

CALIFORNIA WATER SERVICE GROUP
Form 10-Q
August 01, 2013
[Table of Contents](#)

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

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 1-13883

CALIFORNIA WATER SERVICE GROUP

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation or organization)

77-0448994
(I.R.S. Employer identification No.)

1720 North First Street, San Jose, CA.
(Address of principal executive offices)

95112
(Zip Code)

408-367-8200

(Registrant's telephone number, including area code)

Not Applicable

(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 x No o

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a 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 o No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Common shares outstanding as of August 1, 2013 47,734,035

Table of Contents

TABLE OF CONTENTS

	Page
<u>PART I Financial Information</u>	3
<u>Item 1 Financial Statements</u>	3
<u>Condensed Consolidated Balance Sheets (unaudited) as of June 30, 2013 and December 31, 2012</u>	3
<u>Condensed Consolidated Statements of Income (unaudited) For the Three months Ended June 30, 2013 and 2012</u>	4
<u>Condensed Consolidated Statements of Income (unaudited) For the Six months Ended June 30, 2013 and 2012</u>	5
<u>Condensed Consolidated Statements of Cash Flows (unaudited) For the Six months Ended June 30, 2013 and 2012</u>	6
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	7
<u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
<u>Item 3 Quantitative and Qualitative Disclosure about Market Risk</u>	35
<u>Item 4 Controls and Procedures</u>	35
<u>PART II Other Information</u>	
<u>Item 1 Legal Proceedings</u>	35
<u>Item 1A Risk Factors</u>	36
<u>Item 5 Other Information</u>	36
<u>Item 6 Exhibits</u>	36
<u>Signatures</u>	37
<u>Exhibit Index</u>	38

Table of Contents

PART I FINANCIAL INFORMATION

Item 1.

FINANCIAL STATEMENTS

The condensed consolidated financial statements presented in this filing on Form 10-Q have been prepared by management and are unaudited.

CALIFORNIA WATER SERVICE GROUP**CONDENSED CONSOLIDATED BALANCE SHEETS**

Unaudited

(In thousands, except per share data)

	June 30, 2013	December 31, 2012
ASSETS		
Utility plant:		
Utility plant	\$ 2,160,706	\$ 2,096,363
Less accumulated depreciation and amortization	(670,452)	(639,307)
Net utility plant	1,490,254	1,457,056
Current assets:		
Cash and cash equivalents	38,668	38,790
Receivables: net of allowance for doubtful accounts of \$714 for both periods presented		
Customers	41,493	29,958
Regulatory balancing accounts	25,560	34,020
Other	14,335	11,943
Unbilled revenue	24,750	15,394
Materials and supplies at weighted average cost	5,720	5,874
Taxes, prepaid expenses and other assets	13,550	10,585
Total current assets	164,076	146,564
Other assets:		
Regulatory assets	353,910	344,419
Goodwill	2,615	2,615
Other assets	47,752	45,270
Total other assets	404,277	392,304
	\$ 2,058,607	\$ 1,995,924
CAPITALIZATION AND LIABILITIES		
Capitalization:		

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

Common stock, \$.01 par value; 68,000,000 shares authorized, 47,734,035 and 41,908,218 outstanding in 2013 and 2012, respectively	\$	477	\$	419
Additional paid-in capital		327,628		221,013
Retained earnings		250,375		252,280
Total common stockholders' equity		578,480		473,712
Long-term debt, less current maturities		430,705		434,467
Total capitalization		1,009,185		908,179
Current liabilities:				
Current maturities of long-term debt		48,040		46,783
Short-term borrowings		28,815		89,475
Accounts payable		57,158		47,199
Regulatory balancing accounts		4,717		5,018
Accrued interest		4,608		4,705
Accrued expenses and other liabilities		52,872		49,887
Total current liabilities		196,210		243,067
Unamortized investment tax credits		2,180		2,180
Deferred income taxes, net		167,611		158,846
Pension and postretirement benefits other than pensions		248,003		244,901
Regulatory and other liabilities		88,578		92,593
Advances for construction		186,202		187,584
Contributions in aid of construction		160,638		158,574
Commitments and contingencies				
	\$	2,058,607	\$	1,995,924

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

Unaudited

(In thousands, except per share data)

For the three months ended	June 30,		June 30,
	2013		2012
Operating revenue	\$ 154,555	\$	143,552
Operating expenses:			
Operations:			
Water production costs	59,645		52,678
Administrative and general	23,155		22,167
Other operations	17,030		17,729
Maintenance	4,188		4,605
Depreciation and amortization	14,491		13,712
Income taxes	9,548		9,062
Property and other taxes	5,715		3,977
Total operating expenses	133,772		123,930
Net operating income	20,783		19,622
Other income and expenses:			
Non-regulated revenue	3,215		4,051
Non-regulated expenses, net	(3,240)		(3,695)
Income tax benefit (expense) on other income and expenses	16		(138)
Net other (expense) income	(9)		218
Interest expense:			
Interest expense	7,803		7,821
Less: capitalized interest	(539)		(946)
Net interest expense	7,264		6,875
Net income	\$ 13,510	\$	12,965
Earnings per share			
Basic	\$ 0.28	\$	0.31
Diluted	\$ 0.28	\$	0.31
Weighted average shares outstanding			
Basic	47,729		41,911
Diluted	47,760		41,911
Dividends declared per share of common stock	\$ 0.16000	\$	0.15750

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

Unaudited

(In thousands, except per share data)

For the six months ended	June 30,	June 30,
	2013	2012
Operating revenue	\$ 265,999	\$ 260,301
Operating expenses:		
Operations:		
Water production costs	101,342	91,630
Administrative and general	48,436	45,185
Other operations	32,675	41,555
Maintenance	8,321	10,365
Depreciation and amortization	29,120	27,663
Income taxes	8,402	9,090
Property and other taxes	11,150	8,584
Total operating expenses	239,446	234,072
Net operating income	26,553	26,229
Other income and expenses:		
Non-regulated revenue	6,737	8,187
Non-regulated expenses, net	(5,657)	(5,794)
Income tax (expense) on other income and expenses	(435)	(961)
Net other income	645	1,432
Interest expense:		
Interest expense	15,840	15,460
Less: capitalized interest	(1,079)	(1,849)
Net interest expense	14,761	13,611
Net income	\$ 12,437	\$ 14,050
Earnings per share		
Basic	\$ 0.28	\$ 0.34
Diluted	\$ 0.28	\$ 0.34
Weighted average shares outstanding		
Basic	45,004	41,877
Diluted	45,034	41,877
Dividends declared per share of common stock	\$ 0.32000	\$ 0.31500

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

Unaudited

(In thousands)

For the six months ended :	June 30,		June 30,
	2013		2012
Operating activities			
Net income	\$ 12,437	\$	14,050
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	30,088		28,554
Change in value of life insurance contracts	(504)		(1,635)
Other changes in noncurrent assets and liabilities	1,350		(1,658)
Changes in operating assets and liabilities:			
Receivables	(19,686)		(20,701)
Accounts payable	8,787		8,879
Other current assets	(3,889)		(5,108)
Other current liabilities	8,193		9,716
Net cash provided by operating activities	36,776		32,097
Investing activities:			
Utility plant expenditures	(66,190)		(61,984)
Purchase of life insurance	(1,608)		(1,357)
Change in restricted cash and other changes	1,079		6
Net cash used in investing activities	(66,719)		(63,335)
Financing activities:			
Short-term borrowings	32,615		62,635
Repayment of short-term borrowings	(93,275)		(22,000)
Proceeds from long-term debt	48		123
Repayment of long-term debt	(2,553)		(1,645)
Advances and contributions in aid of construction	5,006		2,760
Refunds of advances for construction	(3,512)		(3,835)
Issuance of common stock	110,688		
Common stock issuance cost	(4,853)		
Dividends paid	(14,343)		(13,187)
Net cash provided by financing activities	29,821		24,851
Change in cash and cash equivalents	(122)		(6,387)
Cash and cash equivalents at beginning of period	38,790		27,203
Cash and cash equivalents at end of period	\$ 38,668	\$	20,816
Supplemental information			
Cash paid for interest (net of amounts capitalized)	\$ 14,383	\$	13,143
Cash paid for income taxes	\$	\$	
Supplemental disclosure of non-cash activities:			
Accrued payables for investments in utility plant	\$ 9,492	\$	8,998
Utility plant contribution by developers	\$ 6,809	\$	8,710

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

Table of Contents

CALIFORNIA WATER SERVICE GROUP

Notes to Unaudited Condensed Consolidated Financial Statements

June 30, 2013

(Amounts in thousands, except share and per share amounts)

Note 1. Organization and Operations and Basis of Presentation

California Water Service Group (the Company) is a holding company that provides water utility and other related services in California, Washington, New Mexico and Hawaii through its 100% owned subsidiaries. California Water Service Company (Cal Water), Washington Water Service Company (Washington Water), New Mexico Water Service Company (New Mexico Water), and Hawaii Water Service Company, Inc. (Hawaii Water) provide regulated utility services under the rules and regulations of their respective state's regulatory commissions (jointly referred to herein as the Commissions). CWS Utility Services and HWS Utility Services LLC provide non-regulated water utility and utility-related services.

The Company operates in one reportable segment, providing water and related utility services.

Basis of Presentation

The unaudited interim financial information has been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission (SEC) and therefore do not contain all of the information and footnotes required by GAAP and the SEC for annual financial statements. The condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2012, included in its annual report on Form 10-K as filed with the SEC on February 28, 2013.

The preparation of the Company's condensed consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet dates and the reported amounts of revenues and expenses for the periods presented. These include, but are not limited to, estimates and assumptions used in determining the Company's regulatory asset and liability balances based upon probability assessments of regulatory recovery, revenues earned but not yet billed, asset retirement obligations, allowance for doubtful accounts, pension and other employee benefit plan liabilities, and income tax-related assets and liabilities. Actual results could differ from these estimates.

In the opinion of management, the accompanying condensed consolidated financial statements reflect all adjustments, consisting of normal recurring accruals that are necessary to provide a fair presentation of the results for the periods covered. The results for interim periods are not necessarily indicative of the results for any future period.

Due to the seasonal nature of the water business, the results for interim periods are not indicative of the results for a 12-month period. Revenue and income are generally higher in the warm, dry summer months when water usage and sales are greater. Revenue and income are lower in the winter months when cooler temperatures and rainfall curtail water usage and sales.

The Company evaluated its operations through the time these financials were issued and determined there were no subsequent events requiring adjustments or disclosures as of the time these financial statements were issued.

Note 2. Summary of Significant Accounting Policies

Revenue

Revenue generally includes monthly cycle customer billings for regulated water and wastewater services at rates authorized by regulatory commissions (plus an estimate for water used between the customer's last meter reading and the end of the accounting period) and billings to certain non-regulated customers at rates authorized by contract with government agencies.

The Company's regulated water and waste water revenue requirements are authorized by the Commissions in the states in which it operates. The revenue requirements are intended to provide the Company a reasonable opportunity to recover its operating costs and earn a return on investments.

Table of Contents

For metered customers, Cal Water recognizes revenue from rates which are designed and authorized by the California Public Utilities Commission (CPUC). Under the Water Revenue Adjustment Mechanism (WRAM), Cal Water records the adopted level of volumetric revenues, which would include recovery of cost of service and a return on investments, as established by the CPUC for metered accounts (adopted volumetric revenues). In addition to volumetric-based revenues, the revenue requirements approved by the CPUC include service charges, flat rate charges, and other items not subject to the WRAM. The adopted volumetric revenue considers the seasonality of consumption of water based upon historical averages. The variance between adopted volumetric revenues and actual billed volumetric revenues for metered accounts is recorded as a component of revenue with an offsetting entry to a regulatory asset or liability balancing account (tracked individually for each Cal Water district) subject to certain criteria under the accounting for regulated operations being met. The variance amount may be positive or negative and represents amounts that will be billed or refunded to customers in the future.

Cost-recovery rates are designed to permit full recovery of certain costs allowed to be recovered by the Commissions. Cost-recovery rates such as the Modified Cost Balancing Account (MCBA) provides for recovery of adopted expense levels for purchased water, purchased power and pump taxes, as established by the CPUC. In addition, cost-recovery rates include recovery of cost related to water conservation programs and certain other operation expenses adopted by the CPUC. Variances (which include the effects of changes in both rate and volume for the MCBA) between adopted and actual costs are recorded as a component of revenue, as the amount of such variances will be recovered from or refunded to our customers at a later date. There is no markup for return or profit for cost-recovery expenses and they are generally recognized when expenses are incurred.

The balances in the WRAM and MCBA assets and liabilities accounts will fluctuate on a monthly basis depending upon the variance between adopted and actual results. The recovery or refund of the WRAM is netted against the MCBA over- or under-recovery for the corresponding district and is interest bearing at the current 90 day commercial paper rate. At the end of any calendar year, Cal Water files with the CPUC to refund or collect the balance in the accounts. Most undercollected net WRAM and MCBA receivable balances are collected over 12 and 18 months. Cal Water defers net WRAM and MCBA operating revenues and associated costs whenever the net receivable balances are estimated to be collected more than 24 months after the respective reporting periods in which it was recognized. The deferred net WRAM and MCBA revenues and associated costs were determined using forecasts of rate payer consumption trends in future reporting periods and the timing of when the CPUC will authorize Cal Water's filings to recover the undercollected balances. Deferred net WRAM and MCBA revenues and associated costs will be recognized as revenues and costs in future periods when collection is within twenty-four months of the respective reporting period.

The change to deferred net WRAM and MCBA balances during the six months ended June 30, 2013 was:

	Operating Revenues		Operating Costs		Income Before Income Taxes
Net WRAM and MCBA deferral as of December 31, 2012	\$ 882	\$	\$ 719	\$	\$ 163
Less: reversal of prior year deferral during the six months ended June 30, 2013	(415)		(317)		(98)
Add: net WRAM and MCBA deferral during the six months ended June 30, 2013	800		687		113
Net amount during the six months ended June 30, 2013	385		370		15
Net WRAM and MCBA deferral as of June 30, 2013	\$ 1,267	\$	\$ 1,089	\$	\$ 178

The change to deferred net WRAM and MCBA balances during the six months ended June 30, 2012 was:

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

	Operating Revenues		Operating Costs		Income Before Income Taxes
Net WRAM and MCBA deferral as of December 31, 2011	\$ 12,864	\$	10,492	\$	2,372
Less: reversal of prior year deferral during the six months ended June 30, 2012	(9,486)		(7,736)		(1,750)
Add: net WRAM and MCBA deferral during the six months ended June 30, 2012	462		377		85
Net amount during the six months ended June 30, 2012	(9,024)		(7,359)		(1,665)
Net WRAM and MCBA deferral as of June 30, 2012	\$ 3,840	\$	3,133	\$	707

Table of Contents

The net WRAM and MCBA under- or overcollected balances are:

	June 30, 2013	December 31, 2012
Net short-term regulatory balancing accounts (receivable)	\$ 25,560	\$ 34,020
Net long-term regulatory assets (receivable)	18,644	12,051
Total regulatory assets	\$ 44,204	\$ 46,071
Net short-term regulatory balancing accounts (liability)	\$ 196	\$ 371
Net long-term regulatory liability	183	119
Total payable	\$ 379	\$ 490

Flat rate customers are billed in advance at the beginning of the service period. The revenue is prorated so that the portion of revenue applicable to the current period is included in that period's revenue, with the balance recorded as unearned revenue on the balance sheet and recognized as revenue when earned in the subsequent accounting period. Unearned revenue liability was \$1.6 million and \$1.7 million as of June 30, 2013 and December 31, 2012, respectively. This liability is included in accrued expenses and other liabilities on the condensed consolidated balance sheets.

Cash and Cash Equivalents

Cash equivalents include highly liquid investments with maturities of three months or less. Cash and cash equivalents was \$38.7 million and \$38.8 million as of June 30, 2013 and December 31, 2012, respectively. Restricted cash is included in taxes, prepaid expenses and other assets and was \$1.2 million and \$2.3 million as of June 30, 2013 and December 31, 2012, respectively.

Adoption of New Accounting Standards

On February 1, 2013, the Financial Accounting Standards Board issued an accounting standards update (ASU) for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements. The ASU will impact the Company's recognition, measurement, and disclosure requirements for guarantees on third party debt of its 100%-owned subsidiaries. The ASU effective date for the Company's interim and annual reporting is January 1, 2014. The Company is reviewing its contracts to determine if there are any of these arrangements and the impact, if any, on the Company's condensed consolidated financial statements.

Note 3. Stock-based Compensation

Equity Incentive Plan

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

The Company's equity incentive plan was approved by stockholders on April 27, 2005. The Company is authorized to issue awards up to 2,000,000 shares of common stock.

During the six months ended June 30, 2013 and 2012, the Company granted annual Restricted Stock Awards (RSAs) of 70,557 and 98,422 shares, respectively, of common stock to officers and directors of the Company and no RSAs were cancelled. Employee RSAs granted in 2013 vest over 36 months and RSAs granted in 2012 vest over 48 months. Director RSAs generally vest at the end of 12 months. During the first six months of 2013 and 2012, the shares granted were valued at \$20.62 and \$17.96 per share, respectively, based upon the fair market value of the Company's common stock on the date of grant.

On March 1, 2013, the Company granted performance-based Restricted Stock Unit Awards (RSUs) of 50,267 shares of common stock to officers. Each award reflects a target number of shares that may be issued to the award recipient. The awards may be earned upon the completion of the three-year performance period ending February 28, 2016. Whether RSUs are earned at the end of the performance period will be determined based on the achievement of certain performance objectives set by the Board of Director Compensation Committee in connection with the issuance of the RSUs. The performance objectives are based on the Company's business plan covering the performance period. The performance objectives include achieving the budgeted return on equity, budgeted investment in utility plant, customer service standards, and water quality standards. Depending on the results achieved during the three-year performance period, the actual number of shares that a grant recipient receives at the end of the performance period may range from 0% to 200% of the target shares granted, provided that the grantee is continuously employed by the Company through the vesting date. If prior to the vesting date employment is terminated by reason of death, disability or normal retirement, then a pro rata portion of this award will vest. RSUs are not included in diluted shares for financial reporting until earned. The RSUs are recognized as expense ratably over the three year performance period using a fair market value of \$20.62 per share and an estimate of RSUs earned during the performance period.

Table of Contents

The Company has recorded compensation costs for the RSAs and RSUs which are included in operating expense in the amount of \$0.8 million and \$0.6 million for the six months ended June 30, 2013 and June 30, 2012, respectively. The Company has recorded compensation costs for the RSAs and RSUs in operating expense in the amount of \$0.5 million and \$0.4 million for the three months ended June 30, 2013 and June 30, 2012, respectively.

Note 4. Equity

The Company's changes in equity for the six months ended June 30, 2013 were as follows:

	Total Stockholders	Equity
Balance at December 31, 2012	\$	473,712
Common stock issued, net		105,835
Share-based compensation expense		839
Common stock dividends declared		(14,343)
Net income		12,437
Balance at June 30, 2013	\$	578,480

On March 26, 2013, the Company sold 5,750,000 shares of its common stock in an underwritten public offering for cash proceeds of \$105.8 million, net of \$4.9 million underwriting discounts and commissions and offering expenses. The net proceeds from the sale of common stock were added to our general funds to be used for general corporate purposes. In April 2013, the Company used a portion of the net proceeds from the offering to repay outstanding borrowings on the Company and Cal Water lines of credit of \$68.3 million and \$25.0 million, respectively.

Note 5. Earnings Per Share Calculations

The computations of basic and diluted earnings per share are noted below. Basic earnings per share are computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts were exercised or converted into common stock. RSAs are included in the common shares outstanding because the shares have all the same voting and dividend rights as issued and unrestricted common stock.

A total of 333,856 shares of Stock Appreciation Rights were vested and outstanding and all were dilutive as of June 30, 2013 and anti-dilutive as of June 30, 2012 as shown in the tables below.

	Three months Ended June 30	
	2013	2012
Net income available to common stockholders	\$ 13,510	\$ 12,965
Weighted average common shares, basic	47,729	41,911
Dilutive common stock appreciation rights (treasury method)	31	
Shares used for dilutive computation	47,760	41,911

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

Net income per share - basic	\$	0.28	\$	0.31
Net income per share - diluted	\$	0.28	\$	0.31

	Six months Ended June 30			
		2013		2012
Net income available to common stockholders	\$	12,437	\$	14,050
Weighted average common shares, basic		45,004		41,877
Dilutive common stock appreciation rights (treasury method)		30		
Shares used for dilutive computation		45,034		41,877
Net income per share - basic	\$	0.28	\$	0.34
Net income per share - diluted	\$	0.28	\$	0.34

Table of Contents

Note 6. Pension Plan and Other Postretirement Benefits

The Company provides a qualified, defined-benefit, non-contributory pension plan for substantially all employees. The Company makes annual contributions to fund the amounts accrued for the qualified pension plan. The Company also maintains an unfunded, non-qualified, supplemental executive retirement plan. The costs of the plans are charged to expense or are capitalized in utility plant as appropriate.

The Company offers medical, dental, vision, and life insurance benefits for retirees and their spouses and dependents. Participants are required to pay a premium, which offsets a portion of the cost.

Cash payments by the Company related to pension plans and other postretirement benefit plans were \$17.8 million for the six months ended June 30, 2013 compared to \$15.8 million for the six months ended June 30, 2012. The 2013 estimated cash contribution to the pension plans is \$31.3 million and to the other postretirement benefit plans is \$9.6 million.

The following table lists components of net periodic benefit costs for the pension plans and other postretirement benefits. The data listed under pension plan includes the qualified pension plan and the non-qualified supplemental executive retirement plan. The data listed under other benefits is for all other postretirement benefits.

	Three months Ended June 30					
	Pension Plan			Other Benefits		
	2013	2012	2013	2012	2013	2012
Service cost	\$ 4,658	\$ 3,709	\$ 1,695	\$ 1,330		
Interest cost	4,063	3,864	1,109	1,005		
Expected return on plan assets	(3,565)	(2,886)	(598)	(448)		
Recognized net initial APBO (1)	N/A	N/A	2	69		
Amortization of prior service cost	1,541	1,570	20	29		
Recognized net actuarial loss	2,224	2,075	916	822		
Net periodic benefit cost	\$ 8,921	\$ 8,332	\$ 3,144	\$ 2,807		

	Six months Ended June 30					
	Pension Plan			Other Benefits		
	2013	2012	2013	2012	2013	2012
Service cost	\$ 9,316	\$ 7,725	\$ 3,390	\$ 2,747		
Interest cost	8,126	7,643	2,218	1,972		
Expected return on plan assets	(7,130)	(5,779)	(1,196)	(916)		
Recognized net initial APBO (1)	N/A	N/A	4	138		
Amortization of prior service cost	3,082	3,141	40	58		
Recognized net actuarial loss	4,448	4,001	1,832	1,586		
Net periodic benefit cost	\$ 17,842	\$ 16,731	\$ 6,288	\$ 5,585		

(1) APBO - Accumulated postretirement benefit obligation

Note 7. Short-term and Long-term Borrowings

On June 29, 2011, the Company and Cal Water entered into Syndicated Credit Facilities, which provide for unsecured revolving credit facilities of up to an initial aggregate amount of \$400 million. The Syndicated Credit Facilities amend, expand, and replace the Company's and its subsidiaries' existing credit facilities originally entered into on October 27, 2009. The new credit facilities extended the terms until June 29, 2016, increased the Company's and Cal Water's unsecured revolving lines of credit, and lowered interest rates and fees. The Company and subsidiaries which it designates may borrow up to \$100 million under the Company's revolving credit facility. Cal Water may borrow up to \$300 million under its revolving credit facility; however, all borrowings need to be repaid within 12-months unless otherwise authorized by the CPUC. The proceeds from the revolving credit facilities may be used for working capital purposes, including the short-term financing of capital projects. The base loan rate may vary from LIBOR plus 72.5 basis points to LIBOR plus 95 basis points, depending on the Company's total capitalization ratio. Likewise, the unused commitment fee may vary from 8 basis points to 12.5 basis points based on the same ratio.

Both short-term unsecured credit agreements contain affirmative and negative covenants and events of default customary for credit facilities of this type including, among other things, limitations and prohibitions relating to additional indebtedness, liens, mergers, and asset sales. Also, these unsecured credit agreements contain financial covenants governing the Company and its subsidiaries' consolidated total capitalization ratio and interest coverage ratio. As of June 30, 2013, the Company and Cal Water have met all borrowing covenants for both credit agreements.

Table of Contents

As of June 30, 2013 and December 31, 2012, the outstanding borrowings on the Company lines of credit were \$8.8 million and \$64.5 million, respectively, and the outstanding borrowings on the Cal Water lines of credit were \$20.0 million and \$25.0 million. For the six months ended June 30, 2013, the average borrowing rate was 2.3% compared to 1.6% for the same period last year.

Note 8. Income Taxes

The Company accounts for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Measurement of the deferred tax assets and liabilities is at enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date.

The Company anticipates that future rate actions by the regulatory commissions will reflect revenue requirements for the tax effects of temporary differences recognized, which have previously been passed through to customers. The regulatory commissions have granted us rate increases to reflect the normalization of the tax benefits of the federal accelerated methods and available Investment Tax Credits (ITCs) for all assets placed in service after 1980. ITCs are deferred and amortized over the lives of the related properties for book purposes.

During 2012, the Company filed an application for a change in accounting method (section 481 adjustment) with the Internal Revenue Service (IRS) to implement the new repairs and maintenance deduction. The new deduction is for qualified tangible property placed into service during 2012 and prior years. The new tax regulations allow the Company to deduct a significant amount of costs previously capitalized for book and tax purposes. The 2012 repairs and maintenance deductions resulted in a federal net operating loss (NOL) of \$26.0 million and a state NOL of \$55.7 million. The NOL carry-forward amounts are more likely than not to be recovered and therefore require no valuation allowance. The NOL carry-forward does not begin to expire until 2033.

The American Taxpayer Relief Act of 2012 provided the Company with additional 50% first-year bonus depreciation for assets placed in service from December 31, 2012 to December 31, 2013. The federal income tax bonus deduction was estimated at \$3.1 million in 2012. The 2012 estimate will be finalized when the Company files its 2012 tax returns during the third quarter of 2013.

The IRS is presently auditing the Company's 2010 and 2011 federal income tax returns. It is uncertain when the IRS will complete its audit. The Company believes that the final resolution of the IRS audit will not have a material adverse impact on its financial condition, cash flows, or results of operations.

Note 9. Regulatory Assets and Liabilities

During 2011, the CPUC issued a decision regarding the \$34.2 million of litigation proceeds previously received by Cal Water during 2008 which is being used to replace infrastructure damaged by the gasoline additive Methyl tert-butyl ether (MTBE). The decision requires use of these proceeds for costs incurred as a result of MTBE contamination with any related benefits to be provided to Cal Water customers. Such

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

usage includes transfer of the amount to contributions in aid of construction (CIAC) for remediation or replacement project costs once complete. Usage of the proceeds is reported to the CPUC through an Advice Letter or General Rate Case filing. As of December 31, 2012, \$22.4 million of the proceeds was recorded as CIAC. Cal Water used \$1.2 million of the proceeds to replace damaged infrastructure during the second quarter of 2013. The remaining balance of \$10.6 million at June 30, 2013 is included in regulatory and other liabilities.

During 2011, Cal Water added balancing accounts for its pension plans and conservation program. Both balancing account effective dates were January 1, 2011. The pension plans balancing account is a two-way balancing account that tracks the differences between actual expenses and adopted rate recovery which will result in either a regulatory asset or liability. The conservation program is a one-way balancing account that tracks the differences between actual expenses and adopted rate recovery which may result in a regulatory liability if actual conservation expenses are less than adopted over the three year period ending December 31, 2013. As of June 30, 2013 and December 31, 2012, the pension balancing account was a regulatory asset of \$3.7 million and \$2.4 million, respectively. The conservation balancing account was a regulatory liability of \$6.8 million and \$6.5 million as of June 30, 2013 and December 31, 2012, respectively.

Table of Contents

Note 10. Commitment and Contingencies

Commitments

The Company has significant commitments to lease certain office spaces and water systems and to purchase water from water wholesalers. These commitments are described in Form 10-K for the year ended December 31, 2012. As of June 30, 2013, there were no significant changes from December 31, 2012.

Contingencies

Groundwater Contamination

The Company has undertaken litigation against third parties to recover past and future costs related to ground water contamination in our service areas. The cost of litigation is expensed as incurred and any settlement is first offset against such costs. The Company records gain contingencies as a regulatory liability when the net litigation proceeds are received. The Commission's general policy requires all proceeds from contamination litigation to be used first to pay transactional expenses, then to make ratepayers whole for water treatment costs to comply with the Commission's water quality standards. The Commission allows for a risk-based consideration of contamination proceeds which exceed the costs of the remediation described above and may result in some sharing of proceeds with the shareholder, determined on a case by case basis. The Commission has authorized various memorandum accounts that allow the Company to track significant litigation costs to request recovery of these costs in future filings and uses of proceeds to comply with Commission's general policy.

Other Legal Matters

From time to time, the Company is involved in various disputes and litigation matters that arise in the ordinary course of business. The status of each significant matter is reviewed and assessed for potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount of the range of loss can be estimated, a liability is accrued for the estimated loss in accordance with the accounting standards for contingencies. Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, accruals are based on the best information available at the time. While the outcome of these disputes and litigation matters cannot be predicted with any certainty, management does not believe when taking into account existing reserves the ultimate resolution of these matters will materially affect the Company's financial position, results of operations, or cash flows. The Company recognized a liability of \$1.0 million and \$1.1 million for all known legal matters as of June 30, 2013 and December 31, 2012, respectively. The cost of litigation is expensed as incurred and any settlement is first offset against such costs. Any settlement in excess of the cost to litigate is accounted for on a case by case basis, dependant on the nature of the settlement.

Note 11. Fair Value of Financial Assets and Liabilities

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

The accounting guidance for fair value measurements and disclosures provides a single definition of fair value and requires certain disclosures about assets and liabilities measured at fair value. A hierarchical framework for disclosing the observability of the inputs utilized in measuring assets and liabilities at fair value is established by this guidance. The three levels in the hierarchy are as follows:

- Level 1 - Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. The types of assets and liabilities included in Level 1 are highly liquid and actively traded instruments with quoted prices.
- Level 2 - Pricing inputs are other than quoted prices in active markets, but are either directly or indirectly observable as of the reporting date. The types of assets and liabilities included in Level 2 are typically either comparable to actively traded securities or contracts, or priced with discounted cash flow or option pricing models using highly observable inputs.
- Level 3 - Significant inputs to pricing have little or no observability as of the reporting date. The types of assets and liabilities included in Level 3 are those valued with models requiring significant management judgment or estimation.

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

Table of Contents

Specific valuation methods include the following:

Cash equivalents, accounts receivable, accounts payable, and short-term borrowings carrying amounts approximated the fair value because of the short-term maturity of the instruments.

Long-term debt fair values were estimated using the published quoted market price, if available, or the discounted cash flow analysis, based on the current rates available using a risk-free rate (a U.S. Treasury securities yield curve) plus a risk premium of 1.19%.

Advances for construction fair values were estimated using broker quotes from companies that frequently purchase these investments.

	June 30, 2013					Total
	Cost	Fair Value				
		Level 1	Level 2	Level 3		
Long -term debt, including current maturities	\$ 478,745	\$	\$ 571,083	\$	\$	\$ 571,083
Advances for construction	186,202		71,801			71,801
Total	\$ 664,947	\$	\$ 642,884	\$	\$	\$ 642,884

	December 31, 2012					Total
	Cost	Fair Value				
		Level 1	Level 2	Level 3		
Long -term debt, including current maturities	\$ 481,250	\$	\$ 613,211	\$	\$	\$ 613,211
Advances for construction	187,584		70,914			70,914
Total	\$ 668,834	\$	\$ 684,125	\$	\$	\$ 684,125

Note 12. Condensed Consolidating Financial Statements

On April 17, 2009, Cal Water issued \$100 million aggregate principal amount of 5.875% First Mortgage Bonds due 2019, and on November 17, 2010, Cal Water issued \$100 million aggregate principal amount of 5.500% First Mortgage Bonds due 2040. All of the guarantees are full and unconditional, and all of the guarantees are joint and several.

The following tables present the condensed consolidating balance sheets as of June 30, 2013 and December 31, 2012, the condensed consolidating statements of income for the three and six months ended June 30, 2013 and 2012 and the condensed consolidating statements of cash flow for the six months ended June 30, 2013 and 2012 of (i) California Water Service Group, the guarantor of the first mortgage bonds and the parent company; (ii) California Water Service Company, the issuer of the first mortgage bonds and a 100% owned subsidiary of California Water Service Group; and (iii) the other 100% owned subsidiaries of California Water Service Group.

Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING BALANCE SHEET**

As of June 30, 2013

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS					
Utility plant:					
Utility plant	\$ 1,079	\$ 1,984,718	\$ 182,106	\$ (7,197)	\$ 2,160,706
Less accumulated depreciation and amortization	(136)	(636,860)	(35,015)	1,559	(670,452)
Net utility plant	943	1,347,858	147,091	(5,638)	1,490,254
Current assets:					
Cash and cash equivalents	2,871	34,054	1,743		38,668
Receivables and unbilled revenue, net	76	102,379	3,683		106,138
Receivables from affiliates	26,696	3,504	264	(30,464)	
Other current assets	146	18,125	999		19,270
Total current assets	29,789	158,062	6,689	(30,464)	164,076
Other assets:					
Regulatory assets		351,299	2,611		353,910
Investments in affiliates	524,923			(524,923)	
Long-term affiliate notes receivable	30,578			(30,578)	
Other assets	1,309	42,047	7,215	(204)	50,367
Total other assets	556,810	393,346	9,826	(555,705)	404,277
	\$ 587,542	\$ 1,899,266	\$ 163,606	\$ (591,807)	\$ 2,058,607
CAPITALIZATION AND LIABILITIES					
Capitalization:					
Common stockholders' equity	\$ 578,480	\$ 478,802	\$ 51,573	\$ (530,375)	\$ 578,480
Affiliate long-term debt			30,578	(30,578)	
Long-term debt, less current maturities		429,188	1,517		430,705
Total capitalization	578,480	907,990	83,668	(560,953)	1,009,185
Current liabilities:					
Current maturities of long-term debt		46,120	1,920		48,040
Short-term borrowings	8,815	20,000			28,815
Payables to affiliates	820	260	29,384	(30,464)	
Accounts payable		53,503	3,655		57,158
Accrued expenses and other liabilities	6	58,897	3,294		62,197
Total current liabilities	9,641	178,780	38,253	(30,464)	196,210
Unamortized investment tax credits		2,180			2,180
Deferred income taxes, net	(579)	164,246	4,334	(390)	167,611
Pension and postretirement benefits other than pensions		248,003			248,003
Regulatory and other liabilities		79,847	8,731		88,578
Advances for construction		185,465	737		186,202
Contributions in aid of construction		132,755	27,883		160,638
	\$ 587,542	\$ 1,899,266	\$ 163,606	\$ (591,807)	\$ 2,058,607

Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING BALANCE SHEET**

As of December 31, 2012

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS					
Utility plant:					
Utility plant	\$ 606	\$ 1,927,190	\$ 175,764	\$ (7,197)	\$ 2,096,363
Less accumulated depreciation and amortization	(108)	(607,992)	(32,710)	1,503	(639,307)
Net utility plant	498	1,319,198	143,054	(5,694)	1,457,056
Current assets:					
Cash and cash equivalents	1,470	34,609	2,711		38,790
Receivables, net		87,482	3,833		91,315
Receivables from affiliates	19,367	3,195	1,152	(23,714)	
Other current assets		15,535	924		16,459
Total current assets	20,837	140,821	8,620	(23,714)	146,564
Other assets:					
Regulatory assets		341,877	2,542		344,419
Investments in affiliates	492,188			(492,188)	
Long-term affiliate notes receivable	31,218	7,781		(38,999)	
Other assets	1,023	40,005	7,062	(205)	47,885
Total other assets	524,429	389,663	9,604	(531,392)	392,304
	\$ 545,764	\$ 1,849,682	\$ 161,278	\$ (560,800)	\$ 1,995,924
CAPITALIZATION AND LIABILITIES					
Capitalization:					
Common stockholders equity	\$ 473,712	\$ 442,923	\$ 54,774	\$ (497,697)	\$ 473,712
Affiliate long-term debt	7,781		31,218	(38,999)	
Long-term debt, less current maturities		431,433	3,034		434,467
Total capitalization	481,493	874,356	89,026	(536,696)	908,179
Current liabilities:					
Current maturities of long-term debt		46,104	679		46,783
Short-term borrowings	64,475	25,000			89,475
Payables to affiliates	77	1,152	22,485	(23,714)	
Accounts payable		41,352	5,847		47,199
Accrued expenses and other liabilities	298	58,293	1,019		59,610
Total current liabilities	64,850	171,901	30,030	(23,714)	243,067
Unamortized investment tax credits		2,180			2,180
Deferred income taxes, net	(579)	155,481	4,334	(390)	158,846
Pension and postretirement benefits other than pensions		244,901			244,901
Regulatory and other liabilities		83,942	8,651		92,593
Advances for construction		186,753	831		187,584
Contributions in aid of construction		130,168	28,406		158,574
	\$ 545,764	\$ 1,849,682	\$ 161,278	\$ (560,800)	\$ 1,995,924

Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING STATEMENT OF INCOME**

For the three months ended June 30, 2013

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	\$	\$ 146,730	\$ 7,825	\$	\$ 154,555
Operating expenses:					
Operations:					
Water production costs		57,102	2,543		59,645
Administrative and general		20,460	2,695		23,155
Other operations		15,418	1,737	(125)	17,030
Maintenance		4,029	159		4,188
Depreciation and amortization	28	13,697	794	(28)	14,491
Income tax (benefit) expense	(93)	9,813	(542)	370	9,548
Property and other taxes		5,015	700		5,715
Total operating (income) expenses	(65)	125,534	8,086	217	133,772
Net operating income (loss)	65	21,196	(261)	(217)	20,783
Other Income and Expenses:					
Non-regulated revenue	597	3,005	408	(795)	3,215
Non-regulated expense, net		(2,873)	(367)		(3,240)
Income tax (expense) benefit on other income and expense	(244)	(54)	(45)	359	16
Net other income (expense)	353	78	(4)	(436)	(9)
Interest:					
Interest expense	199	7,631	642	(669)	7,803
Less: capitalized interest		(405)	(134)		(539)
Net interest expense	199	7,226	508	(669)	7,264
Equity earnings of subsidiaries	13,291			(13,291)	
Net income (loss)	\$ 13,510	\$ 14,048	\$ (773)	\$ (13,275)	\$ 13,510

Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING STATEMENT OF INCOME**

For the six months ended June 30, 2013

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	\$	\$ 251,161	\$ 14,838	\$	\$ 265,999
Operating expenses:					
Operations:					
Water production costs		96,543	4,799		101,342
Administrative and general		43,069	5,367		48,436
Other operations		29,607	3,320	(252)	32,675
Maintenance		7,994	327		8,321
Depreciation and amortization	28	27,454	1,694	(56)	29,120
Income tax (benefit) expense	(229)	9,086	(1,171)	716	8,402
Property and other taxes		9,869	1,281		11,150
Total operating (income) expenses	(201)	223,622	15,617	408	239,446
Net operating income (loss)	201	27,539	(779)	(408)	26,553
Other Income and Expenses:					
Non-regulated revenue	1,167	6,187	940	(1,557)	6,737
Non-regulated expense, net		(4,793)	(864)		(5,657)
Income tax (expense) on other income and expense	(476)	(568)	(84)	693	(435)
Net other income (expense)	691	826	(8)	(864)	645
Interest:					
Interest expense	533	15,358	1,254	(1,305)	15,840
Less: capitalized interest		(784)	(295)		(1,079)
Net interest expense	533	14,574	959	(1,305)	14,761
Equity earnings of subsidiaries	12,078			(12,078)	
Net income (loss)	\$ 12,437	\$ 13,791	\$ (1,746)	\$ (12,045)	\$ 12,437

Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING STATEMENT OF INCOME**

For the three months ended June 30, 2012

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	\$	\$ 135,291	\$ 8,261	\$	\$ 143,552
Operating expenses:					
Operations:					
Water production costs		50,207	2,471		52,678
Administrative and general	(36)	19,752	2,451		22,167
Other operations		16,035	1,821	(127)	17,729
Maintenance		4,452	153		4,605
Depreciation and amortization	5	13,042	694	(29)	13,712
Income tax (benefit) expense	(126)	9,016	(155)	327	9,062
Property and other taxes		3,208	769		3,977
Total operating expenses	(157)	115,712	8,204	171	123,930
Net operating income	157	19,579	57	(171)	19,622
Other Income and Expenses:					
Non-regulated revenue	484	3,671	615	(719)	4,051
Non-regulated expense, net		(3,157)	(538)		(3,695)
Income tax (expense) on other income and expense	(197)	(210)	(45)	314	(138)
Net other income	287	304	32	(405)	218
Interest:					
Interest expense	340	7,540	534	(593)	7,821
Less: capitalized interest		(682)	(264)		(946)
Net interest expense	340	6,858	270	(593)	6,875
Equity earnings of subsidiaries	12,861			(12,861)	
Net income (loss)	\$ 12,965	\$ 13,025	\$ (181)	\$ (12,844)	\$ 12,965

Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING STATEMENT OF INCOME**

For the six months ended June 30, 2012

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	\$	\$ 245,116	\$ 15,185	\$	\$ 260,301
Operating expenses:					
Operations:					
Water production costs		86,749	4,881		91,630
Administrative and general		40,404	4,781		45,185
Other operations		38,407	3,401	(253)	41,555
Maintenance		10,009	356		10,365
Depreciation and amortization		26,342	1,380	(59)	27,663
Income tax (benefit) expense	(266)	9,263	(570)	663	9,090
Property and other taxes		7,267	1,317		8,584
Total operating expenses	(266)	218,441	15,546	351	234,072
Net operating income (loss)	266	26,675	(361)	(351)	26,229
Other Income and Expenses:					
Non-regulated revenue	955	7,495	1,188	(1,451)	8,187
Non-regulated expense, net		(4,855)	(939)		(5,794)
Income tax (expense) on other income and expense	(389)	(1,076)	(134)	638	(961)
Net other income	566	1,564	115	(813)	1,432
Interest:					
Interest expense	654	14,946	1,059	(1,199)	15,460
Less: capitalized interest		(1,280)	(569)		(1,849)
Net interest expense	654	13,666	490	(1,199)	13,611
Equity earnings of subsidiaries	13,872			(13,872)	
Net income (loss)	\$ 14,050	\$ 14,573	\$ (736)	\$ (13,837)	\$ 14,050

Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS**

For the six months ended June 30, 2013

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating activities:					
Net income (loss)	\$ 12,437	\$ 13,791	\$ (1,746)	\$ (12,045)	\$ 12,437
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Equity earnings of subsidiaries	(12,078)			12,078	
Dividends received from affiliates	14,343			(14,343)	
Depreciation and amortization		28,350	1,794	(56)	30,088
Change in value of life insurance contracts		(504)			(504)
Other changes in noncurrent assets and liabilities	108	883	336	23	1,350
Changes in operating assets and liabilities	(514)	(7,765)	1,684		(6,595)
Net cash provided by (used in) operating activities	14,296	34,755	2,068	(14,343)	36,776
Investing activities:					
Utility plant expenditures		(57,764)	(8,426)		(66,190)
Investment in affiliates	(35,000)			35,000	
Net changes in affiliate advances	(7,294)	(324)	742	6,876	
Repayment of affiliates long-term debt	605	7,796		(8,401)	
Purchase of life insurance		(1,608)			(1,608)
Restricted cash and other changes, net		1,079			1,079
Net cash provided by (used in) investing activities	(41,689)	(50,821)	(7,684)	33,475	(66,719)
Financing Activities:					
Short-term borrowings	12,615	20,000			32,615
Repayment of short-term borrowings	(68,275)	(25,000)			(93,275)
Proceeds from long-term debt			48		48
Repayment of long-term debt		(2,230)	(323)		(2,553)
Net changes in affiliate advances	758	(892)	7,010	(6,876)	
Repayment of affiliates long-term debt	(7,796)		(605)	8,401	
Advances and contributions in aid for construction		4,989	17		5,006
Refunds of advances for construction		(3,467)	(45)		(3,512)
Dividends paid to non-affiliates	(14,343)				(14,343)
Dividends paid to affiliates		(12,889)	(1,454)	14,343	
Issuance of common stock	105,835				105,835
Investment from affiliates		35,000		(35,000)	
Net cash (used in) provided by financing activities	28,794	15,511	4,648	(19,132)	29,821
Change in cash and cash equivalents	1,401	(555)	(968)		(122)
	1,470	34,609	2,711		38,790

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

Cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period	\$	2,871	\$	34,054	\$	1,743	\$	38,668
--	----	-------	----	--------	----	-------	----	--------

Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS****For the six months ended June 30, 2012****(In thousands)**

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating activities:					
Net income (loss)	\$ 14,050	\$ 14,573	\$ (736)	\$ (13,837)	\$ 14,050
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Equity earnings of subsidiaries	(13,872)			13,872	
Dividends received from affiliates	13,187			(13,187)	
Depreciation and amortization	28	27,147	1,438	(59)	28,554
Change in value of life insurance contracts		(1,635)			(1,635)
Other changes in noncurrent assets and liabilities	927	(2,568)	(61)	44	(1,658)
Changes in operating assets and liabilities	(209)	(681)	(6,304)	(20)	(7,214)
Net cash provided by (used in) operating activities	14,111	36,836	(5,663)	(13,187)	32,097
Investing activities:					
Utility plant expenditures	(151)	(54,398)	(7,435)		(61,984)
Net changes in affiliate advances	(9,905)	1,696		8,209	
Repayment of affiliates long-term debt	273	24		(297)	
Purchase of life insurance		(1,357)			(1,357)
Restricted cash and other changes, net		6			6
Net cash provided by (used in) investing activities	(9,783)	(54,029)	(7,435)	7,912	(63,335)
Financing Activities:					
Short-term borrowings	11,635	51,000			62,635
Repayment of short-term borrowings	(1,000)	(21,000)			(22,000)
Proceeds from long-term debt			123		123
Repayment of long-term debt		(1,314)	(331)		(1,645)
Net changes in affiliate advances		798	7,411	(8,209)	
Repayment of affiliates long-term debt	(24)		(273)	297	
Advances and contributions in aid for construction		2,703	57		2,760
Refunds of advances for construction		(3,778)	(57)		(3,835)
Dividends paid to non-affiliates	(13,187)				(13,187)
Dividends paid to affiliates		(11,777)	(1,410)	13,187	
Net cash (used in) provided by financing activities	(2,576)	16,632	5,520	5,275	24,851
Change in cash and cash equivalents	1,752	(561)	(7,578)		(6,387)
Cash and cash equivalents at beginning of period	89	18,475	8,639		27,203
Cash and cash equivalents at end of period	\$ 1,841	\$ 17,914	\$ 1,061	\$	\$ 20,816

Table of Contents

Item 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollar amounts in thousands, except where otherwise noted and per share amounts)

FORWARD LOOKING STATEMENTS

This quarterly report, including all documents incorporated by reference, contains forward-looking statements within the meaning established by the Private Securities Litigation Reform Act of 1995 (Act). Forward-looking statements in this quarterly report are based on currently available information, expectations, estimates, assumptions and projections, and our management's beliefs, assumptions, judgments and expectations about us, the water utility industry and general economic conditions. These statements are not statements of historical fact. When used in our documents, statements that are not historical in nature, including words like expects, intends, plans, believes, may, estimates, assumes, anticipates, projects, predicts, forecasts, should, seeks, or variations of these words or similar expressions are intended to identify forward-looking statements. The forward-looking statements are not guarantees of future performance. They are based on numerous assumptions that we believe are reasonable, but they are open to a wide range of uncertainties and business risks. Consequently, actual results may vary materially from what is contained in a forward-looking statement.

Factors which may cause actual results to be different than those expected or anticipated include, but are not limited to:

- governmental and regulatory commissions' decisions, including decisions on proper disposition of property;
- changes in regulatory commissions' policies and procedures;
- the timeliness of regulatory commissions' actions concerning rate relief;
- changes in the capital markets and access to sufficient capital on satisfactory terms;
- new legislation;

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

- changes in California Department of Public Health water quality standards;
- changes in environmental compliance and water quality requirements;
- changes in accounting valuations and estimates;
- changes in accounting treatment for regulated companies, including adoption of International Financial Reporting Standards, if required;
- electric power interruptions;
- increases in suppliers' prices and the availability of supplies including water and power;
- fluctuations in interest rates;
- litigation that may result in damages or costs not recoverable from third parties;
- acquisitions and the ability to successfully integrate acquired companies;
- the ability to successfully implement business plans;
- civil disturbances or terrorist threats or acts, or apprehension about the possible future occurrences of acts of this type;
- the involvement of the United States in war or other hostilities;
- our ability to attract and retain qualified employees;

- labor relations matters as we negotiate with the unions;

Table of Contents

- federal health care law changes could result in increases to Company health care costs and additional income tax expenses in future years;
- changes in federal and state income tax regulations and treatment of such by regulatory commissions;
- implementation of new information technology systems;
- changes in operations that result in an impairment to acquisition goodwill;
- restrictive covenants in or changes to the credit ratings on current or future debt that could increase financing costs or affect the ability to borrow, make payments on debt, or pay dividends;
- general economic conditions, including changes in customer growth patterns and our ability to collect billed revenue from customers;
- changes in customer water use patterns and the effects of conservation;
- the impact of weather on water sales and operating results;
- the ability to satisfy requirements related to the Sarbanes-Oxley Act and other regulations on internal controls; and
- the risks set forth in **Risk Factors** included elsewhere in this quarterly report.

In light of these risks, uncertainties and assumptions, investors are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this quarterly report or as of the date of any document incorporated by reference in this report, as applicable. When considering forward-looking statements, investors should keep in mind the cautionary statements in this quarterly report and the documents incorporated by reference. We are not under any obligation, and we expressly disclaim any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise.

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

CRITICAL ACCOUNTING POLICIES

We maintain our accounting records in accordance with accounting principles generally accepted in the United States of America (GAAP) and as directed by the Commissions to which our operations are subject. The process of preparing financial statements in accordance with GAAP requires the use of estimates on the part of management. The estimates used by management are based on historic experience and an understanding of current facts and circumstances. Management believes that the following accounting policies are critical because they involve a higher degree of complexity and judgment, and can have a material impact on our results of operations, financial condition, and cash flows of the business. These policies and their key characteristics are discussed in detail in the 2012 Form 10-K. They include:

- revenue recognition and the water revenue adjustment mechanism;
- modified cost balancing accounts;
- expense balancing and memorandum accounts;
- regulatory utility accounting;
- income taxes;
- pension benefits;
- workers' compensation and other claims;
- goodwill accounting and evaluation for impairment; and
- contingencies.

For the six-month period ended June 30, 2013, there were no changes in the methodology for computing critical accounting estimates, no additional accounting estimates met the standards for critical accounting policies, and there were no material changes to the important assumptions underlying the critical accounting estimates.

Table of Contents

RESULTS OF SECOND QUARTER 2013 OPERATIONS COMPARED TO
SECOND QUARTER 2012 OPERATIONS

Amounts in thousands except share data

Overview

Second quarter of 2013 net income was \$13.5 million or \$0.28 per diluted common share compared to net income of \$13.0 million or \$0.31 per diluted common share in the second quarter of 2012. The increase to net income during the second quarter of 2013 was mostly due to rate increases net of cost offsets and the cost of capital adjustment mechanism of \$0.8 million, a \$3.6 million increase in the accrual for unbilled operating revenue, and a \$0.4 million decrease in pre-tax maintenance expense which was partially offset by a \$1.7 million increase in property taxes mostly due to a \$1.0 million benefit during the second quarter of 2012, \$1.2 million of pre-tax wage and benefit cost increases, \$0.8 million of pre-tax depreciation expense increases, and a \$0.4 million reduction to pre-tax capitalized interest.

Operating Revenue

Operating revenue increased \$11.0 million or 8% to \$154.6 million in the second quarter of 2013. As disclosed in the following table, the increase was primarily due to increases in usage and rates.

The factors impacting operating revenue for the second quarter of 2013 as compared to 2012, are as follows:

Rate increases	\$	3,793
Conservation balancing account		(872)
Deferral of net WRAM and MCBA revenue		436
Usage and other		11,845
Pension balancing account		(1,530)
Net effect of WRAM		(2,669)
Net operating revenue increase	\$	11,003

The deferral of net WRAM and MCBA revenue in the table above occurs whenever a district net receivable balance is estimated to be collected more than 24 months after the respective reporting period in which it was recognized. The deferrals are reversed when district net receivable balances are estimated to be collected within 24-months. The \$0.4 million net revenue increase during the second quarter of 2013 as compared to the second quarter of 2012 was mostly due to a larger deferral of net WRAM and MCBA revenues during the second quarter of 2012 as compared to the second quarter of 2013.

The net change in usage and other in the above table refers primarily to the difference between actual metered customer consumption during the three months ended June 30, 2013 compared to the three months ended June 30, 2012. The \$11.8 million usage and other revenue increase was

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

due to an increase in customer consumption during the second quarter of 2013 compared to the prior year. In part, this reflects a \$3.6 million increase in accrued unbilled operating revenue which is not a component of the WRAM. The WRAM is a cash basis mechanism which records changes in billed operating revenue. The quarterly changes in the accrued unbilled operating revenue usually vary year over year. These changes are usually most variable in the first and third quarters due to weather conditions and have not had a significant impact on annual revenue in past years.

The net effect of WRAM in the above table refers primarily to the revenue changes recognized by the WRAM and MCBA. The WRAM is impacted by changes in consumption patterns from our historical trends as well as an increase in conservation efforts. The MCBA, which records the differences in production costs from the adopted costs, is recorded as an element of revenue as it represents pass through costs which are billed to customers. The MCBA is impacted by changes in total production quantities, the production mix of the source of water, the price paid for purchased water and power, and the amount of pump taxes paid. The net change during the three months ended June 30, 2013 compared to the three months ended June 30, 2012 resulted in a decrease to revenue of \$2.7 million.

The components of the rate increases are listed in the following table:

Purchased water offset increases	\$	3,037
Step rate increases		2,395
General rate case (GRC) increases		236
Cost of capital adjustment mechanism and other		(1,875)
Total increase in rates	\$	3,793

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

Table of Contents

Total Operating Expenses

Total operating expenses were \$133.8 million for the second quarter of 2013, compared to \$123.9 million for the same period in 2012, an 8% increase.

Water production expense consists of purchased water, purchased power, and pump taxes. It represents the largest component of total operating expenses, accounting for approximately 45% of total operating expenses in the second quarter of 2013. Water production expenses increased \$7.0 million, or 13%, during the second quarter of 2013 compared to the same period last year due to purchased water price increases and an increase in customer usage. Our 100% owned operating subsidiaries, Washington Water, New Mexico Water, and Hawaii Water obtain all of their water supply from wells.

Sources of water as a percent of total water production are listed in the following table:

	Three Months Ended June 30	
	2013	2012
Well production	47%	47%
Purchased	48%	47%
Surface	5%	6%
Total	100%	100%

The components of water production costs are shown in the table below:

	Three Months Ended June 30			Change
	2013	2012	2012	
Purchased water	\$ 47,883	\$ 41,935	\$ 5,948	
Purchased power	8,778	7,995	783	
Pump taxes	2,984	2,748	236	
Total	\$ 59,645	\$ 52,678	\$ 6,967	

Purchased water costs increased due to price increases from water wholesalers. Total water production, measured in acre feet, increased by 5% during the second quarter of 2013 as compared with the second quarter of 2012 due to higher customer usage.

Administrative and general expense and other operations expense increased \$0.3 million, or 1%. Employee wage and benefit cost increases of \$1.2 million were partially offset by reductions to conservation program expenses during the second quarter of 2013 as compared to the second quarter of 2012. Wage increases became effective January 1, 2013. At June 30, 2013, there were 1,127 employees and at June 30, 2012, there were 1,114 employees.

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

Maintenance expenses decreased by 9% to \$4.2 million in the second quarter of 2013 compared to \$4.6 million in the second quarter of 2012, due to a decrease in main and service repairs.

Depreciation and amortization expense increased \$0.8 million, or 6%, mostly due to 2012 capital additions.

Federal and state income taxes charged to operating expenses and other income and expenses increased \$0.3 million, from a provision of \$9.2 million in the second quarter of 2012 to \$9.5 million in the second quarter of 2013, due to an increase in pretax income. We expect the effective tax rate to be between 38% and 42% for fiscal year 2013.

Other Income and Expense

Net other (expense) income decreased during the second quarter of 2013 mostly due to costs incurred to develop new business opportunities.

Interest Expense

Total interest expense, net of interest capitalized, increased \$0.4 million to \$7.3 million for the second quarter of 2013 compared to the same period last year. This increase was attributable to a decrease in capitalized interest charged to construction projects during the second quarter of 2013 compared to the same period last year.

Table of Contents

Company Health Care Benefits

In March 2010, both the federal Patient Protection and Affordable Care Act (P.L. 111-148) and Health Care and Education Reconciliation Act (H.R. 4872) were enacted. We have not determined the impact of this legislation on the Company's health care costs during 2013 and in future years. However, we anticipate that the Company's health care and other costs will increase as a result of the new federal health care laws and based on available information. A new memorandum account was established for Cal Water, effective January 1, 2011, to account for health care cost changes due to federal legislation, as these costs were not included in the 2009 GRC decision.

Table of Contents

RESULTS OF THE SIX MONTHS ENDED JUNE 2013 COMPARED TO
THE SIX MONTHS ENDED JUNE 2012 OPERATIONS

Amounts in thousands except per share data

Overview

Net income for the six-month period ended June 30, 2013 was \$12.4 million or \$0.28 per diluted common share as compared to net income of \$14.1 million or \$0.34 per diluted common share for the six month period ended June 30, 2012. The decrease during the first six months of 2013 was mostly due to the reversal of 2011 deferred WRAM operating revenue of \$9.5 million and MCBA associated costs of \$7.7 million during the first six months of 2012, which had added net income of \$1.1 million during the first six months of 2012, which was a one-time benefit in the prior year. During the first six months of 2013 as compared to the first six months of 2012, operating revenue increased \$5.7 million which was offset by pre-tax wage and benefit cost increases of \$3.5 million, pre-tax property taxes expense increase of \$2.6 million, pre-tax depreciation expense increase of \$1.5 million, pre-tax self-insurance cost increase of \$0.8 million, and a \$0.8 million reduction to pre-tax capitalized interest. Net other (expense) income decreased \$0.8 million, mostly due to a lower unrealized gain on our benefit plan insurance investments during the six-month period ended June 30, 2013 as compared to the prior year.

Operating Revenue

Operating revenue increased \$5.7 million or 2% to \$266.0 million in the six month period ended June 30, 2013. As disclosed in the following table, the increase was due to increases in and rates.

The factors impacting operating revenue for the six months ended June 30, 2013 as compared to 2012 are as follows:

Usage and other	\$	5,640
Rate increases		6,326
Deferral of net WRAM and MCBA revenue		(9,409)
Conservation balancing account		299
Pension balancing account		(1,773)
Net effect of WRAM		4,614
Net operating revenue increase	\$	5,697

The deferral of net WRAM and MCBA revenue in the table above occurs whenever a district net receivable balance is estimated to be collected more than 24 months after the respective reporting period in which it was recognized. The deferrals are reversed when district net receivable balances are estimated to be collected within 24-months. The \$9.4 million net revenue decrease during the six months ended June 30, 2013 compared to the six months ended June 30, 2012 was mostly due to a \$9.5 million benefit during the six months ended June 30, 2012 from the reversal of the 2011 deferred net WRAM and MCBA revenue and from the deferral of net WRAM and MCBA revenue of \$0.8 million during the six months ended June 30, 2013.

The net change in usage and other in the above table refers primarily to the difference between actual metered customer consumption during the six months ended June 30, 2013 compared to the six months ended June 30, 2012. The \$5.6 million usage and other revenue increase was due to an increase in customer consumption during the first six months of 2013 compared to the prior year. In part, this reflects a \$0.7 million increase in accrued unbilled operating revenue which is not a component of the WRAM. The WRAM is a cash basis mechanism which records changes in billed operating revenue. The changes in the accrued unbilled operating revenue usually vary year over year. These changes are usually most variable due to weather conditions and have not had a significant impact on annual revenue in past years.

The net effect of WRAM in the above table refers primarily to the revenue changes recognized by the WRAM and MCBA. The WRAM is impacted by changes in consumption patterns from our historical trends as well as an increase in conservation efforts. The MCBA, which records the differences in production costs from the adopted costs, is recorded as an element of revenue as it represents pass through costs which are billed to customers. The MCBA is impacted by changes in total production quantities, the production mix of the source of water, the price paid for purchased water and power, and the amount of pump taxes paid. The net change during the six months ended June 30, 2013 compared to the six months ended June 30, 2012 resulted in an increase to revenue of \$4.6 million.

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

Table of Contents

The components of the rate increases are as follows:

Purchased water offset increases	\$	4,637
Step rate increases		3,820
General rate case (GRC) increases		953
Cost of capital adjustment mechanism and other		(3,084)
Total increase in rates	\$	6,326

Total Operating Expenses

Total operating expenses were \$239.4 million for the six month period ended June 30, 2013, compared to \$234.1 million for the same period in 2012, a 2% increase.

Water production expense consists of purchased water, purchased power, and pump taxes. It represents the largest component of total operating expenses, accounting for approximately 42% of total operating expenses in the six month period ended June 30, 2013. Water production expenses increased 11% compared to the same period last year mostly due to increased costs for purchased water and increased customer usage. Our 100% owned operating subsidiaries, Washington Water, New Mexico Water, and Hawaii Water obtain all of their water supply from wells.

Sources of water as a percent of total water production are listed in the following table:

	Six months Ended June 30	
	2013	2012
Well production	46%	46%
Purchased	49%	49%
Surface	5%	5%
Total	100%	100%

The components of water production costs are shown in the table below:

		Six months Ended June 30		
		2013	2012	Change
Purchased water	\$	82,729	\$ 73,791	\$ 8,938
Purchased power		13,629	13,137	492
Pump taxes		4,984	4,702	282
Total	\$	101,342	\$ 91,630	\$ 9,712

Purchased water costs increased primarily due to price increases from water wholesalers and an increase in customer usage.

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

Administrative and general expense and other operations expense decreased 6.0% to \$81.1 million. The decrease during the first six months of 2013 was partially due to the reversal of December 31, 2011 deferred MCBA associated costs of \$7.7 million during the first six months of 2012 which was partially offset by employee wage and benefit costs increases and conservation program expense increases during the six month period ended June 30, 2013 as compared to the six month period ended June 30, 2012. Wage increases became effective January 1, 2013.

Maintenance expense decreased by 20% to \$8.3 million during the six month period ended June 30, 2013 compared to \$10.4 million during the six month period ended June 30, 2012, due to a decrease in transmission and distribution mains repairs.

Depreciation and amortization expense increased \$1.5 million, or 5%, mostly due to 2012 capital additions.

Federal and state income taxes charged to operating expenses and other income and expenses decreased \$1.2 million, during the six month period ended June 30, 2013 mostly due to a decrease in taxable earnings. We expect the effective tax rate to be between 38% and 42% for fiscal year 2013.

Other Income and Expense

Net other (expense) income decreased \$0.8 million mostly due to an unrealized gain on our benefit plan insurance investments of \$0.5 million for the six months ended June 30, 2013, as compared to an unrealized gain of \$1.6 million for the six months ended June 30, 2012.

Table of Contents

Interest Expense

Net interest expense, net of interest capitalized, increased \$1.2 million, or 8%, to \$14.8 million for the six month period ended June 30, 2013 compared to the same period last year. The increase was mostly due to a decrease in capitalized interest charged to construction projects.

REGULATORY MATTERS

Rates and Regulation

State regulatory utility commissions have plenary powers over investor-owned utilities to set rates and operating standards. As such, state commission decisions significantly impact the Company's revenues, earnings, and cash flows. The amounts discussed herein are generally annual amounts, unless specifically stated, and the financial impact to recorded revenue is expected to occur over a 12-month period from the effective date of a decision. In California, water utilities are required to make several different types of filings. Most filings result in rate changes that remain in place until new rates are adopted in the next General Rate Case (GRC). As explained below, surcharges and surcredits to recover amounts in balancing and memorandum accounts, as well as interim GRC rate relief, are temporary rate changes for specific time frames. GRC applications, escalation rate increase filings, and offset filings change rates to amounts that will remain in effect until the next GRC.

The CPUC adopted a Rate Case Plan for Class A water utilities that requires Cal Water to file a GRC application for its regulated operating districts every three years. In a GRC proceeding, the CPUC not only considers the utility's rate setting requests, but may also consider other issues that affect the utility's rates and operations. The CPUC is generally required to issue its GRC decision prior to the first day of the test year, or alternatively, to authorize interim rates. Cal Water's 2009 GRC application was resolved in the fourth quarter of 2010, and new rates effective became effective January 1, 2011. As discussed in greater detail below, Cal Water filed a GRC application on July 5, 2012 requesting rate increases in all regulated operating districts in California beginning January 1, 2014.

Between GRC filings, utilities may request escalation rate increases that allow the utility to recover cost increases, primarily from inflation and incremental investment, during the second and third years of the rate case cycle. However, escalation rate increases are subject to a weather-normalized earnings test on a district-by-district basis. Under the earnings test, the CPUC may reduce the requested escalation increase in a district if, in the most recent 12-month period, applying the earnings test indicates that earnings in the district exceed what the CPUC authorized for that district.

In addition, California water utilities are entitled to file offset requests to increase rates between GRCs. Cal Water files two kinds of rate offset requests: ratebase offsets allow a revenue increase after a previously-authorized construction project is placed in service, and; expense offsets are for higher fees charged to the Company for purchased water, purchased power, and pump taxes (referred to as offsettable expenses). Such rate changes approved in offset filings remain in effect until the next GRC is approved.

In pursuit of the CPUC's water conservation goals, the CPUC decoupled Cal Water's revenue requirement from customer consumption levels in 2008 by authorizing Water Revenue Adjustment Mechanisms (WRAMs) and Modified Cost Balancing Accounts (MCBAs) for each ratemaking

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

area. The WRAMs/MCBAs ensure that Cal Water recovers all of the quantity revenues authorized by the CPUC, and no more, regardless of customer consumption. This removes the Company's historical disincentive against the promotion of lower water usage among customers. Through an annual advice letter filing, Cal Water recovers any uncollected quantity revenue amounts authorized, or refunds over-collected quantity revenues, via surcharges and surcredits. The advice letters are filed between February and April of each year and address the net WRAM/MCBA balances collected for the previous calendar year. Most WRAM/MCBA balances have been revenue under-collections that are amortized through surcharges for a period of 12 or 18 months. The WRAM and MCBA amounts are cumulative, so if they are not amortized in a given calendar year, the balance will be carried forward and included with the following year balance.

2013 Regulatory Activity

California GRC filing

On July 5, 2012, Cal Water filed its 2012 GRC application covering all district and general office revenue requirements. The GRC application requested an increase of \$92.7 million or 19.4% in rates for 2014, \$17.2 million or 3.0% in rates for 2015 and \$16.9 million or 2.9% in rates for 2016. Additionally, the GRC includes a number of special requests. The Division of Ratepayer Advocates (DRA) at the CPUC has reviewed the filing and submitted testimony and has made recommendation regarding Cal

Table of Contents

Water's filing. In addition, five intervening parties representing various ratepayer interests submitted testimony recommending changes to Cal Water's proposals. Cal Water submitted rebuttal testimony challenging many parties' analyses and recommendations. Settlement negotiations with interested parties began in May. The parties requested a delay of evidentiary hearings (originally scheduled for mid-June) due to progress in those negotiations, and hearings were re-scheduled for July and August. Any rate change as a result of this filing is expected to be effective on January 1, 2014.

Building Renovation on General Office Campus

On March 4, 2013, Cal Water and the CPUC's Division of Ratepayer Advocates submitted a proposed settlement that would allow Cal Water to recover \$5.7 million in capital costs for renovating a building on Cal Water's San Jose campus that houses the information technology, human resources, and customer service departments. Cal Water originally requested recovery of \$6.0 million for the renovation, which included reconfiguration and expansion of the old building. While the substantive issues are being evaluated in a separate proceeding, the revenue increase Cal Water proposed in its 2012 GRC filing already includes the \$6.0 million requested for the renovation. The level of cost recovery the CPUC authorizes for the renovation in the separate proceeding will be incorporated into the final rates adopted in the 2012 GRC proceeding that are expected to be effective on January 1, 2014.

Federal Income Tax Bonus Depreciation

In 2011, Cal Water filed for and received approval to track the benefits from federal income tax accelerated depreciation in a memorandum account due to the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. Additional federal income tax deductions for assets placed in service after September 8, 2010, and before December 31, 2011, were \$0.1 million for 2010 and \$12.2 million for 2011. The memorandum account may result in a surcredit because of the impact to Cal Water's revenue requirement for changes to working cash estimates, reductions to federal income tax qualified U.S. production activities deductions (QPAD), and changes to contributions-in-aid-of-construction. As of June 30, 2013, the estimated surcredit range is between \$0.6 million and \$1.1 million. The CPUC will determine the disposition of amounts recorded in the memorandum account in Cal Water's next GRC proceeding.

Service Line Insurance Billing

As a consequence of D.07-12-055, which resolved Cal Water's 2006 GRC, Cal Water was required to demonstrate that its non-regulated Extended Service Protection (ESP) business or its successor complies with CPUC rules. Cal Water made an administrative compliance filing in 2008 which was rejected. Cal Water subsequently filed A.08-05-019 requesting Commission confirmation that the interaction between Cal Water, CWS Utility Services, and HomeServe USA complied with all applicable rules. During the proceeding, the CPUC established a memorandum account to record Cal Water's revenues and expenses related to the non-regulated service line insurance business. On February 28, 2013, the CPUC adopted D.13-02-026 and approved the settlement between Cal Water and the CPUC's Division of Ratepayer Advocates resolving all issues in the proceeding and authorizing Cal Water to continue providing billing services to HomeServe USA. Beginning in April 2013, Cal Water amortized a portion of the memorandum account balance, plus \$2.2 million as required by the settlement, through surcredits to residential ratepayers over a 12-month period. New rates in 2014 resulting from the current GRC proceeding will include a forecast of the costs and revenues associated with this billing service. After the new rates go into effect, Cal Water will amortize the remaining balance and close the memorandum account.

Escalation Increase filings

Cal Water's 2009 GRC decision authorized annual escalation rate increases for 2012 and 2013 if the earnings test requirements are met. In January 2012, Cal Water implemented escalation rate increases in 17 districts. The annual gross revenue associated with these increases was \$8.7 million. In January 2013, Cal Water implemented escalation rate increases in 19 districts, resulting in an annual gross revenue increase of \$9.6 million.

WRAM/MCBA filings

In March 2013, Cal Water filed three advice letters to true up the revenue under-collections in the WRAMs/MCBAs of its regulated districts. A total under-collection of \$23.6 million is being collected from customers in the form of 12, 18 or 20+ month surcharges (depending on the size of a balance in relation to the annual revenues of the district).

Expense Offset filings

Expense offsets are dollar-for-dollar increases in revenue to match increased expenses, and therefore do not affect net operating income. In March 2013, Cal Water filed advice letters to offset increased purchased water and pump tax rates in five of its regulated districts totaling \$4.6 million in annual revenue. In May 2013, Cal Water filed an additional offset for purchased water and pump taxes totaling \$2 million in annual revenue.

Table of Contents

Ratebase Offset filings

In February 2013, Cal Water filed advice letters to offset several infrastructure improvement projects in two districts totaling \$0.5 million in annual revenue. For construction projects that are authorized in GRCs as advice letter projects, companies are allowed to file rate base offsets to increase revenues after the plant is placed into service. The projects filed in this quarter were authorized in the 2009 GRC. Some of the remaining advice letter projects approved in the 2009 GRC are scheduled to be completed during 2013 or later, while others may be canceled due to changes in operational needs.

Regulatory Activity *Other States*

Pukalani (Hawaii) GRC Filing

In August 2011, Hawaii Water filed a general rate case for the Pukalani wastewater system requesting \$1.3 million in additional annual revenues. Hawaii Water reached a comprehensive and conceptual settlement with the Consumer Advocate. This settlement would result in an increase of \$0.2 million in 2013, another increase of \$0.2 million in 2014, and another increase of \$0.2 million in 2015. Each increase is separated by one year. A Decision and Order from the Commission approving this stipulated settlement is currently pending.

Waikoloa (Hawaii) GRC Filings

In August 2012, Hawaii Water filed general rate cases for the Waikoloa water, wastewater, and irrigation systems in Waikoloa Village and Waikoloa Resort requesting \$6.3 million in additional annual revenues. Hawaii Water and the Consumer Advocate are currently engaged in settlement discussions for two of the three filings (Waikoloa Village Water and Wastewater); the Consumer Advocate is scheduled to file its testimony regarding the Waikoloa Resort proceeding by August 1, 2013. Hawaii Water cannot determine the timing or final amount of rate relief these filings will generate.

LIQUIDITY

Cash flow from Operations

Cash flow from operations was \$36.8 million during the six months ended June 30, 2013, compared to \$32.1 million for the same period of 2012. In general, cash flow from operations is primarily generated by net income, non-cash expense for depreciation and amortization, deferred income taxes, regulatory liabilities, and other current liabilities. Cash generated by operations varies during the year due to customer billings, timing of contributions to our benefit plans, and timing of vendor and tax payments.

During the six months ended June 30, 2013, we made contributions of \$17.8 million to our pension and retiree health care plans compared to \$15.8 million for the same period of 2012. The net WRAM and MCBA undercollected balances decreased \$1.9 million to \$44.2 million as of June 30, 2013 compared to December 31, 2012.

The water business is seasonal. Billed revenue is lower in the cool, wet winter months when less water is used compared to the warm, dry summer months when water use is highest. This seasonality results in the possible need for short-term borrowings under the bank lines of credit in the event cash is not available to cover operating and capital costs during the winter period. The increase in cash flows during the summer allows short-term borrowings to be paid down. Customer water usage can be lower than normal in years when more than normal precipitation falls in our service areas or temperatures are lower than normal, especially in the summer months. The reduction in water usage reduces cash flows from operations and increases the need for short-term bank borrowings. In addition, short-term borrowings are used to finance capital expenditures until long-term financing is arranged.

Investing Activities

During the six months ended June 30, 2013 and 2012, we used \$66.2 million and \$62.0 million, respectively, of cash for both Company-funded and developer-funded capital expenditures. For 2013, our capital budget is approximately \$120 to \$130 million. Annual expenditures fluctuate each year due to the availability of construction resources and our ability to obtain construction permits in a timely manner.

Table of Contents

Financing Activities

On March 26, 2013, the Company sold 5,750,000 shares of its common stock in an underwritten public offering for cash proceeds of approximately \$105.8 million, net of underwriting discounts and commissions and offering expenses. The net proceeds from the sale of common stock were added to our general funds to be used for general corporate purposes. In April 2013, the Company used a portion of the net proceeds from the offering to repay outstanding borrowings on the Company and Cal Water lines of credit of \$68.3 million and \$25.0 million, respectively.

During the six months ended June 30, 2013, there were new borrowings of \$32.6 million on our unsecured revolving credit facilities.

The undercollected net WRAM and MCBA receivable balances were \$44.2 million as of June 30, 2013 and \$46.1 million as of December 31, 2012, respectively. The CPUC shortened the amortization periods for undercollected net WRAM and MCBA balances such that most balances will be collected within 18-months. This change is expected to improve cash flows during 2013. The undercollected balances were primarily financed by Cal Water using short-term and long-term financing arrangements to meet operational cash requirements. Interest on the undercollected balances, the interest recoverable from ratepayers, is limited to the current 90-day commercial paper rates which is significantly lower than Cal Water's short and long-term financing rates.

Short-Term and Long-Term Debt

Short-term liquidity is provided by our unsecured revolving credit facilities, which were amended and replaced on June 29, 2011, and internally generated funds. Long-term financing is accomplished through the use of both debt and equity. As of June 30, 2013, there were short-term borrowings of \$28.8 million outstanding on the unsecured revolving credit facilities compared to \$89.5 million as of December 31, 2012.

Given our ability to access our lines of credit on a daily basis, cash balances are managed to levels required for daily cash needs and excess cash is invested in short-term or cash equivalent instruments. Minimal operating levels of cash are maintained for Washington Water, New Mexico Water, and Hawaii Water.

Both short-term credit agreements contain affirmative and negative covenants and events of default customary for credit facilities of this type including, among other things, limitations and prohibitions relating to additional indebtedness, liens, mergers, and asset sales. Also, these unsecured credit agreements contain financial covenants governing the Company and its subsidiaries' consolidated total capitalization ratio not to exceed 66.7% and an interest coverage ratio of three or more. As of June 30, 2013, the Company's total capitalization ratio was 51.9% (trade payable is included as debt for this calculation) and interest ratio slightly exceeds five. As of June 30, 2013, we have met all of the covenant requirements and are eligible to use the full amount of the commitment.

Bond principal and other long-term debt payments were \$2.6 million during the six months ended June 30, 2013, compared to \$1.6 million during the same period of 2012. In addition, Cal Water has \$40 million of first mortgage bonds maturing during the fourth quarter of 2013.

Long-term financing, which includes senior notes, other debt securities, and common stock, has typically been used to replace short-term borrowings and fund capital expenditures. Internally generated funds, after making dividend payments, provide positive cash flow, but have not been at a level to meet the needs of our capital expenditure requirements. Management expects this trend to continue given our capital expenditures plan for the next five years. Some capital expenditures are funded by payments received from developers for contributions in aid of construction or advances for construction. Funds received for contributions in aid of construction are non-refundable, whereas funds classified as advances in construction are refundable. Management believes long-term financing is available to meet our cash flow needs through issuances in both debt and equity instruments.

On September 23, 2010, the CPUC authorized Cal Water to issue \$350 million of debt and common stock to finance capital projects and operations. During the six months ended June 30, 2013, we utilized cash generated from the equity offering, operations, and borrowings on the unsecured revolving credit facilities. In future periods, management anticipates funding our capital needs and repayment of long-term debt through a relatively balanced approach between long-term debt and equity.

Dividends, Book Value and Shareholders

The second quarter of 2013 common stock dividend of \$0.16 per share was paid on May 17, 2013, compared to a quarterly dividend in the second quarter of 2012 of \$0.1575. This was our 273rd consecutive quarterly dividend. Annualized, the 2013 dividend rate is \$0.64 per common share, compared to \$0.63 in 2012. For the full year 2012, the payout ratio was 54% of net income. On a long-term basis, our goal is to achieve a dividend payout ratio of 60% of net income accomplished through future earnings growth.

At its July 31, 2013 meeting, the Board declared the third quarter dividend of \$0.16 per share payable on August 23, 2013, to stockholders of record on August 12, 2013. This was our 274th consecutive quarterly dividend.

Table of Contents

2013 Financing Plan

We intend to fund our capital needs in future periods through a relatively balanced approach between long-term debt and equity. The Company and Cal Water have a three-year syndicated unsecured revolving line of credit of \$100 million and \$300 million, respectively for short-term borrowings. As of June 30, 2013, the Company's availability on these unsecured revolving lines of credit was \$371.2 million.

Book Value and Stockholders of Record

Book value per common share was \$12.12 at June 30, 2013 compared to \$11.30 at December 31, 2012.

There were approximately 2,307 stockholders of record for our common stock as of July 24, 2013.

Utility Plant Expenditures

During the second quarter of 2013, capital expenditures totaled \$66.2 million for Company-funded and developer-funded projects. The planned 2013 Company-funded capital expenditure budget is approximately \$120 to \$130 million. The actual amount may vary from the budget number due to timing of actual payments related to current year and prior year projects. Also, potential changes in California Department of Public Health (CDPH) water quality standards for chromium-6 may require significant capital and operating expenditures in certain operating Districts.

We do not control third-party-funded capital expenditures and therefore are unable to estimate the amount of such projects for 2013.

At June 30, 2013, construction work in progress was \$152.7 million compared to \$132.4 million at December 31, 2012. Work in progress includes projects that are under construction but not yet complete and placed in service.

WATER SUPPLY

Our source of supply varies among our operating districts. Certain districts obtain all of their supply from wells; some districts purchase all of their supply from wholesale suppliers; and other districts obtain supply from a combination of wells and wholesale suppliers. A small portion of supply comes from surface sources and is processed through Company-owned water treatment plants. To the best of management's knowledge, we are meeting water quality, environmental, and other regulatory standards for all company-owned systems.

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

California's normal weather pattern yields little precipitation between mid-spring and mid-fall. The Washington Water service areas receive precipitation in all seasons, with the heaviest amounts during the winter. New Mexico Water's rainfall is heaviest in the summer monsoon season. Hawaii Water receives precipitation throughout the year, with the largest amounts in the winter months. Water usage in all service areas is highest during the warm and dry summers and declines in the cool winter months. Rain and snow during the winter months replenish underground water aquifers and fill reservoirs, providing the water supply for subsequent delivery to customers. As of July 1, 2013, the State of California snowpack water content and rainfall accumulation during the 2012-2013 water year is 91% of normal (per the California Department of Water Resources, Northern Sierra Precipitation Accumulation report). Precipitation during the six months ended June 30, 2013 was below average. Management believes that supply pumped from underground aquifers and purchased from wholesale suppliers will be adequate to meet customer demand during 2013 and beyond. Long-term water supply plans are developed for each of our districts to help assure an adequate water supply under various operating and supply conditions. Some districts have unique challenges in meeting water quality standards, but management believes that supplies will meet current standards using current treatment processes.

CONTRACTUAL OBLIGATIONS

During the six months ended June 30, 2013, there were no material changes in contractual obligations outside the normal course of business.

Table of Contents

Item 3.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We do not hold, trade in or issue derivative financial instruments and therefore are not exposed to risks these instruments present. Our market risk to interest rate exposure is limited because the cost of long-term financing and short-term bank borrowings, including interest costs, is covered in consumer water rates as approved by the commissions. We do not have foreign operations; therefore, we do not have a foreign currency exchange risk. Our business is sensitive to commodity prices and is most affected by changes in purchased water and purchased power costs.

Historically, the CPUC's balancing account or offsetable expense procedures allowed for increases in purchased water and purchased power costs to be passed on to consumers. Traditionally, a significant percentage of our net income and cash flows comes from California regulated operations; therefore the CPUC's actions have a significant impact on our business. See Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies -Expense Balancing and Memorandum Accounts and Regulatory Matters .

Item 4.

CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow for timely decisions regarding required disclosure.

In designing and evaluating the disclosure controls and procedures, management recognized any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Accordingly, our disclosure controls and procedures have been designed to provide reasonable assurance of achieving their objectives.

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

Our management, with the participation of our CEO and our CFO, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2013. Based on that evaluation, we concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

(b) Changes to Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1.

LEGAL PROCEEDINGS

From time to time, the Company has been named as a co-defendant in asbestos-related lawsuits. Several of these cases against the Company have been dismissed without prejudice. In other cases the Company's contractors and insurance policy carriers have settled the cases with no effect on the Company's financial statements. As such, the Company does not currently believe there is any potential loss that is probable to occur related to these matters and therefore no accrual has been recorded.

From time to time, the Company is involved in various disputes and litigation matters that arise in the ordinary course of business. The status of each significant matter is reviewed and assessed for potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount of the range of loss can be estimated, a liability is accrued for the estimated loss in accordance with the accounting standards for contingencies. Legal proceedings are subject to uncertainties, and

Table of Contents

the outcomes are difficult to predict. Because of such uncertainties, accruals are based on the best information available at the time. While the outcome of these disputes and litigation matters cannot be predicted with any certainty, management does not believe when taking into account existing reserves the ultimate resolution of these matters will materially affect the Company's financial position, results of operations, or cash flows. In the future, we may be involved in disputes and litigation related to a wide range of matters, including employment, construction, environmental issues and operations. Litigation can be time consuming and expensive and could divert management's time and attention from our business. In addition, if we are subject to additional lawsuits or disputes, we might incur significant legal costs and it is uncertain whether we would be able to recover the legal costs from ratepayers or other third parties. As such, the Company does not currently believe there is any potential loss that is probable to occur related to these matters and therefore no accrual has been recorded.

Item 1A.

RISK FACTORS

New and more stringent water quality regulations could increase our operating costs.

We are subject to water quality standards set by federal, state and local authorities that have the power to issue new regulations. Compliance with new regulations that are more stringent than current regulations could increase our operating costs.

On July 18, 2013, an Alameda County Superior Court judge directed CDPH to propose a drinking water quality standard in California for chromium-6 by the end of August 2013. There can be no assurance that our existing operations will comply with the drinking water quality standards for chromium-6 proposed by the CDPH. More stringent drinking water quality standards could require us to develop new quality control procedures which could increase our operating costs, restrict our available water supplies, or increase future capital expenditures in certain operating Districts. Although we would likely seek permission to recover additional costs of compliance through rate increases, we can give no assurance that the CPUC would approve rate increases to enable us to recover these additional compliance costs.

Other than the additional risk factor above, there have been no material changes to the Company's risk factors set forth in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year-ended December 31, 2012, filed with the SEC on February 28, 2013.

Item 5.

OTHER INFORMATION

On July 31, 2013, Peter C. Nelson, Chairman and Chief Executive Officer of the Company resigned as an officer and employee of the Company. The Company's Board of Directors (the Board) appointed Martin A. Kropelnicki as Chief Executive Officer of the Company and elected

Edgar Filing: CALIFORNIA WATER SERVICE GROUP - Form 10-Q

Kropelnicki as a member of the Board, all effective September 1, 2013. Nelson will continue to serve as the Company's non-executive Chairman of the Board.

Kropelnicki, age 47, joined the Company as Vice President, Chief Financial Officer and Treasurer in March of 2006 and currently serves as President and Chief Operating Officer. Kropelnicki has over 25 years of experience, including 15 years as Chief Financial Officer at publicly listed companies. Previously, he held executive and management level positions at PowerLight Corporation, Hall Kinion & Associates, Deloitte & Touche Consulting Group, and Pacific Gas & Electric Company. Kropelnicki holds a Bachelor of Arts Degree and Master of Arts Degree in Business Economics from San Jose State University.

In connection with his appointment, Kropelnicki's base salary will increase to \$640,000 per year and was awarded additional equity compensation of \$40,000. Kropelnicki will also continue to participate in the Company's Equity Incentive Plan and California Water Service Company's Supplemental Executive Retirement Plan (as amended).

Item 6.

EXHIBITS

Exhibit	Description
31.1	Chief Executive Officer certification of financial statements pursuant to Section 302 of the Sarbanes- Oxley Act of 2002
31.2	Chief Financial Officer certification of financial statements pursuant to Section 302 of the Sarbanes- Oxley Act of 2002
32	Chief Executive Officer and Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes- Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

SIGNATURES

Pursuant to the requirement 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.

CALIFORNIA WATER SERVICE GROUP
Registrant

August 1, 2013

By: /s/ Thomas F. Smegal III
Thomas F. Smegal III
Vice President,
Chief Financial Officer and Treasurer

Table of Contents

Exhibit Index

Exhibit	Description
31.1	Chief Executive Officer certification of financial statements pursuant to Section 302 of the Sarbanes- Oxley Act of 2002
31.2	Chief Financial Officer certification of financial statements pursuant to Section 302 of the Sarbanes- Oxley Act of 2002
32	Chief Executive Officer and Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes- Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document