting in a slight delay of when the Company expects to become a cash taxpayer for federal income tax purposes. We believe that we will likely begin paying federal income taxes in 2020, when we expect our federal NOL carryforwards will be fully utilized, and expect to be a full cash taxpayer by 2021, although this timing could be impacted by any significant changes in our future results of operations and the outcome of regulatory proceedings regarding the TCJA.

Other Tax Matters

On June 1, 2018, the State of Missouri enacted legislation that decreased the state income tax rate on our taxable income attributable to Missouri from 6.25% to 4.00%, beginning in the 2020 tax year. As a result, we were required to re-measure our cumulative deferred income tax balances using the lower state income tax rate in the second quarter of 2018. This resulted in a decrease to the Company's unitary deferred income tax liability of \$12 million, and an increase to a regulatory liability of \$13 million, as we believe it is probable of refund in future rates.

On May 30, 2018, the State of Iowa enacted legislation that decreased the state income tax rate on our taxable income attributable to Iowa from 12.0% to 9.8%, beginning in the 2021 tax year. The deferred income tax liability for our Iowa subsidiary was reduced by \$1 million, and offset by a regulatory liability, as we believe it is probable of refund in future rates.

On April 13, 2018, the State of Kentucky enacted legislation that decreased the state income tax rate on our taxable income attributable to Kentucky from 6% to 5%, beginning in the 2018 tax year. In addition, beginning in the 2019 tax year, a consolidated return, including all affiliated group members, will be required. As a result, we were required to record a deferred income tax liability of \$7 million for our Kentucky unitary filing group, and the existing deferred income tax liability related to our Kentucky subsidiary was reduced by \$1 million, offset by a regulatory liability, as we believe it is probable of refund in future rates.

The Company performed its annual review of the apportionment rates in all of its unitary filing jurisdictions and implemented changes to reflect considerations for historical results and future business outlooks in each of the jurisdictions. As of September 30, 2018, we recorded a non-cash, cumulative charge to earnings of \$3 million,

resulting from the legislative changes described above and the adjustments made through various state income tax apportionment rates.

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On July 1, 2018, the State of New Jersey enacted legislation that increased the corporate business tax rate from 9.0% to 11.5% for the 2018 and 2019 tax years, and to 10.5% for the 2020 and 2021 tax years. The tax rate will revert back to 9.0% for tax year 2022 and beyond. Additionally, the new legislation states that for the year beginning on and after January 1, 2019, a unitary group will be required to file a combined unitary New Jersey tax return. The legislation allows a deduction over a 10-year period, commencing five years after the enactment of unitary combined reporting, if the combined reporting provisions result in an aggregate increase to the net deferred income tax liability or an aggregated decrease to the net deferred income tax asset. Thus, the deferred income tax liability resulting from the unitary filing requirement would be completely offset by the deferred income tax asset derived from this deduction. There are no underlying impacts to the Company's earnings as a result of the new filing requirement. On October 4, 2018, New Jersey's governor signed a technical correction bill into law. The correction bill provides an exclusion for water and wastewater utility companies whose rates are regulated from the combined reporting requirement. The Company's tax credit granted by the State of New Jersey will not be impacted by the law changes mentioned above.

Legislative Updates

During 2018, our regulatory jurisdictions enacted legislation as follows:

- House File 2307 in Iowa and House Bill 1566 in Maryland allow a fair market value methodology to be included in rate base with respect to prospective acquisitions.

Senate Enrolled Act 362 in Indiana, which, similar to the Water Quality Accountability Act enacted in New Jersey in 2017, sets new operational standards and requirements for water and wastewater treatment plants in areas such as capital asset management, cost-benefit analysis and cybersecurity.

- Senate Bill 705 in Missouri allows the Missouri Public Service Commission to approve a Revenue Stabilization Mechanism ("RSM") for water utilities. In an effort to encourage conservation, a RSM adjusts rates periodically to ensure that a utility's revenue will be sufficient to cover its costs, and customers will not overpay for service.

Senate Bill 592 in Missouri changes the public vote requirement for the sale of a municipal water or wastewater system to a simple majority for more than 500 small towns. Historically, only larger communities required a simple majority, while smaller communities needed a two-thirds majority. This legislation increases the options for small towns, should they decide to address their water and sewer challenges through an asset sale.

- Legislation was passed in Iowa that allows private water utilities to use a future test year approach in rate cases, decreasing potential regulatory lag and helping to spread out the time between rate cases.

In California, Assembly Bill 2179 changed the vote required to allow cities to sell sewer systems to a simple majority as compared to a two-thirds majority, and Assembly Bill 2339 allowed certain cities to sell water systems without an election.

- House Bill 1782 (known as Act 58 of 2018) in Pennsylvania allows public utilities to implement alternative rates and rate mechanisms in rate base proceedings. These alternative rates and rate mechanisms include, but are not limited to the following: revenue stabilization mechanisms, performance-based rates, formula rates, multi-year rate plans, or a combination of those mechanisms or other mechanisms. Petitions to establish alternative rate mechanisms are subject to PUC review and approval and can only be filed by a utility in a rate base proceeding.

On October 23, 2018, President Trump signed America's Water Infrastructure Act of 2018. The legislation includes policies intended to improve water and wastewater system management and authorization for states to assess options for consolidation for systems that do not comply with the federal Safe Drinking Water Act and its rules and regulations. The legislation increases funding to water system funding programs, including the State Revolving Loan Fund program and the Water Infrastructure Finance and Innovation Act.

Condemnation and Eminent Domain

We are periodically subject to condemnation proceedings in the ordinary course of business. For example, a citizens group in Monterey, California has submitted enough signatures to add a measure to the November 2018 election ballot asking voters to decide whether the local water management district should conduct a feasibility study concerning the potential purchase of our California subsidiary's Monterey water service, and, if feasible, to proceed with a purchase without an additional public vote. This service territory represents approximately 40,000 customers. A similar ballot

measure introduced in 2014 involving this subsidiary's Monterey service district was defeated.

Also, five municipalities in the Chicago, Illinois area (approximately 30,300 customers in total) formed a water agency and filed an eminent domain lawsuit against our Illinois subsidiary in January 2013, seeking to condemn the water pipeline that serves those five municipalities. Before filing its eminent domain lawsuit, the water agency made an offer of \$38 million for the pipeline. A jury trial will take place to establish the value of the pipeline. Although the date of this trial has not currently been scheduled, it is likely to commence in the second quarter of 2019.

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Consolidated Results of Operations

The following table presents our consolidated results of operations and the ensuing discussions explain the material variances:

| | For the Three Months Ended September 30, | | | | | For the Nine Months Ended September 30, | | | | |
|--|---|-------|------------------------|---------|---|--|---------|------------------------|---------|---|
| | 2018 | 2017 | Increase (Decrease) | | % | 2018 | 2017 | Increase (Decrease) | | % |
| (In millions) | | | | | | | | | | |
| Operating revenues | \$976 | \$936 | \$40 | 4.3 | % | \$2,590 | \$2,536 | \$54 | 2.1 | % |
| Operating expenses: | | | | | | | | | | |
| Operation and maintenance | 390 | 322 | 68 | 21.1 | % | 1,085 | 1,003 | 82 | 8.2 | % |
| Depreciation and amortization | 141 | 128 | 13 | 10.2 | % | 404 | 378 | 26 | 6.9 | % |
| General taxes | 71 | 61 | 10 | 16.4 | % | 210 | 192 | 18 | 9.4 | % |
| Gain on asset dispositions and purchases | (18) | (7) | (11) | 157.1 | % | (20) | (9) | (11) | 122.2 | % |
| Impairment charge | 57 | — | 57 | 100.0 | % | 57 | — | 57 | 100.0 | % |
| Total operating expenses, net | 641 | 504 | 137 | 27.2 | % | 1,736 | 1,564 | 172 | 11.0 | % |
| Operating income | 335 | 432 | (97) | (22.5) | % | 854 | 972 | (118) | (12.1) | % |
| Other income (expenses): | | | | | | | | | | |
| Interest, net | (89) | (89) | — | — | % | (259) | (259) | — | — | % |
| Non-operating benefit costs, net | 5 | (2) | 7 | (350.0) | % | 10 | (7) | 17 | (242.9) | % |
| Loss on extinguishment of debt | (2) | (6) | 4 | (66.7) | % | (2) | (6) | 4 | (66.7) | % |
| Other, net | 6 | 5 | 1 | 20.0 | % | 14 | 11 | 3 | 27.3 | % |
| Total other income (expenses) | (80) | (92) | 12 | (13.0) | % | (237) | (261) | 24 | (9.2) | % |
| Income before income taxes | 255 | 340 | (85) | (25.0) | % | 617 | 711 | (94) | (13.2) | % |
| Provision for income taxes | 70 | 137 | (67) | (48.9) | % | 164 | 284 | (120) | (42.3) | % |
| Consolidated net income | 185 | 203 | (18) | (8.9) | % | 453 | 427 | 26 | 6.1 | % |
| Net loss attributable to noncontrolling interest | (2) | — | (2) | (100.0) | % | (2) | — | (2) | (100.0) | % |
| Net income attributable to common stockholders | \$187 | \$203 | \$(16) | (7.9) | % | \$455 | \$427 | \$28 | 6.6 | % |

Operating Revenues

For the three months ended September 30, 2018, operating revenues increased primarily due to a:

\$15 million net increase in our Regulated Businesses, including a \$55 million increase principally from authorized rate increases, water and wastewater acquisitions, and organic growth, partially offset by a \$40 million decrease in revenue from the impacts of the TCJA which have benefited or are expected to benefit our customers; and \$25 million net increase in our Market-Based Businesses mainly from our Homeowner Services Group's acquisition of Pivotal on June 4, 2018, partially offset by the sale of the majority of our Contract Services Group's O&M contracts to subsidiaries of Veolia Environnement S.A. during the third quarter of 2018, and lower capital upgrades in our Military Services Group.

For the nine months ended September 30, 2018, operating revenues increased primarily due to a:

\$20 million net increase in our Regulated Businesses, including a \$130 million increase principally from authorized rate increases, water and wastewater acquisitions, and organic growth, partially offset by a \$110 million decrease in revenue from the impacts of the TCJA which have benefited or are expected to benefit our customers; and \$33 million net increase in our Market-Based Businesses mainly from our Homeowner Services Group's contract growth and the acquisition of Pivotal, and in Keystone from market recovery in the shale natural gas industry, partially offset by the sale and expiration of O&M contracts in our Contract Services Group during 2018, and lower capital upgrades in our Military Services Group.

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Operation and Maintenance

For the three months ended September 30, 2018, operation and maintenance expense increased primarily due to a: \$56 million increase in our Regulated Businesses primarily from a \$22 million benefit recorded in the third quarter of 2017, resulting from an insurance settlement related to the Freedom Industries chemical spill in West Virginia, and increases in purchased water and chemical prices and usage, employee-related costs and contracted services in support of the growth of the businesses and casualty insurance expense; and

\$12 million net increase in our Market-Based Businesses mainly from our Homeowner Services Group's acquisition of Pivotal on June 4, 2018, partially offset by the sale of the majority our Contract Services Group's O&M contracts during the third quarter of 2018, and lower capital upgrades in our Military Services Group.

For the nine months ended September 30, 2018, operation and maintenance expense increased primarily due to a: \$68 million increase in our Regulated Businesses primarily from higher production costs due to increases in purchased water and chemical prices and usage, employee-related costs and contracted services mainly in support of the growth of the business, and maintenance materials and supplies, due to a higher volume of main breaks and paving expense during the first quarter of 2018; and

\$9 million increase in our Market-Based Businesses mainly from our Homeowner Services Group's contract growth and the acquisition of Pivotal, and in Keystone from market recovery in the shale natural gas industry, partially offset by the sale and expiration of O&M contracts in our Contract Services Group during 2018, and lower capital upgrades in our Military Services Group.

Depreciation and Amortization

For the three and nine months ended September 30, 2018, depreciation and amortization expense increased primarily due to additional utility plant placed in service.

General Taxes

For the three and nine months ended September 30, 2018, general taxes increased primarily due to incremental property taxes in several of our subsidiaries, including in Missouri, Pennsylvania and New York.

Gain on Asset Dispositions and Purchases

For the three and nine months ended September 30, 2018, gain on asset dispositions and purchases increased primarily due to the sale of 20 of our Contract Services Group's O&M contracts to subsidiaries of Veolia Environnement S.A. The sale agreement includes the transfer of 22 contracts in total, with the sale of the remaining two contracts expected to close by the end of 2018.

Impairment Charge

During the three months ended September 30, 2018, a goodwill and intangible asset impairment charge was recorded for Keystone, the result of operational and financial challenges encountered in the construction business, and the Company's determination to narrow the scope of the Keystone business, to focus on its core operations of providing water transfer services. See Note 6—Goodwill and Other Intangible Assets in the Notes to the Consolidated Financial Statements for further discussion.

Other Income (Expenses)

For the three and nine months ended September 30, 2018, other income (expenses) decreased primarily due to a reduction in the non-service cost components of pension and other postretirement benefits expense resulting from favorable actuarial performance, and an increase in allowance for funds used during construction attributable to higher capital investment in 2018. The presentation of net periodic benefit costs on the Consolidated Statements of Operations was changed pursuant the adoption and retrospective application of ASU 2017-07 on January 1, 2018. See Note 2—Significant Accounting Policies in the Notes to the Consolidated Financial Statements for additional information.

Provision for Income Taxes

For the three and nine months ended September 30, 2018, our provision for income taxes decreased mainly due to the reduction in the federal corporate income tax rate from 35% to 21% as of January 1, 2018, resulting from the enactment of the TCJA. In our Regulated Businesses, we expect the reduced tax rate will benefit our customers through established ratemaking, tax and regulatory normalization provisions. In our Military Services Group, we received guidance on how to apply the TCJA to our contracts with the U.S. government and expect to return the

majority of the benefits received from the lower income tax rate, effective January 1, 2018, as anticipated.

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Segment Results of Operations

Our segments are determined based on how we assess performance and allocate our resources. We evaluate the performance of our segments and allocate resources based on several factors, with the primary measure being net income attributable to common stockholders. The majority of our business is conducted through our Regulated Businesses reportable segment. We also operate several market-based businesses that provide a broad range of related and complementary water and wastewater services within four operating segments that individually do not meet the criteria of a reportable segment in accordance with GAAP. These four, non-reportable operating segments are collectively presented as our Market-Based Businesses, which is consistent with how management assesses the results of our businesses.

Regulated Businesses Segment

The following table summarizes certain financial information for our Regulated Businesses segment:

| | For the Three Months Ended | | | | | For the Nine Months Ended | | | | |
|--|----------------------------|-------|---------------------|---------|---|---------------------------|---------|---------------------|---------|---|
| | September 30, | | Increase (Decrease) | | | September 30, | | Increase (Decrease) | | |
| | 2018 | 2017 | | | % | 2018 | 2017 | | | % |
| (In millions) | | | | | | | | | | |
| Operating revenues | \$857 | \$842 | \$ 15 | 1.8 | % | \$2,267 | \$2,247 | \$ 20 | 0.9 | % |
| Operation and maintenance | 314 | 258 | 56 | 21.7 | % | 856 | 788 | 68 | 8.6 | % |
| Depreciation and amortization | 128 | 121 | 7 | 5.8 | % | 373 | 357 | 16 | 4.5 | % |
| General taxes | 66 | 57 | 9 | 15.8 | % | 197 | 181 | 16 | 8.8 | % |
| Other income (expenses) | (64) | (66) | 2 | (3.0) | % | (191) | (201) | 10 | (5.0) | % |
| Income before income taxes | 288 | 347 | (59) | (17.0) | % | 656 | 731 | (75) | (10.3) | % |
| Provision for income taxes | 76 | 135 | (59) | (43.7) | % | 173 | 285 | (112) | (39.3) | % |
| Net income attributable to common stockholders | 213 | 212 | 1 | 0.5 | % | 484 | 446 | 38 | 8.5 | % |

Operating Revenues

The following tables summarize information regarding the main components of our Regulated Businesses' operating revenues and the ensuing discussions explain the material variances:

| | For the Three Months | | | | | For the Nine Months Ended | | | | |
|--------------------------|----------------------|-------|------------|---------|---|---------------------------|---------|------------|--------|---|
| | Ended September 30, | | Increase | | | September 30, | | Increase | | |
| | 2018 | 2017 | (Decrease) | | % | 2018 | 2017 | (Decrease) | | % |
| (In millions) | | | | | | | | | | |
| Water services: | | | | | | | | | | |
| Residential | \$475 | \$473 | \$2 | 0.4 | % | \$1,253 | \$1,245 | \$8 | 0.6 | % |
| Commercial | 180 | 176 | 4 | 2.3 | % | 465 | 455 | 10 | 2.2 | % |
| Industrial | 40 | 37 | 3 | 8.1 | % | 105 | 104 | 1 | 1.0 | % |
| Public and other | 86 | 97 | (11) | (11.3) | % | 251 | 265 | (14) | (5.3) | % |
| Total water services | 781 | 783 | (2) | (0.3) | % | 2,074 | 2,069 | 5 | 0.2 | % |
| Wastewater services | 41 | 36 | 5 | 13.9 | % | 117 | 106 | 11 | 10.4 | % |
| Other (a) | 35 | 23 | 12 | 52.2 | % | 76 | 72 | 4 | 5.6 | % |
| Total operating revenues | \$857 | \$842 | \$15 | 1.8 | % | \$2,267 | \$2,247 | \$20 | 0.9 | % |

(a) Includes revenues associated with provisional rates, miscellaneous utility charges, alternative revenue programs and lease contracts.

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| | For the Three Months Ended | | | | For the Nine Months Ended | | | |
|--------------------------------|----------------------------|---------|---------------------|---------|---------------------------|---------|---------------------|---------|
| | September 30, | | Increase (Decrease) | | September 30, | | Increase (Decrease) | |
| | 2018 | 2017 | | | 2018 | 2017 | | |
| (Gallons in millions) | | | | | | | | |
| Billed water services volumes: | | | | | | | | |
| Residential | 52,963 | 53,928 | (965) | (1.8)% | 131,201 | 131,488 | (287) | (0.2)% |
| Commercial | 24,914 | 24,913 | 1 | — % | 62,428 | 61,793 | 635 | 1.0 % |
| Industrial | 10,752 | 10,661 | 91 | 0.9 % | 29,647 | 29,218 | 429 | 1.5 % |
| Public and other | 14,504 | 15,085 | (581) | (3.9)% | 38,427 | 38,920 | (493) | (1.3)% |
| Billed water services volumes | 103,133 | 104,587 | (1,454) | (1.4)% | 261,703 | 261,419 | 284 | 0.1 % |

For the three months ended September 30, 2018, operating revenues increased primarily due to a:

\$53 million increase from authorized rate increases, including infrastructure surcharges, principally to fund infrastructure investment in various states; and

\$5 million increase from water and wastewater acquisitions, as well as organic growth in existing systems; partially offset by a

\$40 million decrease from the impacts of the TCJA which have or are expected to benefit our customer rates. This decrease is primarily made up of two components: (i) a reserve on revenue billed during the third quarter of 2018, for the estimated income tax savings resulting from the TCJA, which is expected to benefit our customers in future rates; and (ii) rate adjustments made in certain subsidiaries where our Regulators have authorized an approach to pass the benefits from the lower income tax rate to our customers, or offset other regulatory assets or capital investments; and \$4 million decrease in other operating revenue, primarily in our New Jersey and New York subsidiaries.

For the nine months ended September 30, 2018, operating revenues increased primarily due to a:

\$103 million increase from authorized rate increases, including infrastructure surcharges, principally to fund infrastructure investment in various states;

\$18 million increase from water and wastewater acquisitions, as well as organic growth in existing systems; and

\$7 million increase from higher water services demand, primarily in our California subsidiary; partially offset by a \$110 million decrease from the impacts of the TCJA which have or are expected to benefit our customer rates. This decrease is primarily made up of two components: (i) a reserve on revenue billed during the first nine months of 2018, for the estimated income tax savings resulting from the TCJA, which is expected to benefit our customers in future rates; and (ii) rate adjustments made in certain subsidiaries where our Regulators have authorized an approach to pass the benefits from the lower income tax rate to our customers, or offset other regulatory assets or capital investments.

Operation and Maintenance

The following table summarizes information regarding the main components of our Regulated Businesses' operation and maintenance expense and the ensuing discussions explain the material variances:

| | For the Three Months Ended | | | | For the Nine Months Ended | | | |
|------------------------------------|----------------------------|-------|---------------------|-----------|---------------------------|-------|---------------------|---------|
| | September 30, | | Increase (Decrease) | | September 30, | | Increase (Decrease) | |
| | 2018 | 2017 | | | 2018 | 2017 | | |
| (In millions) | | | | | | | | |
| Production costs | \$92 | \$87 | \$ 5 | 5.7 % | \$238 | \$224 | \$ 14 | 6.3 % |
| Employee-related costs | 116 | 108 | 8 | 7.4 % | 343 | 322 | 21 | 6.5 % |
| Operating supplies and services | 60 | 51 | 9 | 17.6 % | 161 | 150 | 11 | 7.3 % |
| Maintenance materials and supplies | 17 | 15 | 2 | 13.3 % | 56 | 49 | 7 | 14.3 % |
| Customer billing and accounting | 17 | 14 | 3 | 21.4 % | 43 | 37 | 6 | 16.2 % |
| Other | 12 | (17) | 29 | (170.6)% | 15 | 6 | 9 | 150.0 % |
| Total | \$314 | \$258 | \$ 56 | 21.7 % | \$856 | \$788 | \$ 68 | 8.6 % |

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For the three months ended September 30, 2018, operation and maintenance expense increased primarily due to a:

- \$5 million increase in production costs from purchased water price and usage increases in our California subsidiary, along with an increase in chemical costs and usage, the result of wet weather conditions;
- \$8 million increase in employee-related costs due to higher compensation expense and headcount in support of the growth of the businesses;
- \$9 million increase in operating supplies and services related to a settlement agreement in our New York subsidiary to provide prompt rate relief and other benefits to our customers (see Part II, Item 1A—Risk Factors for additional information), along with costs associated with condemnation proceedings in Monterey, California, and higher contracted services;
- \$3 million increase in customer billing and accounting from an increase in customer uncollectible expense and higher call volumes experienced at our customer service centers; and
- \$29 million increase in other operation and maintenance expense from a \$22 million benefit recorded in the third quarter of 2017, resulting from an insurance settlement related to the Freedom Industries chemical spill in West Virginia, as well as higher casualty insurance expense.

For the nine months ended September 30, 2018, operation and maintenance expense increased primarily due to a:

- \$14 million increase in production costs from purchased water price and usage increases in our California subsidiary, along with price and usage increases for chemicals, the result of wet weather conditions, and an increase in waste disposal costs in several of our subsidiaries;
- \$21 million increase in employee-related costs due to higher compensation expense and headcount in support of the growth of the business, as well as an increase in overtime related to a higher volume of main breaks during the first quarter of 2018, the result of harshly frigid weather in the Midwest, Northeast and parts of the Mid-Atlantic;
- \$11 million increase in operating supplies and services related to a settlement agreement in our New York subsidiary to provide prompt rate relief and other benefits to our customers (see Part II, Item 1A—Risk Factors for additional information), along with costs associated with condemnation proceedings in Monterey, California, along with higher contracted services, mainly for legal and technology support services;
- \$7 million increase in maintenance materials and supplies due to a higher volume of main breaks and paving expense in the first quarter of 2018, driven by the colder weather experienced;
- \$6 million increase in customer billing and accounting from an increase in customer uncollectible expense and higher call volumes experienced at our customer service centers; and
- \$9 million increase in other operation and maintenance expense due to lower casualty insurance expense in 2017.

Depreciation and Amortization

For the three and nine months ended September 30, 2018, depreciation and amortization increased primarily due to additional utility plant placed in service.

General Taxes

For the three and nine months ended September 30, 2018, general taxes increased primarily due to incremental property taxes in several of our subsidiaries, including in Missouri, Pennsylvania and New York.

Other Income (Expenses)

For the three and nine months ended September 30, 2018, other income (expenses) decreased primarily due to a reduction in the non-service cost components of pension and other postretirement benefits expense resulting from favorable actuarial performance, and an increase in allowance for funds used during construction attributable to higher capital investment in 2018, partially offset by an increase in interest expense from the issuance of incremental long-term debt in the third quarter of 2018, and higher levels of short-term borrowings during 2018, coupled with an increase in the average short-term borrowing rate in the current year.

Provision for Income Taxes

For the three and nine months ended September 30, 2018, our provision for income taxes decreased primarily due to the reduction in the federal corporate income tax rate from 35% to 21% as of January 1, 2018, resulting from the enactment of the TCJA. We expect the reduced tax rate will benefit our customers through established ratemaking, tax and regulatory normalization provisions.

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Market-Based Businesses

The following table summarizes certain financial information for our Market-Based Businesses and the ensuing discussions explain the material variances:

| | For the Three Months Ended September 30, | | | | | For the Nine Months Ended September 30, | | | | |
|--|---|-------|------------------------|---------|---|--|-------|------------------------|---------|---|
| | 2018 | 2017 | Increase (Decrease) | | % | 2018 | 2017 | Increase (Decrease) | | % |
| (In millions) | | | | | | | | | | |
| Operating revenues | \$125 | \$100 | \$25 | 25.0 | % | \$339 | \$306 | \$33 | 10.8 | % |
| Operation and maintenance | 87 | 75 | 12 | 16.0 | % | 256 | 247 | 9 | 3.6 | % |
| Gain on asset dispositions and purchases | (14) | — | (14) | (100.0) | % | (13) | — | (13) | (100.0) | % |
| Impairment charge | 57 | — | 57 | 100.0 | % | 57 | — | 57 | 100.0 | % |
| Income before income taxes | (14) | 21 | (35) | (166.7) | % | 20 | 46 | (26) | (56.5) | % |
| Provision for income taxes | (5) | 7 | (12) | (171.4) | % | 4 | 17 | (13) | (76.5) | % |
| Net income attributable to common stockholders | (7) | 14 | (21) | (150.0) | % | 18 | 29 | (11) | (37.9) | % |

Operating Revenues

For the three months ended September 30, 2018, operating revenues increased primarily due to a:

\$32 million increase in our Homeowner Services Group from the acquisition of Pivotal on June 4, 2018; partially offset by a

\$5 million decrease in our Contract Services Group from the sale of the majority of our O&M contracts to subsidiaries of Veolia Environnement S.A. during the third quarter of 2018; and

\$4 million decrease in our Military Services Group from lower capital upgrades, largely driven by reduced military base budgets.

For the nine months ended September 30, 2018, operating revenues increased primarily due to a:

\$40 million increase in our Homeowner Services Group from the acquisition of Pivotal and contract growth; and

\$13 million increase in Keystone from market recovery in the shale natural gas industry; partially offset by a

\$13 million decrease in our Military Services Group from lower capital upgrades, as discussed above; and

\$10 million decrease in our Contract Services Group from the sale of the majority of our O&M contracts during the third quarter of 2018, and the expiration of certain contracts during 2018.

Operation and Maintenance

For the three months ended September 30, 2018, operation and maintenance expense increased primarily due to a:

\$20 million increase in our Homeowner Services Group from the acquisition of Pivotal and higher employee expense in support of the growth of the businesses; partially offset by a

\$6 million decrease in our Contract Services Group from the sale of the majority of our O&M contracts during the third quarter of 2018; and

\$5 million decrease in our Military Services Group from lower capital upgrades, largely driven by reduced military base budgets.

For the nine months ended September 30, 2018, operation and maintenance expense increased primarily due to a:

\$18 million increase in our Homeowner Services Group from the acquisition of Pivotal and higher employee expense in support of the growth of the business, offset in part by lower claims expense driven by operational efficiencies gained through improved planning and relationship management of key contractor partnerships; and

\$14 million increase in Keystone from market recovery in the shale natural gas industry; partially offset by a

\$13 million decrease in our Military Services Group from lower capital upgrades, as discussed above; and

\$12 million decrease in our Contract Services Group from the sale of the majority of our O&M contracts, as discussed above, and the expiration of certain contracts during 2018.

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Gain on Asset Dispositions and Purchases

For the three and nine months ended September 30, 2018, gain on asset dispositions and purchases increased due to the sale of 20 of our Contract Services Group's O&M contracts. The sale agreement includes the transfer of 22 contracts in total, with the sale of the remaining two contracts expected to close by the end of 2018.

Impairment Charge

During the three months ended September 30, 2018, a goodwill and intangible asset impairment charge was recorded for Keystone, the result of operational and financial challenges encountered in the construction business, and the Company's determination to narrow the scope of the Keystone business, to focus on its core operations of providing water transfer services. See Note 6—Goodwill and Other Intangible Assets in the Notes to the Consolidated Financial Statements for further discussion.

Provision for Income Taxes

For the three and nine months ended September 30, 2018, our provision for income taxes decreased primarily due to the reduction in the federal corporate income tax rate from 35% to 21% as of January 1, 2018, resulting from the enactment of the TCJA.

Liquidity and Capital Resources

For a general overview of our sources and uses of capital resources, see the introductory discussion in Part II, Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources in our Form 10-K.

We fund liquidity needs for capital investment, working capital and other financial commitments through cash flows from operations, public and private debt offerings, commercial paper markets and, if and to the extent necessary, borrowings under the AWCC revolving credit facility. On March 21, 2018, AWCC and certain lenders amended and restated the credit agreement with respect to AWCC's revolving credit facility to increase the maximum commitments under the facility from \$1.75 billion to \$2.25 billion, and to extend the expiration date of the facility from June 2020 to March 2023. The facility is used principally to support AWCC's commercial paper program and to provide a sub-limit of up to \$150 million for letters of credit. Subject to satisfying certain conditions, the credit agreement also permits AWCC to increase the maximum commitment under the facility by up to an aggregate of \$500 million, and to request extensions of its expiration date for up to two, one-year periods. As of September 30, 2018, AWCC had no outstanding borrowings and \$88 million of outstanding letters of credit under the revolving credit facility, with \$2.16 billion available to fulfill our short-term liquidity needs and to issue letters of credit. We regularly evaluate the capital markets and closely monitor the financial condition of the financial institutions with contractual commitments in our revolving credit facility.

In order to meet our short-term liquidity needs, we, through AWCC, issue commercial paper, which is supported by our revolving credit facility. On March 21, 2018, AWCC increased the maximum aggregate principal amount of short-term borrowings authorized for issuance under its commercial paper program from \$1.60 billion to \$2.10 billion. As of September 30, 2018, the revolving credit facility supported \$564 million in outstanding commercial paper. We believe that our ability to access the capital markets, our revolving credit facility and our cash flows from operations will generate sufficient cash to fund our short-term requirements. However, we can provide no assurances that the lenders will meet their existing commitments to AWCC under the revolving credit facility, or that we will be able to access the commercial paper or loan markets in the future on terms acceptable to us or at all.

On August 9, 2018, AWCC completed a \$1.325 billion debt offering which included the sale of \$625 million aggregate principal amount of its 3.75% Senior Notes due in 2028, and \$700 million aggregate principal amount of its 4.20% Senior Notes due in 2048. At the closing of the offering, AWCC received, after deduction of underwriting discounts and before deduction of offering expenses, net proceeds of approximately \$1.3 billion. AWCC used proceeds from the offering to: (i) lend funds to American Water and its regulated operating subsidiaries; (ii) repay \$191 million principal amount of AWCC's 5.62% Senior Notes due 2018 upon maturity on December 21, 2018; (iii) prepay \$100 million aggregate principal amount of AWCC's outstanding 5.62% Series E Senior Notes due March 29, 2019 (the "Series E Notes") and \$100 million aggregate principal amount of AWCC's outstanding 5.77% Series F Senior Notes due March 29, 2022 (the "Series F Notes", and, together with the Series E Notes, the "Series Notes"); (iv) repay AWCC's commercial paper obligations and for general corporate purposes.

As a result of AWCC's prepayment of the Series Notes, a make-whole premium of \$10 million was paid to the holders thereof on September 11, 2018. Substantially all of the early debt extinguishment costs were allocable to our utility subsidiaries and recorded as regulatory assets, as we believe they are probable of recovery in future rates.

On August 6, 2018, we terminated four forward starting swap agreements with an aggregate notional amount of \$400 million, realizing a net gain of \$9 million, to be amortized through interest, net over 10 and 30 year periods, in correlation with the terms of the new debt issued on August 9, 2018.

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On August 17, 2018, we entered into two forward starting swap agreements, each with a notional amount of \$80 million, to reduce interest rate exposure on debt expected to be issued in 2019. These forward starting swap agreements terminate in August 2019, and have an average fixed rate of 2.98%. On October 11, 2018, we entered into two additional forward starting swap agreements, each with a notional amount of \$100 million, to reduce interest rate exposure on debt expected to be issued in 2019. These forward starting swap agreements terminate in December 2019, and have an average fixed rate of 3.31%. We have designated these forward starting swap agreements as cash flow hedges, with their fair value recorded in accumulated other comprehensive gain or loss. Upon termination, the cumulative gain or loss recorded in accumulated other comprehensive gain or loss will be amortized through interest, net over the term of the new debt.

On April 11, 2018, we effected an equity forward transaction by entering into a forward sale agreement with each of two forward purchasers in connection with a public offering of 2,320,000 shares of our common stock. In the equity forward transaction, the forward purchasers, or an affiliate, borrowed an aggregate of 2,320,000 shares of our common stock from third parties and sold them to the underwriters in the public offering. On June 7, 2018, we elected to fully and physically settle both forward sale agreements, resulting in the issuance of a total of 2,320,000 shares of our common stock at a price of \$79.01 per share, for aggregate net proceeds of \$183 million. The net proceeds of the transaction were used to finance a portion of the purchase price of the Pivotal acquisition on June 4, 2018.

Cash Flows Provided by Operating Activities

Cash flows provided by operating activities primarily result from the sale of water and wastewater services and, due to the seasonality of demand, are generally greater during the third quarter of each fiscal year. The following table provides a summary of the major items affecting cash flows provided by our operating activities:

| | For the Nine Months Ended September 30, 2018 2017 | |
|--|--|---------|
| (In millions) | | |
| Net income | \$455 | \$427 |
| Add (less): | | |
| Depreciation and amortization | 404 | 378 |
| Deferred income taxes and amortization of investment tax credits | 142 | 264 |
| Non-cash impairment charge | 57 | — |
| Other non-cash activities (a) | 48 | 17 |
| Changes in working capital (b) | (61) | (8) |
| Pension and post-retirement healthcare contributions | (11) | (36) |
| Impact of Freedom Industries settlement activities | (40) | (22) |
| Net cash flows provided by operations | \$992 | \$1,020 |

Includes provision for losses on accounts receivable, gain on asset dispositions and purchases, pension and (a) non-pension post-retirement benefits expense and other non-cash, net. Details of each component can be found in the Consolidated Statements of Cash Flows.

(b) Changes in working capital include changes to receivables and unbilled revenues, accounts payable and accrued liabilities, and other current assets and liabilities, net.

For the nine months ended September 30, 2018, cash flows from operating activities decreased \$28 million compared to the same period in 2017, primarily due to the change in deferred income taxes from the lower tax rates in 2018, changes in working capital and the impact of the Freedom Industries settlement activities. The change in working capital was primarily the result of the following: (i) an increase in accounts receivable, net due to increased revenues compared to the same period in the prior year; and (ii) a decrease in unbilled revenues as a result of our Military Services Group achieving significant capital project milestones during 2017. The main factors contributing to the net income increase are described in this section under “Consolidated Results of Operations” and included higher operating revenue and a lower provision for income taxes.

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Cash Flows Used in Investing Activities

The following table provides information regarding cash flows used in our investing activities:

| | For the Nine Months Ended September 30, 2018 2017 | |
|---|---|-----------|
| (In millions) | | |
| Net capital expenditures | \$(1,136) | \$(964) |
| Acquisitions | (381) | (10) |
| Other investing activities, net (a) | (28) | (42) |
| Net cash flows used in investing activities | \$(1,545) | \$(1,016) |

(a) Includes removal costs from property, plant and equipment retirements, net, and proceeds from sale of assets and securities.

For the nine months ended September 30, 2018, cash used in investing activities increased primarily due to continued investment across all infrastructure categories, mainly replacement and renewal of transmission and distribution infrastructure in our Regulated Businesses, and increased cash used for acquisitions, primarily related to the Pivotal acquisition, which closed on June 4, 2018. We expect to make total investments in the range of \$2.0 billion to \$2.1 billion in 2018 for capital expenditures and acquisitions, including the estimated \$365 million used for the Pivotal acquisition. Construction of our new corporate headquarters building in Camden, New Jersey is underway, and is expected to be completed by the end of 2018. The cost of construction is currently estimated to be up to \$164 million, exclusive of any tax incentives, of which \$79 million is expected to be incurred in 2018. During the nine months ended September 30, 2018, we spent approximately \$63 million towards this construction.

Cash Flows Provided by Financing Activities

The following table provides information regarding cash flows provided by our financing activities:

| | For the Nine Months Ended September 30, 2018 2017 | |
|---|---|---------|
| (In millions) | | |
| Proceeds from long-term debt | \$1,355 | \$1,382 |
| Repayments of long-term debt | (330) | (334) |
| Net proceeds from short-term borrowings | (341) | (746) |
| Proceeds from issuance of common stock | 183 | — |
| Make-whole premium on early debt redemption | (10) | (34) |
| Dividends paid | (237) | (215) |
| Anti-dilutive stock repurchases | (45) | (54) |
| Other financing activities, net (a) | 11 | 20 |
| Net cash flows provided by financing activities | \$586 | \$19 |

(a) Includes proceeds from issuances of common stock under various employee stock plans and our dividend reinvestment plan, advances and contributions for construction, net of refunds, and taxes paid related to employee stock plans.

For the nine months ended September 30, 2018, the increase in cash flows provided by financing activities, as compared to the same period in 2017, is primarily due to the issuance of common stock to finance a portion of the purchase price of the Pivotal acquisition and a decrease in cash used for short-term borrowings. Short-term borrowings for the nine months ended September 30, 2018 were used to fund the growth of our Regulated Businesses, finance a portion of the Pivotal acquisition, pay dividends and repay long-term debt, offset by the use of the \$1.3 billion long-term debt issuance to partially repay short-term borrowings.

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Credit Facilities and Short-Term Debt

The following table summarizes information regarding our aggregate credit facility commitments, letter of credit sub-limits and available funds under those revolving credit facilities, as well as outstanding amounts of commercial paper and outstanding borrowings under the respective facilities as of September 30, 2018:

| | Credit Facilities Commitment (a) | Available Credit Facility Capacity (a) | Letter of Credit Sublimit | Available Letter of Credit Capacity | Commercial Paper Limit | Available Commercial Paper Capacity |
|--------------------|-------------------------------------|--|---------------------------------|---|---------------------------|--|
| (In millions) | | | | | | |
| September 30, 2018 | \$ 2,262 | \$ 2,172 | \$ 150 | \$ 62 | \$ 2,100 | \$ 1,536 |

Includes amounts related to the revolving credit facility of Keystone. As of September 30, 2018, the total (a) commitment under the Keystone revolving credit facility was \$12 million, of which \$9 million was available for borrowing, subject to compliance with a collateral base calculation. At September 30, 2018, there were no outstanding borrowings under this credit facility.

The weighted-average interest rate on AWCC short-term borrowings for the three months ended September 30, 2018 and 2017 was approximately 2.39% and 1.38%, respectively. The weighted-average interest rate on AWCC short-term borrowings for the nine months ended September 30, 2018 and 2017 was approximately 2.22% and 1.19%, respectively.

Debt Covenants

Our debt agreements contain financial and non-financial covenants. To the extent that we are not in compliance with these covenants, an event of default may occur under one or more debt agreements and we or our subsidiaries may be restricted in our ability to pay dividends, issue new debt or access our revolving credit facility. Our long-term debt indentures contain a number of covenants that, among other things, prohibit or restrict the Company from issuing debt secured by the Company's assets, subject to certain exceptions. Our failure to comply with any of these covenants could accelerate repayment obligations.

Covenants in certain long-term notes and the revolving credit facility require us to maintain a ratio of consolidated debt to consolidated capitalization (as defined in the relevant documents) of not more than 0.70 to 1.00. On September 30, 2018, our ratio was 0.59 to 1.00 and therefore we were in compliance with the covenants.

Security Ratings

Our access to the capital markets, including the commercial paper market, and respective financing costs in those markets, may be directly affected by our securities ratings. We primarily access the debt capital markets, including the commercial paper market, through AWCC. However, we have also issued debt through our regulated subsidiaries, primarily in the form of tax exempt securities or borrowings under state revolving funds, to lower our overall cost of debt.

The following table presents our long-term and short-term credit rating and rating outlook as of September 30, 2018:

| Securities | Moody's Investors Service | Standard & Poor's Ratings Service |
|-----------------------|------------------------------|--------------------------------------|
| Rating Outlook | Negative | Stable |
| Senior unsecured debt | A3 | A |
| Commercial paper | P-2 | A-1 |

On June 11, 2018, Standard & Poor's Ratings Service affirmed the Company's long-term 'A' and short-term 'A-1' credit ratings, with a stable outlook remaining unchanged.

On January 19, 2018, Moody's Investors Service changed its rating outlook to negative, from stable, for 24 regulated utilities and utility holding companies, including the Company, all of which were primarily impacted by the enactment of the TCJA.

A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating agency, and each rating should be evaluated independently of any other rating. Security ratings are highly dependent upon our ability to generate cash flows in an amount sufficient to service our debt and meet our investment plans. We can provide no assurances that our ability to generate cash flows is sufficient

to maintain our existing ratings. None of our borrowings are subject to default or prepayment as a result of the downgrading of these security ratings, although such a downgrading could increase fees and interest charges under our credit facility.

Dividends

On September 4, 2018, we paid a cash dividend of \$0.455 per share to our stockholders of record as of August 10, 2018.

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On October 30, 2018, our Board of Directors declared a quarterly cash dividend payment of \$0.455 per share, payable on December 4, 2018, to stockholders of record as of November 12, 2018. Future dividends, when and as declared at the discretion of the Board of Directors, will be dependent upon future earnings and cash flows, compliance with various regulatory, financial and legal requirements, and other factors. See Part II, Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Dividends in our Form 10-K for more information regarding restrictions on the payment of dividends on our common stock.

Application of Critical Accounting Policies and Estimates

Our financial condition, results of operations and cash flows are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. See Part II, Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates in our Form 10-K for a discussion of our critical accounting policies. Additionally, see Note 2—Significant Accounting Policies and Note 3—Revenue Recognition in the Notes to the Consolidated Financial Statements for updates to our significant accounting policies previously disclosed in our Form 10-K.

Recent Accounting Standards

See Note 2—Significant Accounting Policies in the Notes to Consolidated Financial Statements for a description of new accounting standards recently adopted or pending adoption.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk in the normal course of business, including changes in commodity prices, equity prices and interest rates. For further discussion of our exposure to market risk, see Part II, Item 7A—Quantitative and Qualitative Disclosures about Market Risk in our Form 10-K. Except as described below, there have been no significant changes to our exposure to market risk since December 31, 2017.

On August 17, 2018, we entered into two forward starting swap agreements, each with a notional amount of \$80 million, to reduce interest rate exposure on debt expected to be issued in 2019. These forward starting swap agreements terminate in August 2019, and have an average fixed rate of 2.98%. The fair value of the forward starting swaps at September 30, 2018 was a gain position of \$5 million. A hypothetical 1% adverse change in interest rates would result in a decrease in the fair value of our forward starting swaps of approximately \$25 million at September 30, 2018.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

American Water maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in its reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

Our management, including the Chief Executive Officer and the Chief Financial Officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of September 30, 2018.

Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2018, our disclosure controls and procedures were effective at a reasonable level of assurance.

Changes in Internal Control over Financial Reporting

On June 4, 2018, the Company completed the acquisition of Pivotal. See Note 4—Acquisitions and Divestitures in the Notes to the Consolidated Financial Statements for additional information. We began to integrate Pivotal into our internal control over financial reporting structure and expect to complete this integration in 2019. We concluded that there have been no changes in internal control over financial reporting that occurred during the three months ended September 30, 2018, other than changes resulting from the acquisition of Pivotal, that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The following information updates and amends the information provided in our Form 10-K in Part I, Item 3—Legal Proceedings, and in our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2018 and June 30, 2018 in Part II, Item 1—Legal Proceedings. Capitalized terms used but not otherwise defined herein have the meanings set forth in our Form 10-K.

Alternative Water Supply in Lieu of Carmel River Diversions

On May 4, 2018, California-American Water Company, our wholly owned subsidiary (“Cal Am”), notified the Monterey Peninsula Water Management District (“MPWMD”) and the California State Water Resources Control Board (the “SWRCB”) that it intends to seek declaratory relief concerning the conflicting regulatory interpretations under the 2009 Order, triggering a 60-day meet and confer period prior to commencement of any action concerning the conflicting interpretations. Having held two meetings previously, the parties have agreed to meet and confer again in December 2018. Any failure to follow MPWMD’s resolution or the SWRCB’s written interpretation, despite these conflicting interpretations, could potentially result in fines, penalties and other actions against Cal Am.

Regional Desalination Project Litigation

On September 21, 2018, RMC Water and Environmental, a private engineering and consulting firm and a party to the consolidated action associated with the failure of the original regional desalination project, filed a motion for judgment on the pleadings as to Cal Am’s fifth amended complaint. On September 24, 2018, Cal Am filed a motion for summary judgment against Marina Coast Water District (“MCWD”) as to MCWD’s claim based on promissory estoppel contained in MCWD’s fourth amended complaint. These motions remain pending. Trial in the consolidated action remains set for March 25, 2019 in San Francisco County Superior Court.

Monterey Peninsula Water Supply Project

Approval of CPCN for Water Supply Project

On August 13, 2018, the California Public Utilities Commission (the “CPUC”) issued its proposed decision granting Cal Am’s request for a certificate of public convenience and necessity (“CPCN”) for a 6.4 million gallon per day desalination plant in Monterey, California, certifying its final environmental impact report and denying all other outstanding motions. On September 13, 2018, the CPUC unanimously adopted a final decision (i) affirming its findings that the Water Supply Project meets the CPUC’s requirements for a CPCN, and (ii) finding that (a) the issuance of the final decision should not be delayed, and (b) an additional procedural phase was not necessary to consider alternative projects. The CPUC’s decision directs Cal Am to enter into negotiations regarding expansion of a groundwater replenishment project (the “GWR Project”) between the Monterey Regional Water Pollution Control Agency and the MPWMD and to indicate whether Cal Am plans to file an application for approval of an agreement to purchase additional water from the GWR Project. The decision notes, however, that the CPUC will only consider such an application if the Water Supply Project is delayed such that Cal Am would not be able to meet the December 31, 2021 deadline to comply with the 2009 Order. The decision accepts Cal Am’s estimates of future water demand in Monterey and concludes that the Water Supply Project is the best project to address those needs, and also adopts Cal Am’s most recent cost estimates. The decision also allows Cal Am to earn an allowance for funds used during construction, or AFUDC, at a rate representative of its actual financing costs. The final decision adopted frameworks as to cost caps, O&M costs, financing, ratemaking and contingency matters.

In addition, the CPUC final decision imposes numerous reporting and filing requirements to ensure the expenditures for the Water Supply Project are reasonable, including that the financing is the lowest cost and most beneficial for ratepayers, and that construction is progressing in a timely manner and within the authorized cost caps. The reasonableness of Water Supply Project costs will be reviewed in the first general rate case filed by Cal Am after the Water Supply Project becomes operational. Cal Am is also required to implement mitigation measures to avoid, minimize or offset significant environmental impacts from the construction and operation of the Water Supply Project and comply with a mitigation monitoring and reporting program, a reimbursement agreement for CPUC costs associated with that program, and reporting requirements on plant operations following placement of the Water Supply Project in service.

Cal Am must file a notice with the CPUC by November 27, 2018 indicating that it accepts the terms of the CPUC's final decision.

On October 12, 2018, MCWD and the City of Marina filed petitions for writ of review with the California Supreme Court challenging the CPUC's final decision. These petitions remain pending.

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Coastal Development Permit Application

On June 22, 2018, Cal Am submitted a coastal development permit application to the City of Marina for those project components of the Water Supply Project located within the City of Marina's coastal zone. Members of the City's Planning Commission, as well as City councilpersons, have publicly expressed opposition to the Water Supply Project. On August 9, 2018, the City deemed Cal Am's application incomplete pending certification and submission of the final environmental impact report, and stated that the City could not rule on the permit until certification. The CPUC certified the final environmental impact report for the Water Supply Project on September 13, 2018.

On August 30, 2018, the City circulated a public review draft of proposed amendments to its local coastal program and zoning ordinance, and placed the matter for consideration on the Planning Commission's agenda for its September 13, 2018 meeting. The proposed amendments would change zoning at the Cemex site to open space and restrict future uses, including with respect to Cal Am's planned use of the site for the slant wells for the Water Supply Project. Any change to the City's local coastal program must ultimately be approved by the California Coastal Commission (the "Coastal Commission"). Cal Am, Cemex and the Coastal Commission each submitted letters opposing the proposed amendments. At the September 13, 2018 meeting, the Planning Commission continued the matter to an unspecified future date.

* * *

Based on the foregoing, Cal Am estimates that the earliest date by which the Water Supply Project desalination plant could be completed is sometime in 2021. There can be no assurance that the Water Supply Project will be completed on a timely basis, if ever. Furthermore, there can be no assurance that Cal Am will be able to comply with the diversion reduction requirements and other remaining requirements under the 2009 Order and the 2016 Order, or that any such compliance will not result in material additional costs or obligations to Cal Am or the Company.

West Virginia Elk River Freedom Industries Chemical Spill

On July 31, 2018, WVAWC filed a motion to dismiss the Lincoln County (West Virginia) Commission's (the "LCC") complaint. On September 21, 2018, the Mass Litigation Panel heard arguments on this motion. This motion remains pending.

On September 28, 2018, the Mass Litigation Panel entered an order dismissing all of its pending cases except for two, one of which was the LCC's complaint.

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ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A—Risk Factors in our Form 10-K, and in our other public filings, which could materially affect our business, financial condition or future results. There have been no material changes from the risk factors previously disclosed in Part I, Item 1A—Risk Factors in our Form 10-K, other than as set forth below:

We are subject to adverse publicity and reputational risks, which make us vulnerable to negative customer perception and could lead to increased regulatory oversight or sanctions.

Water and wastewater utilities, including our regulated subsidiaries and our Market-Based Businesses, have a large direct and indirect customer base and as a result are exposed to public criticism regarding, among other things, the reliability of their water, wastewater and related or ancillary services, the quality of water provided, and the amount, timeliness, accuracy and format of bills that are provided for such services. Adverse publicity and negative consumer sentiment may render legislatures and other governing bodies, state PUCs and other regulatory authorities, and government officials less likely to view us in a favorable light, and may cause us to be susceptible to less favorable legislative, regulatory and economic outcomes, as well as increased regulatory or other oversight and more stringent regulatory or economic requirements.

New York American Water Company, Inc. (“NYAW”) has been the subject of a New York State Public Service Commission (“NYSPSC”) investigation related to the unintentional provision of incorrect data to a taxing authority that resulted in an over-assessment of real property taxes. NYAW self-reported this issue to the NYSPSC promptly after NYAW’s senior leadership became aware of it. Neither NYAW nor any of its employees received any financial benefit as a result of this matter, as all customer overpayments were provided to the local taxing authorities. These errors resulted in the over-recovery by NYAW of an estimated \$0.3 million in cumulative real property tax overpayments from approximately 4,400 of its customers. The NYSPSC investigation also related to the failure of a few employees working on NYAW’s 2016 general rate case to properly disclose these issues in that rate case. On August 9, 2018, the NYSPSC ordered NYAW to refund \$0.3 million to the affected customers and reset customer real property values to further reduce customer bills.

On August 28, 2018, the NYSPSC and the New York State Department of Public Service (the “NYSDPS”) filed a verified petition for injunctive relief against NYAW in the Supreme Court of the State of New York, Albany County. In addition to the allegations covered by the NYSPSC’s investigation, the verified petition alleged that NYAW failed to provide its customers with adequate notice of a change in its rate schedule and also noted that as of August 27, 2018, NYAW had received approximately 1,344 complaints relating to allegedly high water bills. That same day, the parties entered into a Consent and Stipulation agreeing to settle all of the causes of action in the verified petition. The court approved the settlement on September 11, 2018, and NYAW is cooperating with the NYSDPS to implement its terms.

As part of the settlement, and in addition to the refund ordered by the NYSPSC on August 9, 2018, NYAW has agreed that it would provide up to \$4.5 million to benefit NYAW customers through several different mechanisms, which amounts would not be recoverable in rates. NYAW also has agreed to accelerate the timing of the payment of approximately \$6.4 million in aggregate customer credits. Finally, NYAW has agreed to engage and cooperate with up to two independent monitors, at NYAW’s expense (up to \$0.5 million), through September 30, 2021, and to review matters described in the verified petition, including the implementation of process improvements and control recommendations described in the NYSPSC’s staff reports. While the settlement resolves the NYSPSC’s investigation involving NYAW and those matters set forth in the verified petition, there can be no assurance that NYAW will not be subject to additional federal, state or local proceedings regarding these and other related matters, and these proceedings could result in increased oversight and civil, administrative and/or criminal sanctions, which may have a material adverse effect upon our reputation and perception.

Unfavorable regulatory and economic outcomes also may include the enactment of more stringent laws and regulations governing our operations and less favorable economic terms in our agreements related to our Market-Based Businesses, as well as fines, penalties or other sanctions or requirements. The imposition of any of the foregoing could have a material negative impact on us and our financial condition, results of operations and cash flows.

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We have recorded a significant amount of goodwill, and we may never realize the full value of our intangible assets, causing us to record impairments that may negatively affect our results of operations.

Our total assets include \$1.4 billion of goodwill at December 31, 2017, and \$1.6 billion of goodwill at September 30, 2018. The goodwill is primarily associated with the acquisition of American Water by an affiliate of our previous owner in 2003, the acquisition of E'town Corporation by a predecessor to our previous owner in 2001, the acquisition of Pivotal in 2018 and, to a lesser extent, the acquisition of Keystone in 2015. Goodwill represents the excess of the purchase price the purchaser paid over the fair value of the net tangible and other intangible assets acquired. Goodwill is recorded at fair value on the date of an acquisition and is reviewed annually or more frequently if changes in circumstances indicate the carrying value may not be recoverable. As required by the applicable accounting rules, we have taken significant non-cash charges to operating results for goodwill impairments in the past.

We may be required to recognize an impairment of goodwill in the future due to market conditions or other factors related to our performance or the performance of an acquired business. These market conditions could include a decline over a period of time of our stock price, a decline over a period of time in valuation multiples of comparable water utilities, market price performance of our common stock that compares unfavorably to our peer companies, decreases in control premiums, or, with respect to Keystone, fluctuations in the level of exploration and production activities in the Marcellus and Utica shale regions served by Keystone, a prolonged depression of natural gas prices or other factors that negatively impact our current or future forecasts of operating results, cash flows or key assumptions. In this regard, in the third quarter of 2018, we strategically narrowed the scope of the Keystone business solely to water transfer services due to operational and financial challenges in the other businesses of Keystone. As a result of this strategic change, we recorded a non-cash, pre-tax impairment charge of \$57 million in the third quarter of 2018 related to Keystone. See Note 6—Goodwill and Other Intangible Assets in the Notes to the Consolidated Financial Statements for further information.

A decline in the results forecasted in our business plan due to events such as changes in rate case results, capital investment budgets or interest rates, could also result in an impairment charge. Recognition of impairments of goodwill would result in a charge to income in the period in which the impairment occurred, which may negatively affect our financial condition, results of operations and total capitalization. The effects of any such impairment could be material and could make it more difficult to maintain our credit ratings, secure financing on attractive terms, maintain compliance with debt covenants and meet the expectations of our regulators.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In February 2015, the Board of Directors authorized an anti-dilutive stock repurchase program to mitigate the dilutive effect of shares issued through the Company's dividend reinvestment, employee stock purchase and executive compensation activities. The program allows the Company to purchase up to 10 million shares of its outstanding common stock over an unrestricted period of time in the open market or through privately negotiated transactions. The program is conducted in accordance with Rule 10b-18 of the Exchange Act, and, to facilitate these repurchases, the Company enters into Rule 10b5-1 stock repurchase plans with a third-party broker, which allow the Company to repurchase shares of its common stock at times when it otherwise might be prevented from doing so under insider trading laws or because of self-imposed trading blackout periods. Subject to applicable regulations, the Company may elect to amend or cancel the program or the stock repurchase parameters at its discretion to manage dilution.

The Company did not repurchase shares of its common stock during the three months ended September 30, 2018. From April 1, 2015, the date repurchases under the anti-dilutive stock repurchase program commenced, through September 30, 2018, the Company repurchased an aggregate of 4,510,000 shares of its common stock under the program, leaving an aggregate of 5,490,000 shares available for repurchase under this program.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

| Exhibit Number | Exhibit Description |
|-------------------|---|
| 3.1 | <u>Restated Certificate of Incorporation of American Water Works Company, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q, File No. 001-34028, filed November 6, 2008).</u> |
| 3.2 | <u>Amended and Restated Bylaws of American Water Works Company, Inc. (incorporated by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q, File No. 001-34028, filed August 5, 2015).</u> |
| 4.1 | <u>Officers' Certificate of American Water Capital Corp., dated August 9, 2018, establishing the terms of its 3.750% Senior Notes due 2028 (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, File No. 001-34028, filed August 9, 2018).</u> |
| 4.2 | <u>Officers' Certificate of American Water Capital Corp., dated August 9, 2018, establishing the terms of its 4.200% Senior Notes due 2048 (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K, File No. 001-34028, filed August 9, 2018).</u> |
| 10.1 | <u>First Amended and Restated American Water Works Company, Inc. and its Designated Subsidiaries 2017 Nonqualified Employee Stock Purchase Plan, adopted on December 7, 2017, effective as of August 5, 2018 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, File No. 001-34028, filed August 9, 2018).</u> |
| *10.2 | <u>Second Amended and Restated American Water Works Company, Inc. and its Designated Subsidiaries 2017 Nonqualified Employee Stock Purchase Plan, adopted on July 27, 2018, effective as of February 5, 2019.</u> |
| *31.1 | <u>Certification of Susan N. Story, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act.</u> |
| *31.2 | <u>Certification of Linda G. Sullivan, Executive Vice President and Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act.</u> |
| **32.1 | <u>Certification of Susan N. Story, President and Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act.</u> |
| **32.2 | <u>Certification of Linda G. Sullivan, Executive Vice President and Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act.</u> |
| *101 | The following financial statements from American Water Works Company, Inc.'s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2018, filed with the Securities and Exchange Commission on October 31, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations; (iii) the Consolidated Statements of Comprehensive Income; (iv) the Consolidated Statements of Cash Flows; (v) the Consolidated Statements of Changes in Stockholders' Equity; and (vi) the Notes to Consolidated Financial Statements. |

* Filed herewith.

** Furnished herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 31st day of October, 2018.

AMERICAN WATER WORKS COMPANY, INC.

(REGISTRANT)

By/s/ SUSAN N. STORY

Susan N. Story

President and Chief Executive Officer

(Principal Executive Officer)

By/s/ LINDA G. SULLIVAN

Linda G. Sullivan

Executive Vice President and Chief Financial Officer

(Principal Financial Officer)

By/s/ MELISSA K. WIKLE

Melissa K. Wikle

Vice President and Controller

(Principal Accounting Officer)