

American Water Works Company, Inc.
Form 10-Q
November 05, 2014

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, 2014

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	(I.R.S. Employer
incorporation or organization)	Identification No.)
1025 Laurel Oak Road, Voorhees, NJ	08043
(Address of principal executive offices)	(Zip Code)

(856) 346-8200

(Registrant's telephone number, including area code)

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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 at October 30, 2014
Common Stock, \$0.01 par value per share	179,309,045 shares

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REPORT ON FORM 10-Q

FOR THE QUARTER ENDED September 30, 2014

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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 thousands, except per share data)

	September 30, 2014	December 31, 2013
ASSETS		
Property plant and equipment		
Utility plant—at original cost, net of accumulated depreciation of \$4,010,604 at September 30 and \$3,894,326 at December 31	\$ 12,668,123	\$ 12,244,359
Nonutility property, net of accumulated depreciation of \$239,780 at September 30 and \$215,083 at December 31	131,235	143,995
Total property, plant and equipment	12,799,358	12,388,354
Current assets		
Cash and cash equivalents	74,128	26,964
Restricted funds	20,040	28,505
Accounts receivable	284,273	241,926
Allowance for uncollectible accounts	(34,579)	(33,823)
Unbilled revenues	227,037	215,725
Income taxes receivable	9,608	5,778
Materials and supplies	37,203	32,973
Deferred income taxes	104,251	18,609
Assets of discontinued operations	6,256	7,761
Other	28,744	28,276
Total current assets	756,961	572,694
Regulatory and other long-term assets		
Regulatory assets	874,828	858,465
Restricted funds	17,243	754
Goodwill	1,208,065	1,207,764
Other	59,192	60,998
Total regulatory and other long-term assets	2,159,328	2,127,981
TOTAL ASSETS	\$ 15,715,647	\$ 15,089,029

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 thousands, except per share data)

	September 30, 2014	December 31, 2013
CAPITALIZATION AND LIABILITIES		
Capitalization		
Common stock (\$0.01 par value, 500,000 shares authorized, 179,265 shares outstanding at September 30 and 178,379 at December 31)	\$ 1,793	\$ 1,784
Paid-in-capital	6,297,187	6,261,396
Accumulated deficit	(1,333,164)	(1,495,698)
Accumulated other comprehensive loss	(35,942)	(34,635)
Treasury stock	(10,222)	(5,043)
Total common stockholders' equity	4,919,652	4,727,804
Long-term debt		
Long-term debt	5,540,648	5,212,881
Redeemable preferred stock at redemption value	15,958	17,177
Total capitalization	10,476,258	9,957,862
Current liabilities		
Short-term debt	313,979	630,307
Current portion of long-term debt	55,581	14,174
Accounts payable	260,713	264,115
Taxes accrued	46,945	32,166
Interest accrued	97,062	52,087
Liabilities of discontinued operations	1,667	3,824
Other	282,988	238,860
Total current liabilities	1,058,935	1,235,533
Regulatory and other long-term liabilities		
Advances for construction	368,827	375,729
Deferred income taxes	2,118,499	1,841,584
Deferred investment tax credits	25,362	26,408
Regulatory liabilities	385,288	373,319
Accrued pension expense	90,026	108,542
Accrued postretirement benefit expense	88,338	88,419
Other	36,893	38,929
Total regulatory and other long-term liabilities	3,113,233	2,852,930
Contributions in aid of construction	1,067,221	1,042,704
Commitments and contingencies (See Note 10)	—	—
TOTAL CAPITALIZATION AND LIABILITIES	\$ 15,715,647	\$ 15,089,029

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 and Comprehensive Income (Unaudited)

(In thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Operating revenues	\$846,169	\$822,190	\$2,279,950	\$2,172,694
Operating expenses				
Operation and maintenance	341,348	337,674	1,004,377	962,853
Depreciation and amortization	106,789	102,495	318,398	303,002
General taxes	60,807	58,087	178,276	175,789
(Gain) loss on asset dispositions and purchases	(60)	768	(616)	529
Total operating expenses, net	508,884	499,024	1,500,435	1,442,173
Operating income	337,285	323,166	779,515	730,521
Other income (expenses)				
Interest, net	(75,445)	(77,389)	(222,673)	(233,260)
Allowance for other funds used during construction	2,805	2,800	7,064	9,895
Allowance for borrowed funds used during construction	1,570	1,679	4,324	5,102
Amortization of debt expense	(1,669)	(1,524)	(4,971)	(4,729)
Other, net	(733)	(449)	(2,591)	(1,481)
Total other income (expenses)	(73,472)	(74,883)	(218,847)	(224,473)
Income from continuing operations before income taxes	263,813	248,283	560,668	506,048
Provision for income taxes	107,205	98,374	224,773	196,325
Income from continuing operations	156,608	149,909	335,895	309,723
Income (loss) from discontinued operations, net of tax	(4,423)	756	(6,288)	(152)
Net income	\$152,185	\$150,665	\$329,607	\$309,571
Other comprehensive income (loss), net of tax:				
Pension plan amortized to periodic benefit cost:				
Prior service cost, net of tax of \$26 and \$28 for the three				
months and \$79 and \$83 for the nine months, respectively	41	43	124	130
Actuarial loss, net of tax of \$(4) and \$1,424 for the three				
months and \$(14) and \$4,273 for the nine months,				
respectively	(7)	2,228	(22)	6,683
Foreign currency translation adjustment	(490)	296	(594)	(523)
Unrealized loss on cash flow hedge, net of tax of \$(439) for the				
three and nine months	(815)	0	(815)	0
Other comprehensive income (loss)	(1,271)	2,567	(1,307)	6,290
Comprehensive income	\$150,914	\$153,232	\$328,300	\$315,861

Basic earnings per share: (a)

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Income from continuing operations	\$0.87	\$0.84	\$1.88	\$1.74
Income (loss) from discontinued operations, net of tax	\$(0.02)) \$0.00	\$(0.04)) \$(0.00)
Basic earnings per share	\$0.85	\$0.85	\$1.84	\$1.74
Diluted earnings per share: (a)				
Income from continuing operations	\$0.87	\$0.84	\$1.87	\$1.73
Income (loss) from discontinued operations, net of tax	\$(0.02)) \$0.00	\$(0.03)) \$(0.00)
Diluted earnings per share	\$0.85	\$0.84	\$1.83	\$1.73
Average common shares outstanding during the period				
Basic	178,992	177,965	178,800	177,671
Diluted	179,948	179,154	179,723	178,906
Dividends declared per common share	\$0.62	\$0.56	\$0.93	\$0.84

(a) Amounts may not sum 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 Cash Flows (Unaudited)

(In thousands, except per share data)

	Nine Months Ended	
	September 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$329,607	\$309,571
Adjustments		
Depreciation and amortization	318,398	303,002
Provision for deferred income taxes	213,125	195,240
Amortization of deferred investment tax credits	(1,046)	(1,126)
Provision for losses on accounts receivable	26,087	18,331
Allowance for other funds used during construction	(7,064)	(9,895)
(Gain) loss on asset dispositions and purchases	(616)	529
Pension and non-pension postretirement benefits	18,056	58,552
Stock-based compensation expense	9,670	8,916
Other, net	(229)	(12,264)
Changes in assets and liabilities		
Receivables and unbilled revenues	(77,323)	(108,062)
Taxes receivable, including income taxes	(3,830)	(5,513)
Other current assets	(15,292)	(13,188)
Pension and non-pension postretirement benefit contributions	(35,783)	(77,664)
Accounts payable	(30,141)	(28,577)
Taxes accrued, including income taxes	14,779	10,064
Interest accrued	44,975	47,481
Change in book overdraft	(2,052)	(7,993)
Other current liabilities	39,581	1,145
Operating cash flows provided by continuing operations	840,902	688,549
Operating cash flows provided by (used in) discontinued operations, net	(640)	127
Net cash provided by operating activities	840,262	688,676
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(664,859)	(664,975)
Acquisitions	(6,053)	(16,554)
Proceeds from sale of assets	804	749
Removal costs from property, plant and equipment retirements, net	(51,959)	(49,639)
Net funds released	738	11,339
Investing cash flows used in continuing operations	(721,329)	(719,080)
Investing cash flows used in discontinued operations	(12)	(287)
Net cash used in investing activities	(721,341)	(719,367)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt	500,497	2,737
Repayment of long-term debt	(136,739)	(13,149)
Proceeds from short-term borrowings with maturities greater than three months	35,000	20,000
Repayment of short-term borrowings with maturities greater than three months	(256,000)	0
Net short-term borrowings (repayments) with maturities less than three months	(95,328)	99,450
Proceeds from issuances of employee stock plans and DRIP	15,446	19,788

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Advances and contributions for construction, net of refunds of \$16,305 and

\$16,671 at September 30, 2014 and 2013, respectively	21,293	13,486
Debt issuance costs	(4,593)	(1,126)
Redemption of preferred stock	(1,200)	(2,920)
Dividends paid	(160,848)	(99,554)
Tax benefit realized from equity compensation	10,715	0
Net cash (used in) provided by financing activities	(71,757)	38,712
Net increase in cash and cash equivalents	47,164	8,021
Cash and cash equivalents at beginning of period	26,964	24,433
Cash and cash equivalents at end of period	\$74,128	\$32,454
Non-cash investing activity:		
Capital expenditures acquired on account but unpaid at end of period	\$163,053	\$119,807
Non-cash financing activity:		
Advances and contributions	\$8,876	\$9,379
Dividends accrued	\$55,494	\$49,837
Long-term debt issued	\$9,977	\$0
Long-term debt retired	\$(1,215)	\$0

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 thousands, except per share data)

	Common Shares	Stock Par Value	Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock Shares At Cost	Preferred Stock of Subsidiary Companies Without Mandatory Redemption Requirements	Total Stockholders' Equity	
Balance at December 31, 2013	178,379	\$1,784	\$6,261,396	\$(1,495,698)	\$(34,635)	(132)	\$(5,043)	\$0	\$4,727,804
Net income	0	0	0	329,607	0	0	0	0	329,607
Direct stock reinvestment and purchase plan, net of expense of \$22 Employee stock purchase plan Stock-based compensation activity Other comprehensive loss, net of tax of \$(374) Dividends	34	0	1,568	0	0	0	0	0	1,568
	75	1	3,458	0	0	0	0	0	3,459
	777	8	30,765	(640)	0	(122)	(5,179)	0	24,954
	0	0	0	0	(1,307)	0	0	0	(1,307)
	0	0	0	(166,433)	0	0	0	0	(166,433)
Balance at September 30, 2014	179,265	\$1,793	\$6,297,187	\$(1,333,164)	\$(35,942)	(254)	\$(10,222)	\$0	\$4,919,652
	Common Stock				Accumulated Other	Treasury Stock	Preferred Stock of	Total	

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	Shares	Par Value	Paid-in Capital	Accumulated Deficit	Comprehensive Loss	Shares	At Cost	Subsidiary Companies Without Mandatory Redemption Requirements	Stockholders' Equity
Balance at December 31, 2012	176,988	\$1,770	\$6,222,644	\$(1,664,955)	\$(116,191)	0	\$0	\$ 1,720	\$4,444,988
Net income	0	0	0	309,571	0	0	0	0	309,571
Direct stock reinvestment									
and purchase plan, net of									
expense of \$41 Employee stock purchase	35	0	1,399	0	0	0	0	0	1,399
plan Stock-based compensation	81	1	3,270	0	0	0	0	0	3,271
activity Subsidiary preferred stock	1,017	10	23,973	(416)	0	(132)	(5,043)	0	18,524
redemption Other comprehensive	0	0	0	0	0	0	0	(1,720)	(1,720)
income, net of tax									
of \$4,356	0	0	0	0	6,290	0	0	0	6,290
Dividends	0	0	0	(149,391)	0	0	0	0	(149,391)
Balance at September 30, 2013	178,121	\$1,781	\$6,251,286	\$(1,505,191)	\$(109,901)	(132)	\$(5,043)	\$ 0	\$4,632,932

The accompanying notes are an integral part of these consolidated financial statements.

American Water Works Company, Inc. and Subsidiary Companies

Notes to Consolidated Financial Statements (Unaudited)

(In thousands, except per share data)

Note 1: Basis of Presentation

The accompanying Consolidated Balance Sheet of American Water Works Company, Inc. and Subsidiary Companies (the "Company") at September 30, 2014, the Consolidated Statements of Operations and Comprehensive Income for the three and nine months ended September 30, 2014 and 2013, the Consolidated Statements of Cash Flows for the nine months ended September 30, 2014 and 2013, and the Consolidated Statements of Changes in Stockholders' Equity for the nine months ended September 30, 2014 and 2013, are unaudited, but reflect all adjustments, which are, in the opinion of management, necessary to present fairly the consolidated financial position, the consolidated changes in stockholders' equity, the consolidated results of operations and comprehensive income, and the consolidated cash flows for the periods presented. All adjustments are of a normal, recurring nature, except as otherwise disclosed. Because they cover interim periods, the unaudited consolidated financial statements and related notes to the consolidated financial statements do not include all disclosures and notes normally provided in annual financial statements and, therefore, should be read in conjunction with the Company's Consolidated Financial Statements and related Notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the year, due primarily to the seasonality of the Company's operations.

The accompanying Notes to the Consolidated Financial Statements relate to continuing operations only unless otherwise indicated. Certain reclassifications have been made to previously reported data to conform to the current presentation. In 2014 the Company revised the 2013 balance sheet to classify \$18,609 of deferred income taxes as current rather than non-current. The change in classification was not material to the previously issued financial statements.

Note 2: New Accounting Pronouncements

The following recently issued accounting standards have been adopted by the Company and have been included in the consolidated results of operations, financial position or footnotes of the accompanying Consolidated Financial Statements:

Obligations Resulting from Joint and Several Liability Arrangements

In February 2013, the Financial Accounting Standards Board ("FASB") issued guidance for the recognition, measurement and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. Examples of obligations within the scope of the updated guidance include debt arrangements, other contractual obligations and settled litigation and judicial rulings. The update requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date as the sum of the following: (a) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and (b) any additional amount the reporting entity expects to pay on behalf of its co-obligors. The updated guidance also includes additional disclosures regarding the nature and amount of the obligation, as well as other information about those obligations. The update was effective on a retrospective basis for interim and annual periods beginning January 1, 2014. The adoption of this guidance did not have an impact on the Company's results of operations, financial position or cash flows.

Foreign Currency Matters

In June 2013, the FASB issued guidance for a parent's accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. The amendments resolve differing views in practice and apply to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or a business within a foreign entity. The update was effective prospectively for interim and annual periods beginning January 1, 2014. The adoption of this guidance did not have an impact on the Company's results of operations, financial position or cash flows.

The following recently issued accounting standards are not yet required to be adopted by the Company:

Service Concession Arrangements

In January 2014, the FASB issued guidance for an operating entity that enters into a service concession arrangement with a public sector grantor who controls or has the ability to modify or approve the services that the operating entity must provide with the infrastructure, to whom it must provide the services and at what price. The grantor also controls, through ownership or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement. The guidance specifies that an operating entity should not account for the service concession arrangement as a lease. The operating entity should refer instead to other accounting guidance to account for the various aspects of the arrangement. The guidance also specifies that the infrastructure used in the arrangement should not be recognized as property, plant and equipment of the operating entity. This update should be applied on a modified

retrospective basis to service concession arrangements that exist at the beginning of an entity's fiscal year of adoption. This requires the cumulative effect of applying the update to be recognized as an adjustment to the opening retained earnings balance for the annual period of adoption. The update is effective for interim and annual periods beginning January 1, 2015. Early adoption is permitted. The adoption of this updated guidance is not expected to have a material impact on results of operations, financial position or cash flows.

Reporting Discontinued Operations

In April 2014, the FASB issued guidance that changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. Under the updated guidance, a discontinued operation is defined as a component or group of components that is disposed of or is classified as held for sale and represents a strategic shift that has or will have a major effect on an entity's operations and financial results. A strategic shift could include a disposal of a major geographical area of operations, a major line of business, a major equity method investment or other major part of the entity. A component comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity including a reportable segment, an operating segment, a reporting unit, a subsidiary or an asset group. The update no longer precludes presentation as a discontinued operation if there are operations and cash flows of the component that have not been eliminated from the reporting entity's ongoing operations or if there is significant continuing involvement with a component after its disposal. The guidance is effective on a prospective basis for interim and annual periods beginning after January 1, 2015. In general, this guidance is likely to result in fewer disposals of assets qualifying as discontinued operations.

Revenue from Contracts with Customers

In May 2014, the FASB issued a comprehensive new revenue recognition standard that supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the new guidance is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The guidance is effective for annual and interim periods beginning January 1, 2017 and early adoption is not permitted. The new guidance allows for either full retrospective adoption, meaning the guidance is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements. The Company is evaluating the new guidance, the best transition method and the impact the new standard will have on its results of operations, financial position or cash flows.

Accounting for Stock-based Compensation with Performance Targets

In June 2014, the FASB issued guidance for the accounting for stock-based compensation tied to performance targets. The amendments clarify that a performance target that affects vesting of a share-based payment and that could be achieved after the requisite service period is a performance condition. As a result, the target is not reflected in the estimation of the award's grant date fair value and compensation cost would be recognized over the required service period, if it is probable that the performance condition will be achieved. The guidance is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. The Company is evaluating the impact the updated guidance will have on its results of operations, financial position or cash flows.

Disclosures of Uncertainties about an Entity's Ability to Continue as a Going Concern

In August 2014, the FASB issued guidance that explicitly requires an entity's management to assess the entity's ability to continue as a going concern. The new guidance requires an entity to evaluate, at each interim and annual period, whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date the financial statements are issued (or are available to be issued) and to provide

related disclosures, if applicable. The new guidance is effective for annual periods ending after December 15, 2016 and for interim and annual periods thereafter. Early adoption is permitted. The Company does not expect this new guidance to have a material impact on its results of operations, financial position or cash flows.

Note 3: Acquisitions and Divestitures

Acquisitions

During the nine-month period ended September 30, 2014, the Company closed on nine acquisitions: five regulated water systems, one regulated wastewater, and three regulated water and wastewater systems. The aggregate purchase price of these acquisitions totaled \$6,134. Assets acquired, principally plant, totaled \$13,119. Liabilities assumed totaled \$6,985, including contributions in aid of construction of \$4,231 and debt of \$1,683.

Divestitures

In the third quarter of 2014, the Company approved a plan to exit the Class B biosolids management business by selling Terratec Environmental Ltd (“Terratec”), and as a result, has included the results as discontinued operations for all periods presented. Terratec, which was previously included in the Market-Based Operations segment, is based in Canada and provides environmentally sustainable

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management and disposal of biosolids and wastewater by-products. The Company expects to complete the disposition during the fourth quarter of 2014.

Included in the loss on discontinued operations is an estimated loss on the disposal of Terratec in the amount of \$3,470. The provision for income taxes for 2014 includes the utilization of \$1,480 of tax attributes as a result of the expected sale. Charges recorded in connection with the discontinued operations include estimates that are subject to subsequent adjustment.

A summary of discontinued operations presented in the Consolidated Statements of Operations and Comprehensive Income follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	2013	September 30, 2014	2013
Operating revenues	\$4,910	\$7,006	\$12,234	\$16,904
Total operating expenses, net	7,973	6,297	17,657	17,430
Income (loss) from discontinued operations before				
income taxes	(3,063)	709	(5,423)	(526)
Provision (benefit) for income taxes	1,360	(47)	865	(374)
Income (loss) from discontinued operations	\$ (4,423)	\$ 756	\$ (6,288)	\$ (152)

Assets and liabilities of discontinued operations in the accompanying Consolidated Balance Sheets include the following:

	September 30,	December 31,
	2014	2013
ASSETS		
Total property, plant and equipment	\$ 2,168	\$ 2,808
Current assets	4,088	4,953
Total assets of discontinued operations	\$ 6,256	\$ 7,761
LIABILITIES		
Current liabilities	\$ 1,667	\$ 3,824
Total liabilities of discontinued operations	\$ 1,667	\$ 3,824

Note 4: Goodwill

The Company's annual goodwill impairment test is conducted at November 30 of each calendar year. Interim reviews are performed when the Company determines that a triggering event that would more likely than not reduce the fair value of a reporting unit below its carrying value has occurred. The Company has determined no such triggering event had occurred during the nine months ended September 30, 2014.

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The change in the Company's goodwill assets, as allocated between the reporting units is as follows:

	Regulated Unit		Market-Based Operations		Consolidated		Total Net
	Cost	Accumulated Impairment	Cost	Accumulated Impairment	Cost	Accumulated Impairment	
Balance at January 1, 2014	\$3,412,063	\$(2,332,670)	\$235,990	\$(107,619)	\$3,648,053	\$(2,440,289)	\$1,207,764
Goodwill from acquisitions	301	0	0	0	301	0	301
Balance at September 30, 2014	\$3,412,364	\$(2,332,670)	\$235,990	\$(107,619)	\$3,648,354	\$(2,440,289)	\$1,208,065
Balance at January 1, 2013	\$3,411,549	\$(2,332,670)	\$235,990	\$(107,619)	\$3,647,539	\$(2,440,289)	\$1,207,250
Goodwill from acquisitions	405	0	0	0	405	0	405
Reclassifications and other activity	86	0	0	0	86	0	86
Balance at September 30, 2013	\$3,412,040	\$(2,332,670)	\$235,990	\$(107,619)	\$3,648,030	\$(2,440,289)	\$1,207,741

Note 5: Stockholders' Equity

Common Stock

Under American Water Stock Direct, a dividend reinvestment and direct stock purchase plan (the "DRIP"), stockholders may reinvest cash dividends and purchase additional Company common stock, up to certain limits, through the plan administrator without commission fees. The Company's plan administrator may buy newly issued shares directly from the Company or shares held in the Company's treasury. The plan administrator may also buy shares in the public markets or in privately negotiated transactions. Purchases generally will be made and credited to DRIP accounts once each week. As of September 30, 2014, there were 4,621 shares available for future issuance under the DRIP.

The following table summarizes information regarding issuances under the DRIP for the nine months ended September 30, 2014 and 2013:

	2014	2013
Shares of common stock issued	34	35
Cash proceeds received	\$1,590	\$1,440

Cash dividend payments made during the three-month periods ended March 31, June 30 and September 30 were as follows:

	2014	2013
Dividends per share, three months ended:		
March 31	\$0.28	\$0.00
June 30	\$0.31	\$0.28
September 30	\$0.31	\$0.28
Total dividends paid, three months ended:		
March 31	\$49,968	\$0
June 30	\$55,422	\$49,744
September 30	\$55,458	\$49,810

On September 19, 2014, the Company declared a quarterly cash dividend of \$0.31 per share, payable on December 1, 2014 to shareholders of record as of November 10, 2014. As of September 30, 2014, the Company had accrued dividends totaling \$55,494 included in other current liabilities on the accompanying Consolidated Balance Sheet.

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Accumulated Other Comprehensive Income (Loss)

The following table presents changes in accumulated other comprehensive income (loss) by component, net of tax, for the nine months ended September 30, 2014 and 2013, respectively:

	Defined Benefit Plans				Loss	Total
	Employee	Amortization	Amortization	Foreign	on	Accumulated
	Benefit	of Prior	of Actuarial	Currency	Cash	Other
	Plan	Service	(Gain) Loss	Translation	Flow	Comprehensive
	Funded	Cost			Hedge	Loss
	Status					
Beginning balance at January 1, 2014	\$(69,711)	\$ 713	\$ 31,150	\$ 3,213	\$ 0	\$ (34,635)
Other comprehensive income (loss) before reclassifications						
Amounts reclassified from accumulated other comprehensive income (loss)	0	0	0	(594)	(825)	(1,419)
Net comprehensive income (loss) for the period	0	124	(22)	0	10	112
Ending balance at September 30, 2014	\$(69,711)	\$ 837	\$ 31,128	\$ 2,619	\$(815)	\$ (35,942)
Beginning balance at January 1, 2013	\$(143,183)	\$ 539	\$ 22,239	\$ 4,214	\$ 0	\$ (116,191)
Other comprehensive income (loss) before reclassifications						
Amounts reclassified from accumulated other comprehensive income (loss)	0	0	0	(523)	0	(523)
Net comprehensive income (loss) for the period	0	130	6,683	0	0	6,813
Ending balance at September 30, 2013	\$(143,183)	\$ 669	\$ 28,922	\$ 3,691	\$ 0	\$ (109,901)

The Company does not reclassify the amortization of defined benefit pension cost components from accumulated other comprehensive income (loss) directly to net income in its entirety. These accumulated other comprehensive income components are included in the computation of net periodic pension cost. (See Note 9)

The amortization of the loss on cash flow hedge is included in interest, net in the accompanying Consolidated Statements of Operations and Comprehensive Income.

Stock-Based Compensation

The Company has granted stock option and restricted stock unit awards to non-employee directors, officers and other key employees of the Company pursuant to the terms of its 2007 Omnibus Equity Compensation Plan (the "Plan"). As of September 30, 2014, a total of 8,832 shares were available for grant under the Plan. Shares issued under the Plan may be authorized-but-unissued shares of Company stock or reacquired shares of Company stock, including shares purchased by the Company on the open market for purposes of the Plan.

The Company recognizes compensation expense for stock awards over the vesting period of the award. The following table presents stock-based compensation expense recorded in operation and maintenance expense in the accompanying Consolidated Statements of Operations and Comprehensive Income for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Stock options	\$632	\$628	\$1,989	\$2,480
Restricted stock units	2,008	1,681	7,248	6,015
Employee stock purchase plan	148	145	433	421
Stock-based compensation in operation and maintenance expense	2,788	2,454	9,670	8,916
Income tax benefit	(1,087)	(957)	(3,771)	(3,477)
After-tax stock-based compensation expense	\$1,701	\$1,497	\$5,899	\$5,439

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There were no significant stock-based compensation costs capitalized during the nine months ended September 30, 2014 and 2013, respectively.

Stock Options

In the first nine months of 2014, the Company granted non-qualified stock options to certain employees under the Plan. The stock options vest ratably over the three-year service period beginning January 1, 2014. These awards have no performance vesting conditions and the grant date fair value is amortized through expense over the requisite service period using the straight-line method.

The following table presents the weighted-average assumptions used in the Black-Scholes option-pricing model and the resulting weighted-average grant date fair value per share of stock options granted through September 30, 2014:

Dividend yield	2.55 %
Expected volatility	17.75 %
Risk-free interest rate	1.06 %
Expected life (years)	3.6
Exercise price	\$44.29
Grant date fair value per share	\$4.57

Stock options granted under the Plan have maximum terms of seven years, vest over periods ranging from one to three years, and are granted with exercise prices equal to the market value of the Company's common stock on the date of grant. As of September 30, 2014, \$2,241 of total unrecognized compensation cost related to the non-vested stock options is expected to be recognized over the weighted-average period of 1.2 years.

The table below summarizes stock option activity for the nine months ended September 30, 2014:

	Shares	Weighted-Average Exercise Price (per share)	Weighted-Average Remaining Life (years)	Aggregate Intrinsic Value
Options outstanding at January 1, 2014	2,055	\$ 28.80		
Granted	491	44.29		
Forfeited or expired	(36)	39.29		
Exercised	(427)	25.36		
Options outstanding at September 30, 2014	2,083	\$ 32.98	4.1	\$ 31,773
Exercisable at September 30, 2014	1,243	\$ 27.42	3.0	\$ 25,862

The following table summarizes additional information regarding stock options exercised during the nine months ended September 30, 2014 and 2013:

2014	2013
------	------

Intrinsic value	\$8,775	\$10,999
Exercise proceeds	10,831	15,499
Income tax benefit	2,634	3,138

Restricted Stock Units

During 2011, the Company granted selected employees 189 restricted stock units with internal performance measures and, separately, certain market thresholds. These awards vested in January 2014. The terms of the grants specified that if certain performance on internal measures and market thresholds was achieved, the restricted stock units would vest; if performance was surpassed, up to 175% of the target awards would be distributed; and if performance thresholds were not met, awards would be cancelled. In January 2014, an additional 113 restricted stock units were granted and distributed because performance thresholds were exceeded.

In the first nine months of 2014, the Company granted restricted stock units, both with and without performance conditions, to certain employees and non-employee directors under the Plan. The restricted stock units without performance conditions vest ratably over the three-year service period beginning January 1, 2014 and the restricted stock units with performance conditions vest ratably over the three-year performance period beginning January 1, 2014 (the "Performance Period"). Distribution of the performance shares is contingent upon the achievement of internal performance measures and, separately, certain market thresholds over the Performance

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Period. The restricted stock units granted with service-only conditions and those with internal performance measures are valued at the market value of the Company's common stock on the date of grant. The restricted stock units granted with market conditions are valued using a Monte Carlo model.

Weighted-average assumptions used in the Monte Carlo simulation are as follows for restricted stock units with market conditions granted through September 30, 2014:

Expected volatility	17.78%
Risk-free interest rate	0.75 %
Expected life (years)	3

The grant date fair value of the restricted stock unit awards that vest ratably and have market and/or performance and service conditions is amortized through expense over the requisite service period using the graded-vesting method. Restricted stock units that have no performance conditions are amortized through expense over the requisite service period using the straight-line method. As of September 30, 2014, \$6,940 of total unrecognized compensation cost related to the non-vested restricted stock units is expected to be recognized over the weighted-average remaining life of 1.0 years.

The table below summarizes restricted stock unit activity for the nine months ended September 30, 2014:

	Shares	Weighted-Average Grant Date Fair Value (per share)
Non-vested total at January 1, 2014	539	\$ 36.27
Granted	228	45.45
Performance share adjustment	113	30.34
Vested	(325)	31.77
Forfeited	(16)	41.24
Non-vested total at September 30, 2014	539	\$ 41.47

The following table summarizes additional information regarding restricted stock units distributed during the nine months ended September 30, 2014 and 2013:

	2014	2013
Intrinsic value	\$14,938	\$13,983
Income tax benefit	1,592	2,049

If dividends are paid with respect to shares of the Company's common stock before the restricted stock units are distributed, the Company credits a liability for the value of the dividends that would have been paid if the restricted stock units were shares of Company common stock. When the restricted stock units are distributed, the Company pays

the participant a lump sum cash payment equal to the value of the dividend equivalents accrued. The Company accrued dividend equivalents totaling \$640 and \$416 to retained earnings during the nine months ended September 30, 2014 and 2013, respectively.

Employee Stock Purchase Plan

Under the Nonqualified Employee Stock Purchase Plan (the "ESPP"), employees can use payroll deductions to acquire Company stock at the lesser of 90% of the fair market value of (a) the beginning or (b) the end of each three-month purchase period. As of September 30, 2014, there were 1,288 shares of common stock reserved for issuance under the ESPP. During the nine months ended September 30, 2014, the Company issued 75 shares under the ESPP.

Note 6: Long-Term Debt

The Company primarily issues long-term debt to fund capital expenditures at the regulated subsidiaries. The components of long-term debt are as follows:

	Rate	Weighted Average Rate	Maturity	September 30, 2014	December 31, 2013
Long-term debt of American Water Capital Corp.					
("AWCC") (a)					
Private activity bonds and government funded					
debt					
Fixed rate	1.79%-6.25%	5.42%	2021-2040	\$254,655	\$330,732
Senior notes					
Fixed rate	3.40%-8.27%	5.44%	2016-2042	3,812,752	3,312,761
Long-term debt of other subsidiaries					
Private activity bonds and government funded					
debt					
Fixed rate	0.00%-6.20%	4.67%	2015-2041	814,025	863,716
Mortgage bonds					
Fixed rate	4.29%-9.71%	7.41%	2015-2039	676,500	676,500
Mandatorily redeemable preferred stock	8.47%-9.75%	8.61%	2019-2036	17,702	18,902
Capital lease obligations	12.17%	12.17%	2026	893	913
Long-term debt				5,576,527	5,203,524
Unamortized debt, net (b)				32,133	35,984
Interest rate swap fair value adjustment				3,527	4,724
Total long-term debt				\$5,612,187	\$5,244,232

(a) AWCC, which is a wholly-owned subsidiary of the Company, has a strong support agreement with its parent that, under certain circumstances, is the functional equivalent of a guarantee.

(b) Primarily fair value adjustments previously recognized in acquisition purchase accounting.

The Company issued the following long-term debt during 2014.

Company	Type	Rate	Maturity	Amount
American Water Capital Corp.	Senior notes—fixed rate	3.40%-4.30%	2025-2042	\$500,000
Other subsidiaries ⁽¹⁾	Private activity bonds and government funded debt—fixed rate	0.00%-5.00%	2031-2033	10,474
Total issuances				\$510,474

(1) Issuance includes \$9,977 which was initially kept in trust pending the Company's certification that it has incurred qualifying capital expenditures. This amount has been presented as non-cash in the accompanying Consolidated

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Statements of Cash Flows.

The Company also assumed debt of \$1,683 related to an acquisition in the second quarter of 2014.

The following long-term debt was retired through sinking fund payments and maturities during 2014:

Company	Type	Rate	Maturity	Amount
American Water Capital Corp.	Private activity bonds and government			
	funded debt—fixed rate	6.00%-6.75%	2014-2031	\$77,760
American Water Capital Corp.	Senior notes—fixed rate	6.00%	2039	9
Other subsidiaries ⁽¹⁾	Private activity bonds and government			
	funded debt—fixed rate	0.00%-5.25%	2014-2041	60,165
Other subsidiaries	Mandatorily redeemable preferred stock	8.49%	2036	1,200
Other subsidiaries	Capital lease payments			20
Total retirements and redemptions				\$139,154

(1)Includes \$1,215 of non-cash defeasance via the use of restricted funds

Interest income included in interest, net is summarized below:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Interest income	\$3,527	\$2,935	\$9,030	\$8,615

The Company has an interest rate swap to hedge \$100,000 of its 6.085% fixed-rate debt maturing 2017. The Company pays variable interest of six-month LIBOR plus 3.422%. The swap is accounted for as a fair-value hedge and matures with the fixed-rate debt in 2017.

The following table provides a summary of the derivative fair value balance recorded by the Company and the line item in the Consolidated Balance Sheets in which such amount is recorded:

	September 30, 2014	December 31, 2013
Balance sheet classification		
Regulatory and other long-term assets		
Other	\$ 3,515	\$ 4,776
Long-term debt		
Long-term debt	3,527	4,724

For derivative instruments that are designated and qualify as fair-value hedges, the gain or loss on the hedge instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current net income. The Company includes the gain or loss on the derivative instrument and the offsetting loss or gain on the hedged item in interest expense as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Income statement classification				
Interest, net				
Gain (loss) on swap	\$(1,058)	\$385	\$(1,261)	\$(2,670)
Gain (loss) on borrowing	945	(247)	1,198	2,434
Hedge ineffectiveness	(113)	138	(63)	(236)

Note 7: Short-Term Debt

Short-term debt consists of commercial paper borrowings totaling \$313,979 (net of discount of \$21) at September 30, 2014 and \$630,307 (net of discount of \$193) at December 31, 2013. During the first nine months of 2014, the Company borrowed \$35,000 with maturities greater than three months, and repaid \$35,000 and \$221,000 borrowed in 2014 and 2013, respectively, with maturities greater than three months.

Note 8: Income Taxes

The Company's estimated annual effective tax rate was 39.7% for the nine months ended September 30, 2014 and September 30, 2013, excluding various discrete items.

The Company's actual effective tax rates were as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Actual effective tax rate	40.6%	39.6%	40.1%	38.8%

Included in 2013 are discrete items including \$3,274 of tax benefits recorded in the first quarter of 2013 associated with an entity reorganization within the Company's Market-Based Operations segment that allowed for the utilization of state net operating loss carryforwards and the release of a valuation allowance.

Current deferred tax assets increased in 2014 due to the expected utilization of certain tax attributes within the next 12 months.

Note 9: Pension and Other Postretirement Benefits

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

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Components of net periodic pension benefit cost				
Service cost	\$7,943	\$9,468	\$23,830	\$28,404
Interest cost	19,163	17,024	57,489	51,072
Expected return on plan assets	(23,709)	(22,108)	(71,128)	(66,322)
Amortization of:				
Prior service cost (credit)	181	181	543	543
Actuarial (gain) loss	(33)	9,293	(98)	27,878
Net periodic pension benefit cost	\$3,545	\$13,858	\$10,636	\$41,575
Components of net periodic other postretirement benefit cost				
Service cost	\$2,764	\$3,820	\$8,293	\$11,461
Interest cost	7,152	7,175	21,454	21,525
Expected return on plan assets	(6,875)	(7,571)	(20,625)	(22,713)
Amortization of:				
Prior service cost (credit)	(548)	(548)	(1,642)	(1,642)
Actuarial (gain) loss	(20)	2,782	(60)	8,346
Net periodic other postretirement benefit cost	\$2,473	\$5,658	\$7,420	\$16,977

The Company contributed \$26,680 to its defined benefit pension plans in the first nine months of 2014 and expects to contribute \$10,785 during the balance of 2014. In addition, the Company contributed \$9,103 for the funding of its other postretirement plans in the first nine months of 2014 and expects to contribute \$3,034 during the balance of 2014.

Note 10: Commitments and Contingencies

The Company is routinely involved in legal actions incident to the normal conduct of its business. At September 30, 2014, the Company has accrued approximately \$3,200 as probable costs and it is reasonably possible that additional losses could range up to \$31,100 for these matters. For certain matters, the Company is unable to estimate possible losses. The Company believes that damages or settlements recovered by plaintiffs in such claims or actions, if any, will not have a material adverse effect on the Company's results of operations, financial position or cash flows, individually or in the aggregate.

The Company enters into agreements for the provision of services to water and wastewater facilities for the United States military, municipalities and other customers. The Company's military services agreements expire between 2051 and 2064 and have remaining performance commitments as measured by estimated remaining contract revenue of \$2,580,231 at September 30, 2014. The military contracts are subject to customary termination provisions held by the U.S. Federal Government prior to the agreed upon contract expiration. The Company's Operations and Maintenance agreements with municipalities and other customers expire between 2015 and 2048 and have remaining performance commitments as measured by estimated remaining contract revenue of \$882,176 at September 30, 2014. Some of the

Company's long-term contracts to operate and maintain a municipality's, federal government's or other party's water or wastewater treatment and delivery facilities include responsibility for certain maintenance for some of those facilities, in exchange for an annual fee. Unless specifically required to perform certain maintenance activities, the maintenance costs are recognized when the maintenance is performed.

On October 13, 2014, the Company and the Utility Workers Union of America AFL-CIO entered into a settlement agreement designed to resolve a dispute between the Company and most of the labor unions which represent employees in the Regulated Businesses (the "Unions") regarding the Company's national benefit agreements. Among other things, the settlement agreement provides for a new 2014-2018 National Benefits Agreement that will be in effect generally until July 31, 2018. In addition, the Company agreed to make a \$10 million lump-sum payment, to be distributed in accordance with procedures set forth in the settlement agreement among eligible employees represented by the Unions and affected by implementation of the Company's last, best and final offer effective January 1, 2011. The majority of the distributions are expected to be used to reimburse employees for medical claims which were incurred during the relevant period and will be funded by the Group Insurance Plan for American Water Works Company, Inc. and Its Designated Subsidiaries and Affiliates - Active Employees VEBA (the "VEBA Trust"), to which the Company previously has made contributions. Therefore, amounts funded out of the VEBA Trust will not have an impact on our results of operations. The Unions approved the settlement agreement on October 30, 2014 and National Labor Relations Board (the "NLRB") approved the

settlement agreement on October 31, 2014. The NLRB advised the Company that it will dismiss its petition for enforcement filed in the United States Court of Appeals for the Seventh Circuit and close the case after the Company has substantially complied with its obligations under the settlement agreement to make the lump sum payment and to post a notice to employees agreeable to the Company and acceptable to the NLRB.

Note 11: Environmental Matters

The Company's water and wastewater operations are subject to federal, state, local and foreign requirements relating to environmental protection, and as such, the Company periodically becomes subject to environmental claims in the normal course of business. Environmental expenditures that relate to current operations or provide a future benefit are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued, on an undiscounted basis, when it is probable that these costs will be incurred and can be reasonably estimated. Remediation costs accrued amounted to \$2,200 and \$3,300 at September 30, 2014 and December 31, 2013, respectively. The accrual relates to a conservation agreement entered into by a subsidiary of the Company with the National Oceanic and Atmospheric Administration ("NOAA") requiring the Company to, among other provisions, implement certain measures to protect the steelhead trout and its habitat in the Carmel River watershed in the state of California. The Company has agreed to pay \$1,100 annually from 2010 through 2016. The Company pursues recovery of incurred costs through all appropriate means, including regulatory recovery through customer rates. The Company's regulatory assets at September 30, 2014 and December 31, 2013 include \$7,791 and \$8,027, respectively, related to the NOAA agreement.

Note 12: Earnings per Common Share

Earnings per share is calculated using the two-class method. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security. The Company has participating securities related to restricted stock units, granted under the Company's 2007 Omnibus Equity Compensation Plan, that earn dividend equivalents on an equal basis with common shares. In applying the two-class method, undistributed earnings are allocated to both common shares and participating securities.

The following is a reconciliation of the Company's income from continuing operations, income (loss) from discontinued operations and net income and weighted-average common shares outstanding for calculating basic earnings per share:

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Basic				
Income from continuing operations	\$ 156,608	\$ 149,909	\$ 335,895	\$ 309,723
Income (loss) from discontinued operations, net of tax	(4,423)	756	(6,288)	(152)
Net income	152,185	150,665	329,607	309,571
Less: Distributed earnings to common shareholders	55,664	50,007	161,439	99,929
Less: Distributed earnings to participating securities	17	19		