

CALIFORNIA WATER SERVICE GROUP

Form 10-Q

May 06, 2013

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**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 March 31, 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

(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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

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

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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 May 1, 2013 47,728,775

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## 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)

	March 31, 2013	December 31, 2012
<b>ASSETS</b>		
<b>Utility plant:</b>		
Utility plant	\$ 2,123,935	\$ 2,096,363
Less accumulated depreciation and amortization	(655,345)	(639,307)
Net utility plant	1,468,590	1,457,056
<b>Current assets:</b>		
Cash and cash equivalents	127,677	38,790
Receivables:		
Customers	29,204	29,958
Regulatory balancing accounts	29,607	34,020
Other	11,577	11,943
Unbilled revenue	15,551	15,394
Materials and supplies at weighted average cost	5,687	5,874
Taxes, prepaid expenses and other assets	12,393	10,585
Total current assets	231,696	146,564
<b>Other assets:</b>		
Regulatory assets	353,606	344,419
Goodwill	2,615	2,615
Other assets	47,848	45,270
Total other assets	404,069	392,304
	\$ 2,104,355	\$ 1,995,924
<b>CAPITALIZATION AND LIABILITIES</b>		
<b>Capitalization:</b>		

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Common stock, \$.01 par value; 68,000,000 shares authorized, 47,729,000 and 41,908,000 outstanding in 2013 and 2012, respectively	\$	477	\$	419
Additional paid-in capital		327,178		221,013
Retained earnings		244,502		252,280
Total common stockholders' equity		572,157		473,712
Long-term debt, less current maturities		434,153		434,467
Total capitalization		1,006,310		908,179
<b>Current liabilities:</b>				
Current maturities of long-term debt		46,743		46,783
Short-term borrowings		93,275		89,475
Accounts payable		44,293		47,199
Regulatory balancing accounts		6,132		5,018
Accrued interest		11,003		4,705
Accrued expenses and other liabilities		55,308		49,887
Total current liabilities		256,754		243,067
<b>Unamortized investment tax credits</b>		2,180		2,180
<b>Deferred income taxes, net</b>		158,037		158,846
<b>Pension and postretirement benefits other than pensions</b>		248,385		244,901
<b>Regulatory and other liabilities</b>		88,476		92,593
<b>Advances for construction</b>		186,242		187,584
<b>Contributions in aid of construction</b>		157,971		158,574
<b>Commitments and contingencies</b>				
	\$	2,104,355	\$	1,995,924

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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

Unaudited

(In thousands, except per share data)

<b>For the three months ended</b>	<b>March 31,</b>	<b>March 31,</b>
	<b>2013</b>	<b>2012</b>
<b>Operating revenue</b>	\$ 111,444	\$ 116,749
<b>Operating expenses:</b>		
Operations:		
Water production costs	41,697	38,952
Administrative and general	25,281	23,018
Other operations	15,645	23,826
Maintenance	4,133	5,760
Depreciation and amortization	14,629	13,951
Income tax (benefit) expense	(1,146)	28
Property and other taxes	5,435	4,607
Total operating expenses	105,674	110,142
Net operating income	5,770	6,607
<b>Other income and expenses:</b>		
Non-regulated revenue	3,522	4,136
Non-regulated expenses, net	(2,417)	(2,099)
Income tax (expense) on other income and expenses	(451)	(823)
Net other income	654	1,214
<b>Interest expense:</b>		
Interest expense	8,037	7,639
Less: capitalized interest	(540)	(903)
Net interest expense	7,497	6,736
<b>Net (loss) income</b>	<b>\$ (1,073)</b>	<b>\$ 1,085</b>
<b>(Loss) Earnings per share</b>		
Basic	\$ (0.03)	\$ 0.03
Diluted	\$ (0.03)	\$ 0.03
<b>Weighted average shares outstanding</b>		
Basic	42,248	41,842
Diluted	42,248	41,842
<b>Dividends declared per share of common stock</b>	<b>\$ 0.1600</b>	<b>\$ 0.1575</b>

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)

	March 31, 2013	March 31, 2012
<b>For the three months ended:</b>		
<b>Operating activities</b>		
Net (loss) income	\$ (1,073)	\$ 1,085
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	15,110	14,410
Change in value of life insurance contracts	(510)	(1,713)
Other changes in noncurrent assets and liabilities	(38)	2,802
Changes in operating assets and liabilities:		
Receivables	(1,645)	3,524
Accounts payable	(730)	334
Other current assets	(1,729)	(3,371)
Other current liabilities	10,164	5,845
Net cash provided by operating activities	19,549	22,916
<b>Investing activities:</b>		
Utility plant expenditures	(32,101)	(28,665)
Purchase of life insurance	(1,539)	(1,357)
Changes in restricted cash and other changes, net	108	102
Net cash used in investing activities	(33,532)	(29,920)
<b>Financing activities:</b>		
Short-term borrowings	3,800	5,650
Repayment of short-term borrowings		(2,000)
Repayment of long-term debt	(355)	(431)
Advances and contributions in aid of construction	1,916	1,156
Refunds of advances for construction	(1,621)	(1,974)
Issuance of common stock	110,688	
Common stock issuance costs	(4,853)	
Dividends paid	(6,705)	(6,586)
Net cash provided (used in) by financing activities	102,870	(4,185)
Change in cash and cash equivalents	88,887	(11,189)
Cash and cash equivalents at beginning of period	38,790	27,203
Cash and cash equivalents at end of period	\$ 127,677	\$ 16,014
<b>Supplemental information</b>		
Cash paid for interest (net of amounts capitalized)	\$ 1,061	\$ 283
Cash paid for income taxes		
<b>Supplemental disclosure of non-cash activities:</b>		
Accrued payables for investments in utility plant	\$ 6,959	\$ 12,519
Utility plant contribution by developers	1,278	2,586

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements





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CALIFORNIA WATER SERVICE GROUP

Notes to Unaudited Condensed Consolidated Financial Statements

March 31, 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 wholly-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.

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

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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 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 first quarter of 2013 was:

	<b>Operating Revenues</b>		<b>Operating Costs</b>		<b>Income Before Income Taxes</b>
Net WRAM and MCBA deferral as of December 31, 2012	\$ 882	\$	\$ 719	\$	\$ 163
Less: reversal of prior year deferral during the first quarter of 2013	(16)		25		(41)
Add: net WRAM and MCBA deferral the first quarter of 2013	1,125		967		158
Net amount recorded during the first quarter of 2013	1,109		992		117
Net WRAM and MCBA deferral as of March 31, 2013	\$ 1,991	\$	\$ 1,711	\$	\$ 280

The change to deferred net WRAM and MCBA balances during the first quarter of 2012 was:

	<b>Operating Revenues</b>		<b>Operating Costs</b>		<b>Income Before Income Taxes</b>
Net WRAM and MCBA deferral as of December 31, 2011	\$ 12,864	\$	\$ 10,492	\$	\$ 2,372

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Less: reversal of prior year deferral during the first quarter of 2012	(8,846)	(7,215)	(1,631)
Add: net WRAM and MCBA deferral the first quarter of 2012	110	90	20
Net amount recorded during the first quarter of 2012	(8,736)	(7,125)	(1,611)
Net WRAM and MCBA deferral as of March 31, 2012	\$ 4,128	\$ 3,367	\$ 761

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

	<b>March 31, 2013</b>	<b>December 31, 2012</b>
Net short-term receivable	\$ 29,607	\$ 34,020
Net long-term receivable	19,031	12,051
Total receivable	\$ 48,638	\$ 46,071
Net short-term payable	\$ 338	\$ 371
Net long-term payable	374	119
Total payable	\$ 712	\$ 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 \$1.7 million as of March 31, 2013 and December 31, 2012. 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 \$127.7 million and \$38.8 million as of March 31, 2013 and December 31, 2012, respectively. The \$105.8 million net cash proceeds from the March 26, 2013 equity offering was included in Cash and cash equivalents as of March 31, 2013. Restricted cash was presented on the condensed consolidated balance sheet as taxes, prepaid expenses and other assets and was \$2.2 million and \$2.3 million as of March 31, 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 adoption of the new ASU in 2014 is not expected to have a material impact on the Company's condensed consolidated financial statements.

## Note 3. Stock-based Compensation

Equity Incentive Plan

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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 three months ended March 31, 2013 and 2012, the Company granted annual Restricted Stock Awards (RSAs) of 70,557 and 89,980 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 three months of 2013 and 2012, the shares granted were valued at \$20.62 and \$17.98 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.

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The Company has recorded compensation costs for the RSAs and RSUs in Operating Expense in the amount of \$0.4 million and \$0.3 million for the three months ended March 31, 2013 and March 31, 2012, respectively.

#### Note 4. Equity

The Company's changes in equity for the three months ended March 31, 2013 were as follows:

		<b>Total Stockholders</b>	<b>Equity</b>
Balance at December 31, 2012	\$		473,712
Common stock issued, net			105,835
Share-based compensation expense			388
Common stock dividends declared			(6,705)
Net loss			(1,073)
Balance at March 31, 2013	\$		572,157

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 \$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. The issuance of shares of common stock was applied to the condensed consolidated financial statements for the first quarter ended March 31, 2013.

#### 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.

The Company's weighted average number of common shares outstanding during the three months ended March 31, 2013 has been adjusted for the March 26, 2013 equity offering. A total of 333,856 shares of Stock Appreciation Rights were vested and outstanding and all were anti-dilutive as of March 31, 2013 and March 31, 2012 as shown in the table below.

	<b>Three Months Ended March 31</b>			
		<b>2013</b>		<b>2012</b>
Net (loss) income available to common stockholders	\$	(1,073)	\$	1,085
Weighted average common shares, basic		42,248		41,842
Dilutive common stock options (treasury method)				



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Shares used for dilutive computation		42,248		41,842
Net (loss) income per share - basic	\$	(0.03)	\$	0.03
Net (loss) income per share - diluted	\$	(0.03)	\$	0.03

### 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.

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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 \$7.5 million for the three months ended March 31, 2013 and were \$6.0 million during the three months ended March 31, 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.

	Pension Plan		Three Months Ended March 31		Other Benefits	
	2013	2012	2013	2012	2013	2012
Service cost	\$ 4,658	\$ 4,016	\$ 1,695	\$ 1,417		
Interest cost	4,063	3,779	1,109	967		
Expected return on plan assets	(3,565)	(2,893)	(598)	(468)		
Recognized net initial APBO (1)	N/A	N/A	2	69		
Amortization of prior service cost	1,541	1,571	20	29		
Recognized net actuarial loss	2,224	1,926	916	764		
Net periodic benefit cost	\$ 8,921	\$ 8,399	\$ 3,144	\$ 2,778		

(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 Agreements, 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 that 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 March 31, 2013, the Company and Cal Water have met all borrowing covenants for both credit agreements.

As of March 31, 2013 and December 31, 2012, the outstanding borrowings on the Company lines of credit were \$68.3 million and \$64.5 million, respectively, and were \$25.0 million as of March 31, 2013 and December 31, 2012 on the Cal Water lines of credit, respectively. For the three months ended March 31, 2013, the average borrowing rate was 2.26% compared to 1.60% 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

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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.

We anticipate 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 deduction was estimated at \$1.6 million in 2012. The 2012 estimate will be finalized when we file the 2012 tax returns in 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 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 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 did not use any of the proceeds to replace damaged infrastructure during the first quarter of 2013. The remaining balance of \$11.8 million is recorded as other long-term 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 March 31, 2013 and December 31, 2012, the pension balancing account was a regulatory receivable of \$3.1 million and \$2.4 million, respectively. The conservation balancing account was a

regulatory liability of \$5.6 million and \$6.5 million as of March 31, 2013 and December 31, 2012, respectively.

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 March 31, 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

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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 \$1.3 million and \$0.2 million for all known legal matters as of March 31, 2013 and March 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

The accounting guidance for fair value measurements and disclosures (Accounting Standards Update No. 2011-04 and Accounting Standards Codification No. 270-10-45-19, effective January 1, 2012), provides a single definition of fair value and requires certain disclosures about assets and liabilities measured at fair value. A hierarchal 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 inactive 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.

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Specific valuation methods include the following:

Cash equivalents, accounts receivable and accounts payable 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.

	March 31, 2013					Total
	Cost	Fair Value				
		Level 1	Level 2	Level 3		
Money market investments	\$ 107,418	\$ 107,418				\$ 107,418
Long -term debt, including current maturities	480,896		608,302			608,302
Advances for construction	186,242		72,073			72,073
<b>Total</b>	<b>\$ 774,556</b>	<b>\$ 107,418</b>	<b>\$ 680,375</b>	<b>\$</b>	<b>\$</b>	<b>\$ 787,793</b>

	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
<b>Total</b>	<b>\$ 668,834</b>	<b>\$</b>	<b>\$ 684,125</b>	<b>\$</b>	<b>\$</b>	<b>\$ 684,125</b>

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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 which are fully and unconditionally guaranteed by the Company.

The following tables present the condensed consolidating balance sheets as of March 31, 2013 and December 31, 2012, the condensed consolidating statements of income (loss) for the three months ended March 31, 2013 and 2012 and the condensed consolidating statements of cash flows for the three months ended March 31, 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 consolidated subsidiary of California Water Service Group; and (iii) the other 100%-owned consolidated subsidiaries of California Water Service Group.



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As of March 31, 2013

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
<b>ASSETS</b>					
<b>Utility plant:</b>					
Utility plant	\$ 930	\$ 1,951,750	\$ 178,452	\$ (7,197)	\$ 2,123,935
Less accumulated depreciation and amortization	(122)	(622,808)	(33,946)	1,531	(655,345)
Net utility plant	808	1,328,942	144,506	(5,666)	1,468,590
<b>Current assets:</b>					
Cash and cash equivalents	107,418	18,262	1,997		127,677
Receivables and unbilled revenue	139	82,418	3,382		85,939
Receivables from affiliates	23,677	3,105	952	(27,734)	
Other current assets	177	16,871	1,032		18,080
Total current assets	131,411	120,656	7,363	(27,734)	231,696
<b>Other assets:</b>					
Regulatory assets		351,031	2,575		353,606
Investments in affiliates	484,269			(484,269)	
Long-term affiliate notes receivable	30,900	7,769		(38,669)	
Other assets	1,335	42,198	7,133	(203)	50,463
Total other assets	516,504	400,998	9,708	(523,141)	404,069
	\$ 648,723	\$ 1,850,596	\$ 161,577	\$ (556,541)	\$ 2,104,355
<b>CAPITALIZATION AND LIABILITIES</b>					
<b>Capitalization:</b>					
Common stockholders' equity	\$ 572,157	\$ 436,664	\$ 53,084	\$ (489,748)	\$ 572,157
Affiliate long-term debt	7,768		30,901	(38,669)	
Long-term debt, less current maturities		431,230	2,923		434,153
Total capitalization	579,925	867,894	86,908	(528,417)	1,006,310
<b>Current liabilities:</b>					
Current maturities of long-term debt		46,112	631		46,743
Short-term borrowings	68,275	25,000			93,275
Payables to affiliates	955	952	25,827	(27,734)	
Accounts payable	75	40,241	3,977		44,293
Accrued expenses and other liabilities	72	70,081	2,290		72,443
Total current liabilities	69,377	182,386	32,725	(27,734)	256,754
<b>Unamortized investment tax credits</b>		2,180			2,180
<b>Deferred income taxes, net</b>	(579)	154,672	4,334	(390)	158,037
<b>Pension and postretirement benefits other than pensions</b>		248,385			248,385
<b>Regulatory and other liabilities</b>		79,786			