CALIFORNIA WATER SERVICE GROUP
Form 10-Q
October 30, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

or

o 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 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 x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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 October 28, 2014 47,806,190

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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 shares and per share data)

	September 30, 2014	December 31, 2013
ASSETS		
Utility plant:		
Utility plant	$ 2,306,427	$ 2,213,328
Less accumulated depreciation and amortization	(745,742)	(697,497)
Net utility plant	1,560,685	1,515,831
Current assets:		
Cash and cash equivalents	29,485	27,506
Receivables:		
Customers	37,070	31,468
Regulatory balancing accounts	45,073	30,887
Other	15,759	18,700
Unbilled revenue	29,489	17,034
Materials and supplies at weighted average cost	5,912	5,571
Taxes, prepaid expenses and other assets	14,490	8,324
Total current assets	177,278	139,490
Other assets:		
Regulatory assets	277,476	251,681
Goodwill	2,615	2,615
Other assets	51,026	50,238
Total other assets	331,117	304,534
	$ 2,069,080	$ 1,959,855
CAPITALIZATION AND LIABILITIES		
Capitalization:		

Common stock, $.01 par value; 68,000,000 shares authorized, 47,806,000 and 47,741,000 outstanding in 2014 and 2013, respectively	$	478	$	477
Additional paid-in capital		329,840		328,364
Retained earnings		291,964		269,915
Total common stockholders equity		622,282		598,756
Long-term debt, less current maturities		422,825		426,142
Total capitalization		1,045,107		1,024,898
Current liabilities:				
Current maturities of long-term debt		6,619		7,908
Short-term borrowings		61,715		46,815
Accounts payable		71,867		55,087
Regulatory balancing accounts		6,791		1,827
Accrued interest		9,748		4,245
Accrued expenses and other liabilities		58,674		50,702
Total current liabilities		215,414		166,584
Unamortized investment tax credits		2,106		2,106
Deferred income taxes, net		210,357		183,245
Pension and postretirement benefits other than pensions		153,085		145,451
Regulatory and other liabilities		91,713		86,455
Advances for construction		182,172		183,393
Contributions in aid of construction		169,126		167,723
Commitments and contingencies (Note 10)				
	$	2,069,080	$	1,959,855

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Unaudited

(In thousands, except per share data)

For the three months ended		**September 30, 2014**		**September 30, 2013**
Operating revenue	$	191,184	$	184,404
Operating expenses:				
Operations:				
Water production costs		66,980		70,614
Administrative and general		23,765		24,670
Other operations		15,692		17,657
Maintenance		4,800		4,575
Depreciation and amortization		14,648		14,505
Income taxes		19,233		11,165
Property and other taxes		5,232		5,414
Total operating expenses		150,350		148,600
Net operating income		40,834		35,804
Other income and expenses:				
Non-regulated revenue		4,409		3,649
Non-regulated expenses, net		(4,812)		(2,825)
Income tax benefit (expense) on other income and expenses		169		(330)
Net other (loss) income		(234)		494
Interest expense:				
Interest expense		7,221		7,687
Less: capitalized interest		(271)		(540)
Net interest expense		6,950		7,147
Net Income	$	33,650	$	29,151
Earnings per share				
Basic	$	0.70	$	0.61
Diluted		0.70		0.61
Weighted average shares outstanding				
Basic		47,803		47,737
Diluted		47,840		47,770
Dividends declared per share of common stock	$	0.1625	$	0.1600

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Unaudited

(In thousands, except per share data)

For the nine months ended	September 30, 2014	September 30, 2013
Operating revenue	$ 460,115	$ 450,403
Operating expenses:		
Operations:		
Water production costs	174,297	171,956
Administrative and general	72,702	73,106
Other operations	48,072	50,332
Maintenance	14,793	12,896
Depreciation and amortization	46,788	43,625
Income taxes	22,584	19,567
Property and other taxes	15,601	16,564
Total operating expenses	394,837	388,046
Net operating income	65,278	62,357
Other income and expenses:		
Non-regulated revenue	12,163	10,386
Non-regulated expenses, net	(11,184)	(8,482)
Income tax (expense) on other income and expenses	(391)	(765)
Net other income	588	1,139
Interest expense:		
Interest expense	21,373	23,527
Less: capitalized interest	(851)	(1,619)
Net interest expense	20,522	21,908
Net Income	$ 45,344	$ 41,588
Earnings per share		
Basic	$ 0.95	$ 0.91
Diluted	0.95	0.90
Weighted average shares outstanding		
Basic	47,787	45,927
Diluted	47,825	45,957
Dividends declared per share of common stock	$ 0.4875	$ 0.4800

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited

(In thousands)

For the nine months ended:	**September 30, 2014**	**September 30, 2013**
Operating activities		
Net income	$ 45,344	$ 41,588
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	48,481	45,067
Changes in value of life insurance contracts	(501)	(1,147)
Changes in operating assets and liabilities:		
Receivables	(13,781)	(24,636)
Accounts payable	7,239	7,719
Other current assets	(6,859)	(751)
Other current liabilities	6,904	20,558
Other changes in noncurrent assets and liabilities	13,340	13,501
Net cash provided by operating activities	100,167	101,899
Investing activities:		
Utility plant expenditures	(86,258)	(94,782)
Purchase of life insurance contracts	(3,207)	(3,204)
Changes in restricted cash and other changes	354	1,148
Net cash used in investing activities	(89,111)	(96,838)
Financing activities:		
Short-term borrowings	99,900	35,315
Repayment of short-term borrowings	(85,000)	(113,275)
Proceeds from long-term debt		48
Repayment of long-term debt	(4,604)	(3,058)
Advances and contributions in aid of construction	8,780	7,577
Refunds of advances for construction	(4,858)	(5,230)
Issuance of common stock		110,688
Common stock issuance costs		(5,088)
Dividends paid	(23,295)	(21,981)
Net cash (used in) provided by financing activities	(9,077)	4,996
Change in cash and cash equivalents	1,979	10,057
Cash and cash equivalents at beginning of period	27,506	38,790
Cash and cash equivalents at end of period	$ 29,485	$ 48,847
Supplemental information		
Cash paid for interest (net of amounts capitalized)	$ 14,102	$ 15,141
Cash paid for income taxes		
Income tax refunds	(6,000)	
Supplemental disclosure of non-cash activities:		
Accrued payables for investments in utility plant	$ 16,308	$ 11,739
Utility plant contribution by developers	8,148	10,196

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP

Notes to Unaudited Condensed Consolidated Financial Statements

September 30, 2014

(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, 2013, included in its annual report on Form 10-K as filed with the SEC on February 27, 2014.

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 generally lower in the winter months when cooler temperatures and rainfall curtail water usage and sales.

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 an opportunity to recover its operating costs and earn a reasonable 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 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.

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Cost-recovery rates are designed to permit full recovery of certain costs. 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. There is no markup for return or profit for cost-recovery expenses and are generally recognized when expenses are incurred. 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 Cal Water customers at a later date. The variance between adopted costs and actual costs for metered accounts is recorded as a component of revenue with an offsetting entry to a regulatory asset or liability balancing account (transferred individually for each Cal Water District) subject to certain criteria under the accounting for regulated operations being met.

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 or 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 net WRAM and MCBA balances included in regulatory balancing account, assets, and liabilities were:

		September 30, 2014		December 31, 2013
Net short-term receivable	$	27,927	$	30,887
Net long-term receivable		16,608		15,423
Total receivable	$	44,535	$	46,310
Net short-term payable	$	423	$	1,032
Net long-term payable		1,385		906
Total payable	$	1,808	$	1,938

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 sheets and recognized as revenue when earned in the subsequent accounting period. The unearned revenue liability was $1.5 million as of September 30, 2014 and as of December 31, 2013. 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 $29.5 million and $27.5 million as of September 30, 2014 and December 31, 2013, respectively. Restricted cash was included on the condensed consolidated balance sheets as taxes, prepaid expenses and other assets and was $0.8 million and $1.2 million as of September 30, 2014 and December 31, 2013, respectively.

Accounting Standards Update

On May 28, 2014 the Financial Accounting Standards Board issued an accounting standards update (ASU) 2014-09, *Revenue from Contracts with Customers*. This update creates a single, principles based framework for revenue recognition and is based on principles that govern the recognition of revenue at an amount an entity expects to be entitled when goods or services are transferred to customers. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The Company is currently evaluating the impact of adopting the new revenue standard on its consolidated financial statements and related disclosures.

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Note 3. Stock-based Compensation

Equity Incentive Plan

The Company s equity incentive plan was originally approved by stockholders on April 27, 2005 and again on May 20, 2014. Under the equity incentive plan, the Company is authorized to issue up to 2,000,000 shares of common stock awards as defined in the Plan to employees and directors.

The Restricted Stock Awards (RSAs) granted in 2014 and 2013 to employees vest over 36 months. Director RSAs generally vest at the end of 12 months. During the first nine months of 2014, the RSAs granted were valued at $23.61 per share, based upon the fair market value of the Company s common stock on the date of grant.

During the nine months ended September 30, 2014 and 2013, the Company also granted performance-based Restricted Stock Unit Awards (RSUs) of 37,143 shares and 50,267 shares of common stock, respectively, to officers. Each award reflects a target number of shares that may be issued to the award recipient. The 2014 and 2013 awards may be earned upon the completion of the three-year performance period ending on March 4, 2017 and March 5, 2016, respectively. 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, water quality standards, and/or safety 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 were not dilutive as of September 30, 2014 and 2013 and will not be included in diluted shares for financial reporting until they are either dilutive or earned. The 2014 and 2013 RSUs are recognized as expense ratably over the three year performance period using a fair market value of $23.61 per share and $20.62 per share, respectively, and an estimate of RSUs earned during the performance period.

The Company has recorded compensation costs for the RSAs and RSUs in operating expense in the amount of $1.5 million and $1.3 million for the nine months ended September 30, 2014 and September 30, 2013, respectively.

Note 4. Equity

The Company s changes in equity for the nine months ended September 30, 2014 were as follows:

		Total Stockholders Equity
Balance at December 31, 2013	$	598,756
Common stock issued		1

Share-based compensation expense		1,476
Common stock dividends paid		(23,295)
Net income		45,344
Balance at September 30, 2014	$	622,282

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Note 5. Net Income Per Share Calculations

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

A total of 185,420 shares and 283,856 shares of Stock Appreciation Rights were vested and outstanding and all were dilutive as of September 30, 2014 and September 30, 2013, respectively, as shown in the table below.

	Three Months Ended September 30	
	2014	2013
Net Income available to common stockholders	$ 33,650	$ 29,151
Weighted average common shares outstanding, basic (in thousands)	47,803	47,737
Dilutive stock appreciation rights (treasury method) (in thousands)	37	33
Weighted average common shares outstanding, dilutive (in thousands)	47,840	47,770
Net Income per share - basic	$ 0.70	$ 0.61
Net Income per share - diluted	$ 0.70	$ 0.61

	Nine months Ended September 30	
	2014	2013
Net Income available to common stockholders	$ 45,344	$ 41,588
Weighted average common shares outstanding, basic (in thousands)	47,787	45,927
Dilutive stock appreciation rights (treasury method) (in thousands)	38	30
Weighted average common shares outstanding, dilutive (in thousands)	47,825	45,957
Net Income per share - basic	$ 0.95	$ 0.91
Net Income per share - diluted	$ 0.95	$ 0.90

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 was $14.0 million and $2.4 million, respectively, for the nine months ended September 30, 2014 and was $23.4 million to pension plans and $4.7 million to other postretirement benefit plans during the nine months ended September 30, 2013. The 2014 estimated cash contribution to the pension plans is $26.8 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 September 30			
	Pension Plan		Other Benefits	
	2014	2013	2014	2013
Service cost	$ 3,539	$ 4,019	$ 1,398	$ 1,636
Interest cost	4,737	4,140	1,321	1,121
Expected return on plan assets	(4,091)	(3,559)	(832)	(600)
Recognized net initial APBO (1)	N/A	N/A		3
Amortization of prior service cost	1,527	1,542	11	21
Recognized net actuarial loss	1,002	2,404	656	961
Net periodic benefit cost	$ 6,714	$ 8,546	$ 2,554	$ 3,142

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	Nine months Ended September 30			
	Pension Plan		Other Benefits	
	2014	2013	2014	2013
Service cost	$ 11,973	$ 13,335	$ 4,637	$ 5,025
Interest cost	14,190	12,266	3,995	3,339
Expected return on plan assets	(12,449)	(10,689)	(2,339)	(1,796)
Recognized net initial APBO (1)	N/A	N/A		7
Amortization of prior service cost	4,547	4,624	33	61
Recognized net actuarial loss	3,008	6,852	2,206	2,794
Net periodic benefit cost	$ 21,269	$ 26,388	$ 8,532	$ 9,430

(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 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 September 30, 2014 and December 31, 2013, the outstanding borrowings on the Company and Cal Water lines of credit were $61.7 million and $46.8 million, respectively. For the nine months ended September 30, 2014, the average borrowing rate was 1.16% compared to 2.20% 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 the Company 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 tax accounting method with the IRS to implement tangible property regulations specifically in regards to repairs and maintenance deductions. On September 13, 2013, the U.S. Department of the Treasury and Internal Revenue Service (IRS) issued the final and re-proposed tangible property regulations for repairs and maintenance deductions with an effective date of January 1, 2014. These tax regulations allowed the Company to deduct a

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significant amount of linear asset costs previously capitalized for book and tax purposes. The Company filed a tax accounting method change on its 2013 tax return for the repair and maintenance of linear assets within the guidance of the tangible property regulations. The Company s total federal net operating loss (NOL) was $67.1 million and state net operating loss NOL was $106.0 million as of December 31, 2013. 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.

As of September 30, 2014 the Company had unrecognized tax benefits of approximately $7.3 million. Included in the balance of unrecognized tax benefits is approximately $1.6 million of tax benefits that, if recognized, would result in an adjustment to the Company s effective tax rate. The Company does not expect its unrecognized tax benefits to change significantly within the next twelve months.

The State of Hawaii Department of Taxation is presently auditing the Company s 2010, 2011 and 2012 Hawaii state income tax returns. The State of California Board of Equalization is presently auditing the Company s 2010, 2011, and 2012 sales and use tax filings. The State of California Franchise Tax Board is presently auditing the Company s 2008 through 2011 enterprise zone filings. It is uncertain when the state audits will be completed. The Company believes that the final resolution of the state audits will not have a material impact on its financial condition or results of operations.

Note 9. Regulatory Assets and Liabilities

During 2013, the assigned Administrative Law Judge granted Cal Water s request to continue applying existing rates on and after January 1, 2014 as interim rates and allowed Cal Water to track the difference between interim rates and the new authorized rates in a memorandum account. The Commission issued a final order for Cal Water s 2012 General Rate Case (GRC) on August 14, 2014. The 2012 GRC covers the years 2014, 2015, 2016 and replaces the 2009 GRC which covered the years 2011, 2012 and 2013. The difference between Cal Water s interim rates and the adopted new rates for the first eight months of 2014 resulted in a regulatory receivable of $30.6 million. On September 30, 2014, the Commission authorized recovery of this regulatory receivable through ratepayer surcharges over the next three years. As of September 30, 2014, the interim rates memorandum account balance was recorded as a regulatory balancing account asset of $17.1 million and a regulatory asset of $13.0 million, net of deferred revenues of $0.5 million.

As part of the Cal Water GRC decision, a balancing account for Cal Water s employee and retiree health care plans was authorized with an effective date of January 1, 2014. The health care balancing account is a two-way balancing account that tracks the differences between the adopted rate recovery and actual medical expenses. The health care balancing account allows Cal Water to recover from ratepayers eighty-five percent of any actual medical costs that exceed the adopted rate recovery. If the adopted rate recovery exceeds actual medical costs, Cal Water is required to refund eighty-five percent of the excess to ratepayers. As of September 30, 2014 the health care balancing account was recorded as a regulatory asset of $1.9 million.

The Commission authorized balancing accounts for Cal Water s pension plans and conservation program in the 2009 and 2012 GRC decisions. The pension plan s 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 difference between actual expenses and adopted rate recovery which may result in a regulatory liability if actual conservation expenses are less than adopted. During 2014, the Commission authorized a $6.3 million ratepayer refund for the conservation program balancing account authorized in the 2009 GRC. As of September 30, 2014, the 2009 GRC pension balancing account was recorded as a regulatory asset of $3.0 million and the 2012 GRC pension balancing account was recorded as a regulatory liability of $3.5 million. As of September 30, 2014, the 2009 conservation balancing account was recorded as a regulatory balancing account liability of $4.9 million and the 2012 GRC conservation balancing account was recorded in regulatory and other liabilities of $2.0 million.

Note 10. Commitments 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, 2013. As of September 30, 2014, there were no significant changes from December 31, 2013.

Contingencies

Groundwater Contamination

The Company has undertaken litigation against third parties to recover past and future costs related to ground water contamination in the Company s service areas. The cost of litigation is expensed as incurred and any settlement is first offset against such costs. 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 shareholders, 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.

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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 $2.7 million and $1.3 million for all known legal matters as of September 30, 2014 and December 31, 2013, 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, dependent on the nature of the settlement.

Note 11. Fair Value of Financial Assets and Liabilities

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 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 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.

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.

		September 30, 2014			
		Fair Value			
	Cost	Level 1	Level 2	Level 3	Total
Long -term debt, including current maturities	$ 429,444		$ 526,733		$ 526,733
Advances for construction	182,172		74,389		74,389
Total	$ 611,616	$	$ 601,122	$	$ 601,122

		December 31, 2013			
		Fair Value			
	Cost	Level 1	Level 2	Level 3	Total
Long -term debt, including current maturities	$ 434,050	$	$ 511,146	$	$ 511,146
Advances for construction	183,393		73,389		73,389
Total	$ 617,443		$ 584,535	$	$ 584,535

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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. As a result of these guarantee arrangements, we are required to present the following condensed consolidating financial information.

The following tables present the condensed consolidating balance sheets as of September 30, 2014 and December 31, 2013, the condensed consolidating statements of income for the three months ended September 30, 2014 and 2013, the condensed consolidating statements of income for the nine months ended September 30, 2014 and 2013 and the condensed consolidating statements of cash flows for the nine months ended September, 2014 and 2013 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 non-guarantor consolidated subsidiaries of California Water Service Group.

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING BALANCE SHEET

As of September 30, 2014

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS					
Utility plant:					
Utility plant	$ 1,318	$ 2,120,177	$ 192,129	$ (7,197)	$ 2,306,427
Less accumulated depreciation and amortization	(320)	(705,851)	(41,266)	1,695	(745,742)
Net utility plant	998	1,414,326	150,863	(5,502)	1,560,685
Current assets:					
Cash and cash equivalents	1,316	26,218	1,951		29,485
Receivables and unbilled revenue	(756)	118,265	9,976	(94)	127,391
Receivables from affiliates	22,242	977	95	(23,314)	
Other current assets	107	19,078	1,217		20,402
Total current assets	22,909	164,538	13,239	(23,408)	177,278
Other assets:					
Regulatory assets		274,509	2,967		277,476
Investments in affiliates	633,705			(633,705)	
Long-term affiliate notes receivable	25,516			(25,516)	
Other assets	1,037	48,729	4,287	(412)	53,641
Total other assets	660,258	323,238	7,254	(659,633)	331,117
	$ 684,165	$ 1,902,102	$ 171,356	$ (688,543)	$ 2,069,080
CAPITALIZATION AND LIABILITIES					
Capitalization:					
Common stockholders equity	$ 622,282	$ 564,803	$ 74,304	$ (639,107)	$ 622,282
Affiliate long-term debt			25,516	(25,516)	
Long-term debt, less current maturities		421,909	916		422,825
Total capitalization	622,282	986,712	100,736	(664,623)	1,045,107
Current liabilities:					
Current maturities of long-term debt		6,164	455		6,619
Short-term borrowings	61,715				61,715
Payables to affiliates		1,813	21,501	(23,314)	
Accounts payable		68,659	3,208		71,867
Accrued expenses and other liabilities	168	71,269	3,818	(42)	75,213
Total current liabilities	61,883	147,905	28,982	(23,356)	215,414
Unamortized investment tax credits		2,106			2,106
Deferred income taxes, net		206,552	4,369	(564)	210,357
Pension and postretirement benefits other than pensions		153,085			153,085
Regulatory and other liabilities		82,757	8,956		91,713
Advances for construction		181,514	658		182,172
Contributions in aid of construction		141,471	27,655		169,126
	$ 684,165	$ 1,902,102	$ 171,356	$ (688,543)	$ 2,069,080

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING BALANCE SHEET

As of December 31, 2013

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS					
Utility plant:					
Utility plant	$ 1,318	$ 2,034,935	$ 184,272	$ (7,197)	$ 2,213,328
Less accumulated depreciation and amortization	(164)	(661,780)	(37,168)	1,615	(697,497)
Net utility plant	1,154	1,373,155	147,104	(5,582)	1,515,831
Current assets:					
Cash and cash equivalents	5,280	20,790	1,436		27,506
Receivables and unbilled revenue	(756)	90,008	8,931	(94)	98,089
Receivables from affiliates	16,747	5,755		(22,502)	
Other current assets		13,011	884		13,895
Total current assets	21,271	129,564	11,251	(22,596)	139,490
Other assets:					
Regulatory assets		248,938	2,743		251,681
Investments in affiliates	565,347			(565,347)	
Long-term affiliate notes receivable	26,255			(26,255)	
Other assets	1,120	44,827	7,111	(205)	52,853
Total other assets	592,722	293,765	9,854	(591,807)	304,534
	$ 615,147	$ 1,796,484	$ 168,209	$ (619,985)	$ 1,959,855
CAPITALIZATION AND LIABILITIES					
Capitalization:					
Common stockholders equity	$ 598,756	$ 500,290	$ 70,548	$ (570,838)	$ 598,756
Affiliate long-term debt			26,255	(26,255)	
Long-term debt, less current maturities		424,854	1,288		426,142
Total capitalization	598,756	925,144	98,091	(597,093)	1,024,898
Current liabilities:					
Current maturities of long-term debt		6,137	1,771		7,908
Short-term borrowings	16,815	30,000			46,815
Payables to affiliates	48		22,454	(22,502)	
Accounts payable		51,764	3,323		55,087
Accrued expenses and other liabilities	107	55,346	1,321		56,774
Total current liabilities	16,970	143,247	28,869	(22,502)	166,584
Unamortized investment tax credits		2,106			2,106
Deferred income taxes, net	(579)	179,870	4,344	(390)	183,245
Pension and postretirement benefits other than pensions		145,451			145,451
Regulatory and other liabilities		77,627	8,828		86,455
Advances for construction		182,776	617		183,393
Contributions in aid of construction		140,263	27,460		167,723
	$ 615,147	$ 1,796,484	$ 168,209	$ (619,985)	$ 1,959,855

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING STATEMENT OF INCOME

For the three months ended September 30, 2014

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	$	$ 180,768	$ 10,416	$	$ 191,184
Operating expenses:					
Operations:					
Water production costs		64,332	2,648		66,980
Administrative and general	34	21,282	2,449		23,765
Other		14,161	1,657	(126)	15,692
Maintenance		4,620	180		4,800
Depreciation and amortization	57	13,692	926	(27)	14,648
Income tax (benefit) expense	(79)	18,632	393	287	19,233
Taxes other than income taxes		4,409	823		5,232
Total operating expenses	12	141,128	9,076	134	150,350
Net operating (loss) income	(12)	39,640	1,340	(134)	40,834
Other Income and Expenses:					
Non-regulated revenue	448	4,027	446	(512)	4,409
Non-regulated expenses, net		(4,538)	(274)		(4,812)
Income tax (expense) on other income and expense	(182)	207	(132)	276	169
Net other income	266	(304)	40	(236)	(234)
Interest:					
Interest expense	103	7,030	473	(385)	7,221
Less: capitalized interest		(252)	(19)		(271)
Net interest expense	103	6,778	454	(385)	6,950
Equity earnings of subsidiaries	33,499			(33,499)	
Net income (loss)	$ 33,650	$ 32,558	$ 926	$ (33,484)	$ 33,650

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING STATEMENT OF INCOME

For the three months ended September 30, 2013

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	$	$ 174,699	$ 9,705	$	$ 184,404
Operating expenses:					
Operations:					
Water production costs		67,981	2,633		70,614
Administrative and general		22,354	2,316		24,670
Other		15,883	1,900	(126)	17,657
Maintenance		4,382	193		4,575
Depreciation and amortization	14	13,714	805	(28)	14,505
Income tax (benefit) expense	(17)	10,721	107	354	11,165
Taxes other than income taxes		4,680	734		5,414
Total operating (income) expenses	(3)	139,715	8,688	200	148,600
Net operating income (loss)	3	34,984	1,017	(200)	35,804
Other Income and Expenses:					
Non-regulated revenue	572	3,385	475	(783)	3,649
Non-regulated expenses, net		(2,515)	(310)		(2,825)
Income tax (expense) on other income and expense	(232)	(355)	(85)	342	(330)
Net other income (expense)	340	515	80	(441)	494
Interest:					
Interest expense	30	7,608	707	(658)	7,687
Less: capitalized interest		(495)	(45)		(540)
Net interest expense	30	7,113	662	(658)	7,147
Equity earnings of subsidiaries	28,838			(28,838)	
Net income (loss)	$ 29,151	$ 28,386	$ 435	$ (28,821)	$ 29,151

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING STATEMENT OF INCOME

For the nine months ended September 30, 2014

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	$	$ 434,857	$ 25,258	$	$ 460,115
Operating expenses:					
Operations:					
Water production costs		167,214	7,083		174,297
Administrative and general	67	65,144	7,491		72,702
Other		43,186	5,264	(378)	48,072
Maintenance		14,276	517		14,793
Depreciation and amortization	157	43,607	3,104	(80)	46,788
Income tax (benefit) expense	(184)	22,713	(686)	741	22,584
Taxes other than income taxes		13,552	2,049		15,601
Total operating expenses	40	369,692	24,822	283	394,837
Net operating (loss) income	(40)	65,165	436	(283)	65,278
Other Income and Expenses:					
Non-regulated revenue	1,365	11,264	1,193	(1,659)	12,163
Non-regulated expenses, net		(10,286)	(898)		(11,184)
Income tax (expense) on other income and expense	(556)	(399)	(144)	708	(391)
Net other income	809	579	151	(951)	588
Interest:					
Interest expense	228	20,974	1,452	(1,281)	21,373
Less: capitalized interest		(790)	(61)		(851)
Net interest expense	228	20,184	1,391	(1,281)	20,522
Equity earnings of subsidiaries	44,803			(44,803)	
Net income (loss)	$ 45,344	$ 45,560	$ (804)	$ (44,756)	$ 45,344

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING STATEMENT OF INCOME

For the nine months ended September 30, 2013

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	$	$ 425,860	$ 24,543	$	$ 450,403
Operating expenses:					
Operations:					
Water production costs		164,524	7,432		171,956
Administrative and general		65,423	7,683		73,106
Other		45,490	5,220	(378)	50,332
Maintenance		12,376	520		12,896
Depreciation and amortization	42	41,168	2,499	(84)	43,625
Income tax (benefit) expense	(246)	19,807	(1,064)	1,070	19,567
Taxes other than income taxes		14,549	2,015		16,564
Total operating (income) expenses	(204)	363,337	24,305	608	388,046
Net operating income (loss)	204	62,523	238	(608)	62,357
Other Income and Expenses:					
Non-regulated revenue	1,739	9,572	1,415	(2,340)	10,386
Non-regulated expenses, net		(7,308)	(1,174)		(8,482)
Income tax (expense) on other income and expense	(708)	(923)	(169)	1,035	(765)
Net other income (expenses)	1,031	1,341	72	(1,305)	1,139
Interest:					
Interest expense	563	22,966	1,961	(1,963)	23,527
Less: capitalized interest		(1,279)	(340)		(1,619)
Net interest expense	563	21,687	1,621	(1,963)	21,908
Equity earnings of subsidiaries	40,916			(40,916)	
Net income (loss)	$ 41,588	$ 42,177	$ (1,311)	$ (40,866)	$ 41,588

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

For the nine months ended September 30, 2014

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating activities:					
Net income (loss)	$ 45,344	$ 45,560	$ (804)	$ (44,756)	$ 45,344
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Equity earnings of subsidiaries	(44,803)			44,803	
Dividends received from affiliates	23,295			(23,295)	
Depreciation and amortization	157	45,059	3,345	(80)	48,481
Changes in value of life insurance contracts		(501)			(501)
Other changes in noncurrent assets and liabilities	2,160	11,539	(392)	33	13,340
Changes in operating assets and liabilities:	(68)	(7,969)	1,540		(6,497)
Net cash provided by operating activities	26,085	93,688	3,689	(23,295)	100,167
Investing activities:					
Utility plant expenditures		(81,505)	(4,753)		(86,258)
Investment in affiliates	(46,850)			46,850	
Changes in affiliate advances	(5,455)	4,778	(200)	877	
Proceeds from affiliates long-term debt	699			(699)	
Purchase of life insurance contracts		(3,207)			(3,207)
Changes in restricted cash		354			354
Net cash (used in) investing activities	(51,606)	(79,580)	(4,953)	47,028	(89,111)
Financing Activities:					
Short-term borrowings	64,900	35,000			99,900
Repayment of short-term borrowings	(20,000)	(65,000)			(85,000)
Investment from affiliates		42,000	4,850	(46,850)	
Changes in affiliate advances	(48)	1,814	(889)	(877)	
Repayment of affiliates long-term borrowings			(699)	699	
Repayment of long-term debt		(2,919)	(1,685)		(4,604)
Advances and contributions in aid for construction		8,239	541		8,780
Refunds of advances for construction		(4,809)	(49)		(4,858)
Dividends paid to non-affiliates	(23,295)				(23,295)
Dividends paid to affiliates		(23,005)	(290)	23,295	
Net cash (used in) provided by financing activities	21,557	(8,680)	1,779	(23,733)	(9,077)
Change in cash and cash equivalents	(3,964)	5,428	515		1,979
Cash and cash equivalents at beginning of period	5,280	20,790	1,436		27,506
Cash and cash equivalents at end of period	$ 1,316	$ 26,218	$ 1,951	$	$ 29,485

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

For the nine months ended September 30, 2013

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating activities:					
Net income (loss)	$ 41,588	$ 42,177	$ (1,311)	$ (40,866)	$ 41,588
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Equity earnings of subsidiaries	(40,916)			40,916	
Dividends received from affiliates	21,981			(21,981)	
Depreciation and amortization	42	42,509	2,600	(84)	45,067
Change in value of life insurance contracts		(1,147)			(1,147)
Other changes in noncurrent assets and liabilities	1,164	12,415	(29)	(49)	13,501
Changes in operating assets and liabilities	390	4,220	(1,803)	83	2,890
Net cash provided by (used in) operating activities	24,249	100,174	(543)	(21,981)	101,899
Investing activities:					
Utility plant expenditures	(640)	(84,688)	(9,454)		(94,782)
Investment in affiliates	(35,000)			35,000	
Net changes in affiliate advances	(9,583)	(2,359)	1,141	10,801	
Repayment of affiliates long-term debt	913	7,797		(8,710)	
Purchase of life insurance		(3,204)			(3,204)
Changes in restricted cash and other changes, net		1,148			1,148
Net cash (used in) investing activities	(44,310)	(81,306)	(8,313)	37,091	(96,838)
Financing Activities:					
Short-term borrowings	15,315	20,000			35,315
Repayment of short-term borrowings	(68,275)	(45,000)			(113,275)
Proceeds from long-term debt			48		48
Repayment of long-term debt		(2,531)	(527)		(3,058)
Net changes in affiliate advances		(972)	11,773	(10,801)	
Repayment of affiliates long-term debt	(7,796)		(914)	8,710	
Advances and contributions in aid for construction		7,545	32		7,577
Refunds of advances for construction		(5,184)	(46)		(5,230)
Dividends paid to non-affiliates	(21,981)				(21,981)
Dividends paid to affiliates		(19,790)	(2,191)	21,981	
Issuance of common stock, net	105,600				105,600
Investment from affiliates		35,000		(35,000)	
Net cash provided by (used in) financing activities	22,863	(10,932)	8,175	(15,110)	4,996
Change in cash and cash equivalents	2,802	7,936	(681)		10,057
	1,470	34,609	2,711		38,790

Cash and cash equivalents at beginning of period										
Cash and cash equivalents at end of period	$	4,272	$	42,545	$	2,030	$		$	48,847

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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;

- 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;

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- 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;
- our general economic conditions, including changes in customer growth patterns and the Company s ability to collect billed revenue from customers;
- changes in customer water use patterns and the effects of conservation;
- the impact of weather and climate on water sales and operating results;
- the ability to satisfy requirements related to the Sarbanes-Oxley and Dodd-Frank Acts, and other regulations on internal controls;
- the unknown impact of contagious diseases, such as Ebola, avian flu, H1N1 flu and severe accute respiratory syndrome (SARs), on the Company s operations;
- the impact of cyber security breaches on the Company s financial, human resources, and operational information systems; 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.

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 2013 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 nine-month period ended September 30, 2014, 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.

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RESULTS OF THIRD QUARTER 2014 OPERATIONS COMPARED TO

THIRD QUARTER 2013 OPERATIONS

Amounts in thousands except share data

Overview

Net income for the three month period ended September 30, 2014 was $33.7 million or $0.70 per diluted common share compared to net income of $29.2 million or $0.61 per diluted common share for the three month period ended September 30, 2013. Net income increased $4.5 million during the third quarter of 2014 compared to the third quarter of 2013. The increase was mostly due to net rate increases from the Cal Water 2012 General Rate Case (GRC) decision and a smaller effect from reductions to administrative and general, other operations, net interest and property tax expenses. The Cal Water GRC decision was authorized during the third quarter of 2014 and as a result, the Company realized an increase in net income of $8.5 million during the three months ended September 30, 2014. This increase relates to rate increases and regulatory mechanisms associated with the 2012 GRC. The increase to net income was partially offset by increases in income tax, maintenance, and depreciation and amortization expenses. The increase to income taxes during the third quarter of 2014 was due mostly to an increase in net operating income and a decrease in tax benefits during the third quarter of 2014 compared to the prior year. Net other (loss) income, was a loss of $0.2 million during the third quarter of 2014 compared to income of $0.5 million during the three month period ended September 30, 2013. The decrease of $0.7 million was mostly due to an increase in corporate development costs during the third quarter of 2014 compared to the prior year.

Operating Revenue

Operating revenue increased $6.8 million or 3.7% to $191.2 million in the third quarter of 2014. As a result of the authorized rate design in the 2012 GRC, Cal Water s revenue shifted from quantity based WRAM revenue to fixed rate charge revenue. Fixed rate charge revenue is primarily service fee revenue but also includes unmetered flat revenue. The factors that impacted the operating revenue for the third quarter of 2014 as compared to 2013 are as follows:

Net change in service, flat, and other revenue	$	22,167
Health care balancing account		1,949
Pension balancing account		(18)
Conservation balancing account		(636)
Deferral of revenue		(1,650)
Net effect of WRAM		(15,032)
Net operating revenue increase	$	6,780

The net change in to service, flat and other revenue in the above table was mainly driven by an increase in service charge revenue related to the 2012 GRC as there was a shift from quantity to service charge revenue. Service, flat and other revenue of $21.6 million was recorded as interim rates revenue for the first 8 months of 2014. The remaining revenue increase relates to rate increases in 2014 compared to 2013.

The health care balancing account in the above table refers to the difference between actual expenses and adopted rate recovery. The increase of $1.9 million is due to higher actual health care expenses as compared to adopted rate recovery in 2014.

The conservation balancing account in the above table refers to the difference between actual expenses and adopted rate recovery. The decrease of $0.6 million is due to lower actual conservation expenses as compared to adopted rate recovery in 2014.

The deferral of 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 deferral in 2014 has decreased because of an increase in actual consumption relative to adopted consumption, which has caused a decrease in the net receivables that are expected to be collected more than 24 months after the respective reporting period in which it was recognized.

The net effect of WRAM in the above table was 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 adjustment to 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. WRAM revenue decreased $23.0 million during the three months ended September 30, 2014 compared to the three months ended September 30, 2013 due to a decrease in the sales forecast in the 2012 GRC decision. This was partially offset by an increase in the MCBA adjustment of $8.0 million during the three months ended September 30, 2014 compared to the three months ended September 30, 2013 as actual MCBA costs relative to adopted costs has increased.