

CALIFORNIA WATER SERVICE GROUP

Form 10-Q

April 25, 2019

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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, 2019

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** **77-0448994**

(State or other jurisdiction (I.R.S. Employer identification No.)  
of incorporation or organization)

**1720 North First Street, San Jose, CA 95112**

(Address of principal executive offices) (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 every Interactive Data File required to be submitted 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). Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Common shares outstanding as of March 31, 2019 -48,134,000

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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, 2019	December 31, 2018
<b>ASSETS</b>		
<b>Utility plant:</b>		
Utility plant	\$3,281,149	\$3,229,446
Less accumulated depreciation and amortization	(1,021,590 )	(996,723 )
Net utility plant	2,259,559	2,232,723
<b>Current assets:</b>		
Cash and cash equivalents	60,234	47,176
Receivables:		
Customers	27,552	30,037
Regulatory balancing accounts	37,130	42,394
Other	19,460	17,101
Unbilled revenue	24,675	33,427
Materials and supplies at weighted average cost	6,444	6,586
Taxes, prepaid expenses, and other assets	17,230	11,981
Total current assets	192,725	188,702
<b>Other assets:</b>		
Regulatory assets	366,921	353,569
Goodwill	2,615	2,615
Other assets	78,842	60,095
Total other assets	448,378	416,279
<b>TOTAL ASSETS</b>	<b>\$2,900,662</b>	<b>\$2,837,704</b>
<b>CAPITALIZATION AND LIABILITIES</b>		
<b>Capitalization:</b>		
Common stock, \$0.01 par value; 68,000 shares authorized, 48,134 and 48,065 outstanding in 2019 and 2018, respectively	\$481	\$481
Additional paid-in capital	338,728	337,623
Retained earnings	374,920	392,053
Total common stockholders' equity	714,129	730,157
Long-term debt, net	710,602	710,027
Total capitalization	1,424,731	1,440,184
<b>Current liabilities:</b>		
Current maturities of long-term debt, net	105,010	104,911
Short-term borrowings	125,100	65,100
Accounts payable	83,280	95,580
Regulatory balancing accounts	19,984	12,213
Accrued interest	12,181	5,674
Accrued expenses and other liabilities	38,488	37,688
Total current liabilities	384,043	321,166
<b>Unamortized investment tax credits</b>	<b>1,649</b>	<b>1,649</b>
<b>Deferred income taxes</b>	<b>211,382</b>	<b>213,033</b>

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<b>Pension and postretirement benefits other than pensions</b>	200,953	193,538
<b>Regulatory liabilities and other</b>	264,555	256,522
<b>Advances for construction</b>	186,877	186,342
<b>Contributions in aid of construction</b>	226,472	225,270
<b>Commitments and contingencies (Note 10)</b>		
<b>TOTAL CAPITALIZATION AND LIABILITIES</b>	<b>\$2,900,662</b>	<b>\$2,837,704</b>

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

Unaudited (In thousands, except per share data)

For the three months ended	March 31, 2019	March 31, 2018
<b>Operating revenue</b>	\$ 126,111	\$ 134,553
<b>Operating expenses:</b>		
Operations:		
Water production costs	45,592	47,606
Administrative and general	29,097	26,319
Other operations	17,821	17,640
Maintenance	6,455	5,439
Depreciation and amortization	22,368	20,715
Income tax (benefit) expense	(2,991 )	294
Property and other taxes	7,293	6,704
Total operating expenses	125,635	124,717
Net operating income	476	9,836
<b>Other income and expenses:</b>		
Non-regulated revenue	4,901	4,419
Non-regulated expenses	(2,219 )	(5,437 )
Other components of net periodic benefit cost	(1,259 )	(2,546 )
Allowance for equity funds used during construction	1,533	911
Income tax (expense) benefit on other income and expenses	(828 )	758
Net other income (loss)	2,128	(1,895 )
<b>Interest expense:</b>		
Interest expense	11,075	9,198
Allowance for borrowed funds used during construction	(831 )	(495 )
Net interest expense	10,244	8,703
<b>Net loss</b>	\$(7,640 )	\$(762 )
<b>Loss per share:</b>		
Basic	\$(0.16 )	\$(0.02 )
Diluted	(0.16 )	(0.02 )
<b>Weighted average shares outstanding:</b>		
Basic	48,086	48,030
Diluted	48,086	48,030

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements



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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

Unaudited (In thousands)

<b>For the three months ended:</b>	<b>March 31, 2019</b>	<b>March 31, 2018</b>
<b>Operating activities:</b>		
Net loss	\$(7,640 )	\$(762 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	22,893	21,207
Change in value of life insurance contracts	(2,254 )	1,137
Allowance for equity funds used during construction	(1,533 )	(911 )
Changes in operating assets and liabilities:		
Receivables and unbilled revenue	5,147	5,438
Accounts payable	(4,233 )	(7,015 )
Other current assets	(5,027 )	(1,727 )
Other current liabilities	5,268	6,385
Other changes in noncurrent assets and liabilities	7,520	4,500
<b>Net cash provided by operating activities</b>	<b>20,141</b>	<b>28,252</b>
<b>Investing activities:</b>		
Utility plant expenditures	(59,881 )	(70,650 )
<b>Net cash used in investing activities</b>	<b>(59,881 )</b>	<b>(70,650 )</b>
<b>Financing activities:</b>		
Short-term borrowings	60,000	45,022
Repayment of short-term borrowings	—	(45,022 )
Repayment of long-term debt	(226 )	(10,224 )
Advances and contributions in aid of construction	6,044	4,763
Refunds of advances for construction	(1,790 )	(1,918 )
Repurchase of common stock	(2,074 )	(1,239 )
Issuance of common stock	454	—
Dividends paid	(9,493 )	(9,003 )
<b>Net cash provided by (used in) financing activities</b>	<b>52,915</b>	<b>(17,621 )</b>
<b>Change in cash, cash equivalents, and restricted cash</b>	<b>13,175</b>	<b>(60,019 )</b>
<b>Cash, cash equivalents, and restricted cash at beginning of period</b>	<b>47,715</b>	<b>95,352</b>
<b>Cash, cash equivalents, and restricted cash at end of period</b>	<b>\$60,890</b>	<b>\$35,333</b>
<b>Supplemental information:</b>		
Cash paid for interest (net of amounts capitalized)	\$3,352	\$1,251
<b>Supplemental disclosure of non-cash activities:</b>		
Accrued payables for investments in utility plant	\$29,737	\$28,367
Utility plant contribution by developers	\$4,111	\$4,518
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, 2019

Dollar amounts in thousands unless otherwise stated

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 condensed consolidated 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 unaudited condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2018, included in its annual report on Form 10-K as filed with the SEC on February 28, 2019.

The preparation of the Company's unaudited condensed consolidated interim 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 unaudited condensed consolidated interim financial statements reflect all adjustments, consisting of normal recurring transactions that are necessary to provide a fair presentation of the results for the periods covered.

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

Operating revenue

The following table disaggregates the Company's operating revenue by source for the three months ended March 31, 2019 and 2018:

Three Months Ended	
March 31	
2019	2018

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Revenue from contracts with customers	\$117,410	\$134,254
Regulatory balancing account revenue	8,701	299
Total operating revenue	\$126,111	\$134,553

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Table of Contents*Revenue from contracts with customers*

The Company principally generates operating revenue from contracts with customers by providing regulated water and wastewater services at tariff-rates authorized by the Commissions in the states in which they operate and non-regulated water and wastewater services at rates authorized by contracts with government agencies. Revenue from contracts with customers reflects amounts billed for the volume of consumption at authorized per unit rates, for a service charge, and for other authorized charges.

The Company satisfies its performance obligation to provide water and wastewater services over time as services are rendered. The Company applies the invoice practical expedient and recognizes revenue from contracts with customers in the amount for which the Company has a right to invoice. The Company has a right to invoice for the volume of consumption, for the service charge, and for other authorized charges.

The measurement of sales to customers is generally based on the reading of their meters, which occurs on a systematic basis throughout the month. At the end of each month, the Company estimates consumption since the date of the last meter reading and a corresponding unbilled revenue is recognized. The estimate is based upon the number of unbilled days that month and the average daily customer billing rate from the previous month (which fluctuates based upon customer usage).

Contract terms are generally short-term and at will by customers and, as a result, no separate financing component is recognized for the Company's collections from customers, which generally require payment within 30 days of billing. The Company applies judgment, based principally on historical payment experience, in estimating its customers' ability to pay.

Certain customers are not billed for volumetric consumption, but are instead billed a flat rate at the beginning of each monthly service period. The amount billed is initially deferred and subsequently recognized over the monthly service period, as the performance obligation is satisfied. The deferred revenue balance or contract liability, which is included in "accrued expenses and other liabilities" on the consolidated balance sheets, is inconsequential.

In the following table, revenue from contracts with customers is disaggregated by class of customers for the three months ended March 31, 2019 and 2018:

	<b>Three Months Ended</b>	
	<b>March 31</b>	
	2019	2018
Residential	\$84,259	\$91,319
Business	25,481	27,057
Industrial	7,264	7,579
Public authorities	4,471	5,444
Other (a)	(4,065)	2,855
Total revenue from contracts with customers	\$117,410	\$134,254

(a) Other includes the accrued unbilled revenue.

*Regulatory balancing account revenue*

The Company's ability to recover revenue requirements authorized by the California Public Utilities Commission (CPUC) in its triennial General Rate Case (GRC), is decoupled from the volume of the sales. Regulatory balancing account revenue is revenue related to rate mechanisms authorized in California by the CPUC, which allow the Company to recover the authorized revenue and are not considered contracts with customers.

The Water Revenue Adjustment Mechanism (WRAM) allows the Company to recognize the adopted level of volumetric revenues. The variance between adopted volumetric revenues and actual billed volumetric revenues for metered accounts is recorded as regulatory balancing account revenue.

Cost-recovery rates, such as the Modified Cost Balancing Account (MCBA), provide for recovery of the adopted levels of expenses for purchased water, purchased power, pump taxes, water conservation program costs, pension, and health care. Variances between adopted and actual costs are recorded as regulatory balancing account revenue.

Each district's WRAM and MCBA regulatory assets and liabilities are allowed to be netted against one another. The Company recognizes regulatory balancing account revenues that have been authorized for rate recovery, are objectively determinable and probable of recovery, and are expected to be collected within 24 months. To the extent that regulatory balancing account revenue is estimated to be collectible beyond 24 months, recognition is deferred.

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The following table disaggregates the Company's non-regulated revenue by source for the three months ended March 31, 2019 and 2018:

	Three Months Ended March 31	
	2019	2018
Operating and maintenance revenue	\$3,046	\$3,165
Other non-regulated revenue	1,296	743
Non-regulated revenue from contracts with customers	\$4,342	\$3,908
Lease revenue	\$559	\$511
Total non-regulated revenue	\$4,901	\$4,419

Operating and maintenance services are provided for non-regulated water and wastewater systems owned by private companies and municipalities. The Company negotiates formal agreements with the customers, under which they provide operating, maintenance and customer billing services related to the customers' water system. The formal agreements outline the fee schedule for the services provided. The agreements typically call for a fee-per-service or a flat-rate amount per month. The Company satisfies its performance obligation of providing operating and maintenance services over time as services are rendered; as a result, the Company employs the invoice practical expedient and recognizes revenue in the amount that it has the right to invoice. Contract terms are generally short-term and, as a result, no separate financing component is recognized for its collections from customers, which generally require payment within 30 days of billing.

Other non-regulated revenue primarily relates to services for the design and installation of water mains and other water infrastructure for customers outside the regulated service areas and insurance program administration.

Lease revenue is not considered revenue from contracts with customers and is recognized following operating lease standards. The Company is the lessor in operating lease agreements with telecommunications companies under which cellular phone antennas are placed on the Company's property. The company provides the lessee the right to ingress and egress across lessor property to access the Land. The minimum rents are recognized on a straight-line basis over the terms of the leases, which may span multiple years. The excess rents are recognized over amounts contractually due pursuant to the underlying leases and is included in a deferred receivable account in the accompanying balance sheet. The leases generally have terms of 5 years to 10 years, with lessee options to extend the lease for up to 15 years. The exercise of lease renewal options is at the lessee's sole discretion. Most of the Company's lease agreements contain mutual termination options that require prior written notice by either lessee or lessor to be invoked. A subset of the Company's leases contains variable lease payments that depend on changes in the consumer price index (CPI).

The Company determines if an arrangement is a lease at inception. Generally, a lease agreement exists if the Company determines that the arrangement gives the lessee control over the use of an identified asset and obtains substantially all of the benefits from the identified asset.

Maturities of lease payments to be received are as follows:

Year Ending December 31,	Operating Leases
2019	\$ 3,032
2020	2,482
2021	1,809
2022	1,013
2023	534
Thereafter	828



Table of ContentsCash, Cash Equivalents, and Restricted Cash

The following table provides a reconciliation of cash, cash equivalents, and restricted cash within the Condensed Consolidated Balance Sheets that sum to the total of the same such amounts shown on the Condensed Consolidated Statements of Cash Flows:

	March 31, 2019	December 31, 2018
Cash and cash equivalents	60,234	47,176
Restricted cash (included in "taxes, prepaid expenses and other assets")	656	539
Total cash, cash equivalents, and restricted cash shown in the statements of cash flows	\$60,890	\$47,715

Adoption of New Accounting Standards

In February of 2016, the FASB issued guidance on leases, with amendments in 2018. The guidance requires lessees to recognize an asset and liability on the balance sheet for all of their lease obligations. Operating leases were previously not recognized on the balance sheet.

The Company adopted the standard using the modified retrospective method for its existing leases and did not restate its comparative periods in the period of adoption. The Company completed its review of its lease portfolio including significant leases and the Company designed and implemented new controls as part of the adoption of the new standard. The implementation increased lease assets and lease liabilities on the Consolidated Balance Sheets by \$13.8 million as of January 1, 2019.

The Company elected certain practical expedients and carried forward historical conclusions related to (1) contracts that contain leases, (2) existing lease classification for any expired or existing leases, and (3) initial direct costs for any existing leases. The Company also applied the practical expedient that allows the Company to elect, as an accounting policy, by asset class, to include both lease and nonlease components as a single component and account for it as a lease. The Company applied the short-term lease exception for lessees which allowed the Company to not have to apply the recognition requirements of the new leasing guidance for short-term leases and to recognize lease payments in net income on a straight line basis over the lease term. Otherwise, the new standard did not have a material impact on the remaining consolidated financial statements.

## Note 3. Stock-based Compensation

Equity Incentive Plan

During the three months ended March 31, 2019 and 2018, the Company granted annual Restricted Stock Awards (RSAs) of 36,183 and 46,135, respectively, to officers and directors of the Company. During those same periods, 8,334 and 9,464 RSAs, respectively, were canceled. RSAs granted to officers vest over 36 months with the first year cliff vesting. RSAs granted to directors generally vest at the end of 12 months. During the first three months of 2019 and 2018, the RSAs granted were valued at \$52.83 and \$35.40 per share, respectively, based upon the fair value of the Company's common stock on the date of grant.

During the three months ended March 31, 2019 and 2018, the Company granted 26,473 and 28,594 performance-based Restricted Stock Unit Awards (RSUs), respectively, to officers. During those same periods, the Company issued 62,726 RSUs and 48,753 RSUs, respectively, to officers, and canceled 31,177 RSUs and 24,009 RSUs, respectively. Each RSU award reflects a target number of shares that may be issued to the award recipient. The 2019 and 2018 awards may be earned upon completion of the three-year performance period and are recognized as expense ratably over the period using a fair value of \$52.83 per share and \$35.40 per share, respectively, and an estimate of RSUs earned during the period. The Company has recorded compensation costs for the RSAs and RSUs in administrative and general operating expenses in the amount of \$2.7 million and \$0.7 million for the three months ended March 31, 2019 and 2018, respectively.



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## Note 4. Equity

The Company's changes in total common stockholders' equity for the three months ended March 31, 2019 and 2018 were as follows:

	Three months ended March 31, 2019				Total Stockholders' Equity
	Common Stock Shares	Amount	Additional Paid-in Capital	Retained Earnings	
	(In thousands)				
Balance at January 1, 2019	48,065	\$ 481	\$ 337,623	\$ 392,053	\$ 730,157
Net loss				(7,640 )	(7,640 )
Issuance of common stock	109	—	3,179	—	3,179
Repurchase of common stock	(40 )	—	(2,074 )	—	(2,074 )
Dividends paid on common stock (\$0.1975 per share)				(9,493 )	(9,493 )
Balance at March 31, 2019	48,134	481	338,728	374,920	714,129
	Three months ended March 31, 2018				
	Common Stock Shares	Amount	Additional Paid-in Capital	Retained Earnings	Total Stockholders' Equity
	(In thousands)				
Balance at January 1, 2018	48,012	\$ 480	\$ 336,229	\$ 362,512	\$ 699,221
Net loss				(762 )	(762 )
Issuance of common stock	95	1	635	—	636
Repurchase of common stock	(33 )	—	(1,239 )	—	(1,239 )
Dividends paid on common stock (\$0.1875 per share)				(9,003 )	(9,003 )
Balance at March 31, 2018	48,074	481	335,625	352,747	688,853

## Note 5. Loss Per Share

The computations of basic and diluted loss per share are noted in the table below. Basic loss per share are computed by dividing the net loss 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. RSUs are not included in diluted shares for financial reporting until authorized by the Organization & Compensation Committee of the Board of Directors.

	Three Months Ended March 31	
	2019	2018
	(In thousands, except per share data)	
Net loss available to common stockholders	\$(7,640 )	\$(762 )
Weighted average common shares outstanding, basic	48,086	48,030
Weighted average common shares outstanding, dilutive	48,086	48,030
Loss per share - basic	\$(0.16 )	\$(0.02 )
Loss per share - diluted	\$(0.16 )	\$(0.02 )

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## 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 in 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.

There were no cash contributions made to the pension plans for the three months ended March 31, 2019 and there were cash contributions of \$7.3 million made to the pension plans for the three months ended March 31, 2018. Cash contributions made by the Company related to other postretirement benefit plans were \$1.4 million for the three months ended March 31, 2019 and there were no cash contributions made by the Company related to other postretirement benefit plans for the three months ended March 31, 2018. The total 2019 estimated cash contribution to the pension plans is \$18.8 million and to the other postretirement benefit plans is \$7.9 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 March 31			
	Pension Plan		Other Benefits	
	2019	2018	2019	2018
Service cost	\$6,565	\$7,402	\$1,762	\$2,550
Interest cost	6,642	5,995	1,337	1,484
Expected return on plan assets	(7,567 )	(6,862 )	(1,435 )	(1,416 )
Amortization of prior service cost	1,262	1,263	49	11
Recognized net actuarial loss	1,312	2,797	104	773
Net periodic benefit cost	\$8,214	\$10,595	\$1,817	\$3,402

Service cost portion of the pension plan and other postretirement benefits is recognized in "administrative and general" expenses within the Condensed Consolidated Statements of Income. Other components of net periodic benefit costs include interest costs, expected return on plan assets, amortization of prior service costs, and recognized net actuarial loss and are reported together as "other components of net periodic benefit cost" within the Condensed Consolidated Statements of Income.

## Note 7. Short-term and Long-term Borrowings

On March 29, 2019, the Company and Cal Water entered into certain syndicated credit agreements, which provide for unsecured revolving credit facilities of up to an initial aggregate amount of \$550 million for a term of five years. The revolving credit facilities amend, expand, and replace the Company's and its subsidiaries' prior credit facilities originally entered into on May 10, 2015. The new credit facilities extended the terms until March 29, 2024, and increased Cal Water's unsecured revolving line of credit. The Company and subsidiaries that it designates may borrow up to \$150 million under the Company's revolving credit facility. Cal Water may borrow up to \$400 million under its revolving credit facility; however, all borrowings must be repaid within 24 months unless a different period is required or authorized by the CPUC. Additionally, the credit facilities available to the Company may be increased by up to an incremental \$150 million under the Cal Water facility and \$50 million under the Company facility, subject in each case to certain conditions. The proceeds from the revolving credit facilities may be used for working capital purposes, including the short-term financing of capital projects. Borrowings under the credit facilities typically have

maturities varying between one and six months and will bear interest annually at a rate equal to (i) the base rate or (ii) the Eurodollar rate, plus an applicable margin of 0.650% to 0.875%, depending on the Company and its subsidiaries' consolidated total capitalization 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

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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. The outstanding borrowings on the Company line of credit were \$55.1 million as of March 31, 2019 and December 31, 2018. There were \_\_\_\_\_ and \$10.0 million of borrowings on the \_\_\_\_\_ as of March 31, 2019 and December 31, 2018, respectively. The average borrowing rate for borrowings on the Company and Cal Water lines of credit during the three months ended March 31, 2019 was 3.22% compared to 2.45% for the same period last year.

## Note 8. Income Taxes

The Company adjusts its effective tax rate each quarter to be consistent with the estimated annual effective tax rate. The Company also records the tax effect of unusual or infrequently occurring discrete items.

The provision for income taxes is shown in the tables below:

	<b>Three Months Ended</b>	
	<b>March 31</b>	
	2019	2018
Income tax benefit	\$(2,163)	\$(464)

The income tax benefit increased \$1.7 million to \$2.2 million for the three months ended March 31, 2019 as compared to the three months ended March 31, 2018. The increase is mostly due to an increase in pre-tax loss of \$8.6 million for the three months ended March 31, 2019 as compared to the three months ended March 31, 2018.

The Company's 2019 effective tax rate, before discrete items, is estimated to be 22%.

For the year ended December 31, 2018, the Company recorded a re-measurement of its deferred tax balances (related mostly to timing differences for plant-related items). The final impact of the Tax Cuts and Jobs Act (TCJA) may differ from the recorded amounts, possibly materially, due to regulatory decisions that could differ from the Company's determination of how the impact of the TCJA are allocated between customers and shareholders. In addition, changes in interpretations, guidance on legislative intent, and any changes in accounting standards for income taxes in response to the TCJA could also impact the recorded amounts.

The Company is continuing to work with state regulators to finalize the customer net refund of \$107.0 million to ensure compliance with federal normalization rules and will record any adjustments based on state regulator decision. The Company had unrecognized tax benefits of approximately \$10.1 million and \$8.0 million as of March 31, 2019 and 2018, respectively. Included in the balance of unrecognized tax benefits as of March 31, 2019 and 2018 are approximately \$3.0 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 12 months.

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## Note 9. Regulatory Assets and Liabilities

Regulatory assets and liabilities were comprised of the following as of March 31, 2019 and December 31, 2018:

	Recovery Period	March 31, 2019	December 31, 2018
<i>Regulatory Assets</i>			
Pension and retiree group health	Indefinitely	\$ 156,782	\$ 156,947
Property-related temporary differences (tax benefits flowed through to customers)	Indefinitely	99,971	99,376
Other accrued benefits	Indefinitely	26,453	25,717
Net WRAM and MCBA long-term accounts receivable	1-2 years	27,180	17,134
Asset retirement obligations, net	Indefinitely	18,666	18,197
Interim rates long-term accounts receivable	1 year	4,642	4,642
Tank coating	10 years	11,845	11,196
Health care balancing account	1 year	442	442
Pension balancing account	1 year	17,306	16,494
Other components of net periodic benefit cost	Indefinitely	3,560	3,221
Other regulatory assets	Various	74	203
Total Regulatory Assets		\$ 366,921	\$ 353,569
<i>Regulatory Liabilities</i>			
Future tax benefits due to customers		\$ 180,175	\$ 180,205
Health care balancing account		3,547	3,516
Conservation program		6,931	6,880
Net WRAM and MCBA long-term payable		409	222
Tax accounting memorandum account		646	5,039
Cost of capital memorandum account		127	2,834
1,2,3 trichloropropane settlement proceeds		12,091	12,142
Other regulatory liabilities		212	437
Total Regulatory Liabilities		\$ 204,138	\$ 211,275

Short-term regulatory assets and liabilities are excluded from the above table.

The short-term regulatory assets were \$37.1 million as of March 31, 2019 and \$42.4 million as of December 31, 2018. As of March 31, 2019 and December 31, 2018, the short-term regulatory assets primarily consist of net WRAM and MCBA receivables.

The short-term portions of regulatory liabilities were \$20.0 million as of March 31, 2019 and \$12.2 million as of December 31, 2018. The short-term regulatory liabilities as of March 31, 2019, primarily consist of 1,2,3 trichloropropane (TCP) settlement proceeds, tax accounting memorandum account refunds, and cost of capital memorandum account refunds. As of December 31, 2018, the short-term regulatory liabilities primarily consist of TCP settlement proceeds and net WRAM and MCBA liability balances.

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Note 10. Commitments and Contingencies

Commitments

The Company has significant commitments purchase water from water wholesalers. These commitments are described in Form 10-K for the year ended December 31, 2018.

Leases

The Company has operating and finance leases for water systems, offices, land easements, licenses, equipment, and other facilities. The leases generally have remaining lease terms of 1 year to 50 years, some of which include options to extend the lease for up to 25 years. The exercise of lease renewal options is at the Company's sole discretion. Most of the Company's lease agreements contain mutual termination options that require prior written notice by either lessee or lessor to be invoked. The Company's lease agreements do not contain any material residual value guarantees or material restrictive covenants. Certain leases include options to purchase the leased property. The depreciable life of the assets and leasehold improvements are limited by the expected lease term, unless there is a transfer of title or purchase option reasonably certain of exercise. Leases with an initial term of 12 months or less are not recorded on the balance sheet as the Company applied the short-term lease exception allowed by the lease standard. Lease expense for these leases are recognized on a straight-line basis over the lease term. A subset of the Company's leases contains variable lease payments that depend on changes in the CPI.

The Company determines if an arrangement is a lease at inception. Generally, a lease agreement exists if the Company determines that the arrangement gives the Company control over the use of an identified asset and obtains substantially all of the benefits from the identified asset.

The right-of-use (ROU) assets that are recorded represent the Company's right to use an underlying asset for the lease term and lease liabilities represent the Company's obligation to make lease payments arising from the lease. Lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of the Company's operating leases do not provide an implicit rate, the Company uses an incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. The ROU asset and lease liability may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. Variable lease payments that are based on changes in CPI are included in the measurement of ROU asset and lease liability on the basis of the rate at lease commencement. Subsequent changes to the payments as a result of changes to the CPI rate are recognized in the period in which the obligation of these payments is incurred.

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Supplemental balance sheet information related to leases was as follows:

	<b>Three Months Ended March 31 2019</b>	
<i>Operating leases</i>		
Other assets	\$14,128	
Accrued expenses and other liabilities	\$1,261	
Regulatory liabilities and other	12,851	
Total operating lease liabilities	\$14,112	
<i>Finance leases</i>		
Utility plant	\$19,034	
Accumulated depreciation and amortization	(9,573 )	
Net utility plant	\$9,461	
Current maturities of long-term debt, net	\$639	
Long-term debt, net	6,010	
Total finance lease liabilities	\$6,649	
<i>Weighted average remaining lease term</i>		
Operating leases	160	
	months	
Finance leases	82	
	months	
<i>Weighted average discount rate</i>		
Operating leases	3.7	%
Finance leases	5.6	%

The components of lease expense were as follows:

	<b>Three Months Ended March 31 2019</b>
Operating lease cost	\$ 421
Finance lease cost:	
Amortization of right-of-use assets	\$ 313
Interest on lease liabilities	90
Total finance lease cost	\$ 403
Short-term lease cost	\$ 73
Variable lease cost	66
<b>Total lease cost</b>	<b>\$ 963</b>





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Supplemental cash flow information related to leases was as follows:

	<b>Three Months Ended March 31 2019</b>
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	\$ 338
Operating cash flows from finance leases	90
Financing cash flows from finance leases	171
Non-cash activities: right-of-use assets obtained in exchange for lease obligations:	
Operating leases	582
Finance leases	672

Maturities of lease liabilities are as follows:

Year Ending December 31,	Operating Leases	Finance Leases
2019 (a)	\$ 1,304	\$ 1,139
2020	1,760	1,216
2021	1,538	1,217
2022	1,410	1,217
2023	1,319	1,735
Thereafter	10,764	3,217
Total lease payments	\$ 18,095	\$ 9,741

Less imputed interest \$(3,983 ) \$(3,092 )

**Total** **\$14,112** **\$6,649**

(a) Excludes payments made for the first three months of 2019.

As of December 31, 2018, minimum lease payments under non-cancelable operating leases by period were expected to be as follows:

2019	\$ 1,771
2020	1,709
2021	1,485
2022	1,355
2023	1,261
Thereafter	10,538
Total	\$ 18,119

ContingenciesGroundwater Contamination

The Company has undertaken litigation against third parties to recover past and anticipated costs related to groundwater contamination in our service areas. The cost of litigation is expensed as incurred and any settlement is first offset against such costs. The CPUC's general policy requires all proceeds from groundwater contamination litigation to be used first to pay transactional expenses, then to make customers whole for water treatment costs to comply with the CPUC's water quality standards. The CPUC 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 CPUC 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 CPUC's general policy.



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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. As of March 31, 2019 and December 31, 2018, the Company recognized a liability of \$3.2 million and \$2.3 million, respectively, for known legal matters. 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 hierarchical framework for disclosing the observability of the inputs utilized in measuring assets and liabilities at fair value is established by this guidance. The three levels in the hierarchy are as follows:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Plan has the ability to access.

Level 2 - Inputs to the valuation methodology include:

Quoted market prices for similar assets or liabilities in active markets;

Quoted prices for identical or similar assets or liabilities in inactive markets;

Inputs other than quoted prices that are observable for the asset or liability; and

Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Specific valuation methods include the following:

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 1.70%.

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

	March 31, 2019		
	Cost	Fair Value	
		Level 2	Level 3 Total
Long-term debt, including current maturities, net	\$815,612	—\$868,919	— \$868,919
Advances for construction	186,877	—79,400	— 79,400
Total	\$1,002,489	\$—\$948,319	\$ — \$—948,319



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	December 31, 2018			
	Cost	Fair Value		
		Level 1	Level 2	Level 3 Total
Long-term debt, including current maturities, net	\$814,938	\$—	\$849,551	\$—\$849,551
Advances for construction	186,342	—	77,204	— 77,204
Total	\$1,001,280	—	\$926,755	\$—\$926,755

## Note 12. Condensed Consolidating Financial Statements

On April 17, 2009, Cal Water issued \$100.0 million aggregate principal amount of 5.875% First Mortgage Bonds due 2019, and on November 17, 2010, Cal Water issued \$100.0 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, the Company is required to present the following condensed consolidating financial information. The investments in affiliates are accounted for and presented using the “equity method” of accounting. The following tables present the Condensed Consolidating Balance Sheets as of March 31, 2019 and December 31, 2018, the Condensed Consolidating Statements of Income for the three months ended March 31, 2019 and 2018, and the Condensed Consolidating Statements of Cash Flows for the three months ended March 31, 2019 and 2018 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. No other subsidiary of the Company guarantees the securities.

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

As of March 31, 2019

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
<b>ASSETS</b>					
<b>Utility plant:</b>					
Utility plant	\$ 1,318	\$ 3,070,584	\$ 216,444	\$(7,197 )	\$ 3,281,149
Less accumulated depreciation and amortization	(1,037 )	(961,282 )	(61,389 )	2,118	(1,021,590 )
Net utility plant	281	2,109,302	155,055	(5,079 )	2,259,559
<b>Current assets:</b>					
Cash and cash equivalents	905	47,587	11,742	—	60,234
Receivables and unbilled revenue	157	103,631	5,029	—	108,817
Receivables from affiliates	25,460	2,744	48	(28,252 )	—
Other current assets	505	21,657	1,512	—	23,674
Total current assets	27,027	175,619	18,331	(28,252 )	192,725
<b>Other assets:</b>					
Regulatory assets	—	362,726	4,195	—	366,921
Investments in affiliates	715,928	—	—	(715,928 )	—
Long-term affiliate notes receivable	27,321	—	—	(27,321 )	—
Other assets	451	76,460	4,751	(205 )	81,457
Total other assets	743,700	439,186	8,946	(743,454 )	448,378
<b>TOTAL ASSETS</b>	<b>\$ 771,008</b>	<b>\$ 2,724,107</b>	<b>\$ 182,332</b>	<b>\$(776,785 )</b>	<b>\$ 2,900,662</b>
<b>CAPITALIZATION AND LIABILITIES</b>					
<b>Capitalization:</b>					
Common stockholders' equity	\$ 714,129	\$ 642,214	\$ 78,976	\$(721,190 )	\$ 714,129
Affiliate long-term debt	—	—	27,321	(27,321 )	—
Long-term debt, net	—	710,049	553	—	710,602
Total capitalization	714,129	1,352,263	106,850	(748,511 )	1,424,731
<b>Current liabilities:</b>					
Current maturities of long-term debt, net	—	104,730	280	—	105,010
Short-term borrowings	55,100	70,000	—	—	125,100
Payables to affiliates	—	1,259	26,993	(28,252 )	—
Accounts payable	299	78,619	4,362	—	83,280
Accrued expenses and other liabilities	68	67,535	3,050	—	70,653
Total current liabilities	55,467	322,143	34,685	(28,252 )	384,043
<b>Unamortized investment tax credits</b>	<b>—</b>	<b>1,649</b>	<b>—</b>	<b>—</b>	<b>1,649</b>
<b>Deferred income taxes</b>	<b>1,412</b>	<b>208,268</b>	<b>1,740</b>	<b>(38 )</b>	<b>211,382</b>
<b>Pension and postretirement benefits other than pensions</b>	<b>—</b>	<b>200,953</b>	<b>—</b>	<b>—</b>	<b>200,953</b>
<b>Regulatory liabilities and other</b>	<b>—</b>	<b>257,783</b>	<b>6,756</b>	<b>16</b>	<b>264,555</b>
<b>Advances for construction</b>	<b>—</b>	<b>186,390</b>	<b>487</b>	<b>—</b>	<b>186,877</b>
<b>Contributions in aid of construction</b>	<b>—</b>	<b>194,658</b>	<b>31,814</b>	<b>—</b>	<b>226,472</b>
<b>TOTAL CAPITALIZATION AND LIABILITIES</b>	<b>\$ 771,008</b>	<b>\$ 2,724,107</b>	<b>\$ 182,332</b>	<b>\$(776,785 )</b>	<b>\$ 2,900,662</b>

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

As of December 31, 2018

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
<b>ASSETS</b>					
<b>Utility plant:</b>					
Utility plant	\$ 1,318	\$ 3,021,437	\$ 213,888	\$(7,197 )	\$ 3,229,446
Less accumulated depreciation and amortization	(1,013 )	(938,072 )	(59,735 )	2,097	(996,723 )
Net utility plant	305	2,083,365	154,153	(5,100 )	2,232,723
<b>Current assets:</b>					
Cash and cash equivalents	3,779	33,763	9,634	—	47,176
Receivables and unbilled revenue	126	118,632	4,201	—	122,959
Receivables from affiliates	21,318	4,074	61	(25,453 )	—
Other current assets	80	16,907	1,580	—	18,567
Total current assets	25,303	173,376	15,476	(25,453 )	188,702
<b>Other assets:</b>					
Regulatory assets	—	349,414	4,155	—	353,569
Investments in affiliates	733,156	—	—	(733,156 )	—
Long-term affiliate notes receivable	27,829	—	—	(27,829 )	—
Other assets	133	58,959	3,821	(203 )	62,710
Total other assets	761,118	408,373	7,976	(761,188 )	416,279
<b>TOTAL ASSETS</b>	<b>\$786,726</b>	<b>\$2,665,114</b>	<b>\$177,605</b>	<b>\$(791,741 )</b>	<b>\$2,837,704</b>
<b>CAPITALIZATION AND LIABILITIES</b>					
<b>Capitalization:</b>					
Common stockholders' equity	\$ 730,157	\$ 659,340	79,093	\$(738,433 )	\$ 730,157
Affiliate long-term debt	—	—	27,828	(27,828 )	—
Long-term debt, less current maturities	—	709,444	583	—	710,027
Total capitalization	730,157	1,368,784	107,504	(766,261 )	1,440,184
<b>Current liabilities:</b>					
Current maturities of long-term debt	—	104,664	247	—	104,911
Short-term borrowings	55,100	10,000	—	—	65,100
Payables to affiliates	17	488	24,948	(25,453 )	—
Accounts payable	—	92,310	3,270	—	95,580
Accrued expenses and other liabilities	107	53,655	1,813	—	55,575
Total current liabilities	55,224	261,117	30,278	(25,453 )	321,166
<b>Unamortized investment tax credits</b>	<b>—</b>	<b>1,649</b>	<b>—</b>	<b>—</b>	<b>1,649</b>
<b>Deferred income taxes</b>	<b>1,376</b>	<b>210,052</b>	<b>1,648</b>	<b>(43 )</b>	<b>213,033</b>
<b>Pension and postretirement benefits other than pensions</b>	<b>—</b>	<b>193,538</b>	<b>—</b>	<b>—</b>	<b>193,538</b>
<b>Regulatory and other liabilities</b>	<b>(31 )</b>	<b>250,720</b>	<b>5,817</b>	<b>16</b>	<b>256,522</b>
<b>Advances for construction</b>	<b>—</b>	<b>185,843</b>	<b>499</b>	<b>—</b>	<b>186,342</b>
<b>Contributions in aid of construction</b>	<b>—</b>	<b>193,411</b>	<b>31,859</b>	<b>—</b>	<b>225,270</b>
<b>TOTAL CAPITALIZATION AND LIABILITIES</b>	<b>\$786,726</b>	<b>\$2,665,114</b>	<b>\$177,605</b>	<b>\$(791,741 )</b>	<b>\$2,837,704</b>





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**CALIFORNIA WATER SERVICE GROUP**  
**CONDENSED CONSOLIDATING STATEMENT OF INCOME**  
**For the three months ended March 31, 2019**  
**(In thousands)**

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
<b>Operating revenue</b>	\$ —	\$116,074	\$10,037	\$ —	\$126,111
<b>Operating expenses:</b>					
Operations:					
Water production costs	—	43,426	2,166	—	45,592
Administrative and general	—	26,203	2,894	—	29,097
Other operations	—	16,122	1,845	(146 )	17,821
Maintenance	—	6,223	232	—	6,455
Depreciation and amortization	23	20,887	1,479	(21 )	22,368
Income tax (benefit) expense	(135)	(3,105 )	31	218	(2,991 )
Property and other taxes	—	6,506	787	—	7,293
Total operating (income) expenses	(112)	116,262	9,434	51	125,635
Net operating income (loss)	112	(188 )	603	(51 )	476
<b>Other income and expenses:</b>					
Non-regulated revenue	613	4,628	419	(759 )	4,901
Non-regulated expenses	—	(2,038 )	(181 )	—	(2,219 )
Other components of net periodic benefit cost	—	(1,229 )	(30 )	—	(1,259 )
Allowance for equity funds used during construction	—	1,533	—	—	1,533
Income tax expense on other income and expenses	(172)	(810 )	(58 )	212	(828 )
Net other income	441	2,084	150	(547 )	2,128
<b>Interest:</b>					
Interest expense	459	10,613	616	(613 )	11,075
Allowance for borrowed funds used during construction	—	(776 )	(55 )	—	(831 )
Net interest expense	459	9,837			