



California Water Service (CWT)

Updated November 8th, 2018 by Jonathan Weber

Key Metrics

Current Price:	\$44	5 Year CAGR Estimate:	-1.6%	Volatility Percentile:	36.8%
Fair Value Price:	\$30	5 Year Growth Estimate:	4.0%	Momentum Percentile:	48.7%
% Fair Value:	146%	5 Year Valuation Multiple Estimate:	-7.3%	Growth Percentile:	20.1%
Dividend Yield:	1.7%	5 Year Price Target	\$37	Valuation Percentile:	6.8%
Dividend Risk Score:	A	Retirement Suitability Score:	C	Total Return Percentile:	2.4%

Overview & Current Events

California Water Service is the 3rd largest publicly-owned water utility in the U.S., with a market capitalization of \$2.2 billion. It has six subsidiaries which provide water to about two million people in California, Washington, New Mexico, and Hawaii. California Water Service was founded in 1926 and has increased its dividend for 51 consecutive years, which makes the company a Dividend King.

California Water Service reported its third quarter earnings results on November 1. The company generated revenues of \$219 million during the quarter, an increase of 3.4% compared to the prior year's quarter. The company was able to increase its net earnings by 2% compared to Q3 2017, as California Water Service's net earnings rose to \$34.4 million. Profits were impacted by rate increases, which impacted earnings positively by \$4.4 million, but California Water Service also had to battle with higher expenses for depreciation and amortization, as well as with employee wage increases and higher interest expenses. Earnings-per-share totaled \$0.72 during the third quarter.

California Water Service ended its takeover attempt of SJW Group during the third quarter. This was based on the fact that SJW Group's management team had declined the takeover attempt, as it was not seen as favorable for SJW Group's shareholders. California Water Service plans to invest into its own assets (~\$250 million during fiscal 2018), which is why the company issued \$300 million in new bonds during September.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$0.95	\$0.98	\$0.91	\$0.86	\$1.02	\$1.02	\$1.19	\$0.94	\$1.01	\$1.40	\$1.37	\$1.67
DPS	\$0.59	\$0.59	\$0.60	\$0.62	\$0.63	\$0.64	\$0.65	\$0.67	\$0.69	\$0.72	\$0.75	\$0.90
Shares	41	42	42	42	42	48	48	48	48	48	49	50

Since 2008, California Water Service has grown its earnings-per-share at an average annual rate of 4.4%, which is not a bad pace of earnings growth for a utility, but not an overly strong growth rate, either. Earnings-per-share are very seasonal. The second and especially the third quarter are usually significantly more profitable than the rest of the year, as demand for fresh water is significantly higher during the very warm summer months in California.

The company will likely continue to grow at a relatively similar rate in the long run thanks to the rate hikes that are approved by the authorities/regulators. The latter need to continuously encourage the company to keep investing in the expansion and maintenance of its network. The authorities are forced to determine the optimum rate hikes in order to satisfy both the company and the end consumers, who want limited price hikes, but who also benefit from the investments of the company.

Based on our estimate of earnings-per-share of \$1.37 for 2018 California Water Service could earn \$1.67 during 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	19.8	19.7	20.3	21.3	17.9	20.1	19.7	24.8	29.6	26.9	32.1	22.0
Avg. Yld.	3.1%	3.1%	3.2%	3.4%	3.5%	3.1%	2.8%	2.9%	2.3%	1.9%	1.7%	2.4%

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California Water Service' share price has risen considerably over the last couple of years, which was at least in part due to the expansion of the company's price to earnings multiple. Shares traded at a high-teens earnings multiple one decade ago, but the multiple has expanded to the 20s and now even to the 30s. California Water Service looks substantially overvalued right here, we believe that multiple contraction will be a major headwind for total returns over the coming years. California Water Service is a Dividend King, but due to the fact that its dividend yield is lower than that of the broad market, shares are not a suitable income investment right here.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	15.0%	15.3%	17.5%	17.3%	17.9%	18.3%	17.1%	17.0%	16.1%	15.5%	15.0%	17.0%
Debt/A	71.6%	72.4%	74.3%	75.7%	76.3%	69.4%	71.4%	71.3%	72.7%	74.7%	75.0%	77.0%
Int. Cov.	3.4	2.7	2.4	2.3	2.7	2.6	4.1	2.5	2.5	2.9	3.0	3.0
Payout	62.1%	60.2%	65.9%	72.1%	61.8%	62.7%	54.6%	71.3%	68.3%	51.4%	54.7%	53.9%
Std. Dev.	46.1%	28.7%	19.8%	25.0%	16.8%	18.9%	22.6%	25.9%	26.8%	21.7%	25.0%	22.0%

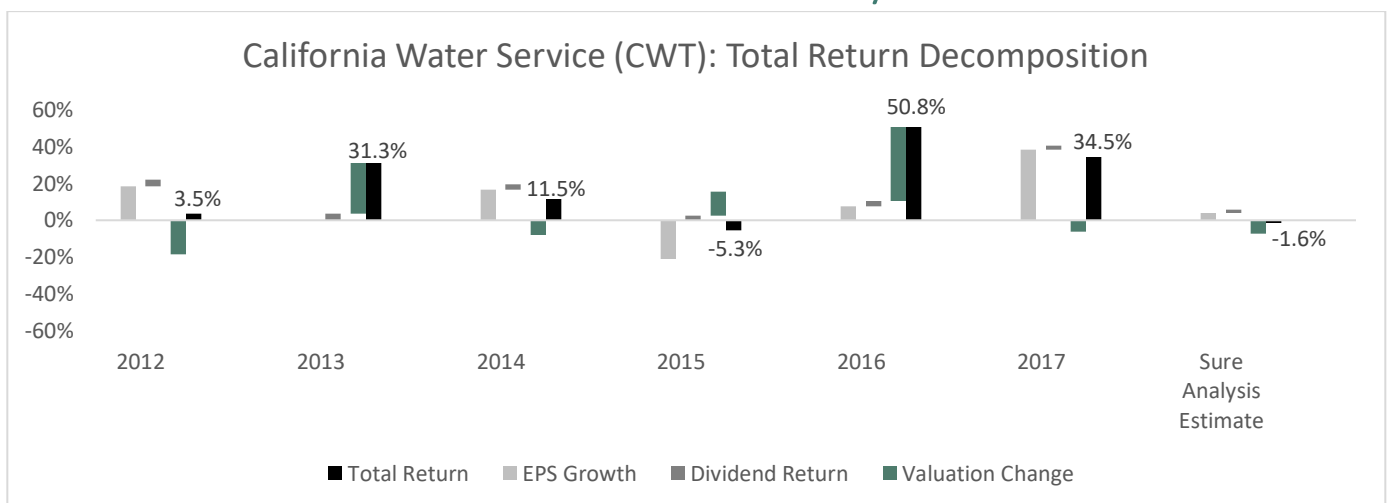
Like many other utility companies California Water Service spends tremendous amounts on capital expenses every year, which has resulted in a relatively high amount of debt on the company's balance sheet. Thanks to its reliable cash flows, it is not likely that California Water Service will have any problem servicing its debt.

Demand for fresh water is not dependent on economic conditions, which is why California Water Service can be described as very recession-proof. California Water Service was able to grow its earnings-per-share during the last financial crisis, while many other companies saw their net earnings drop considerably. California Water Service thus seems like a low-risk investment, at least when it comes to its business model.

Final Thoughts & Recommendation

California Water Service is one of the largest water utilities in the US. The company has a non-cyclical, low-risk business model, as rate increases (approved by regulators) do almost guarantee that earnings will continue to grow during the coming years. California Water Service is nevertheless not a good investment right here, as shares are massively overvalued. The run-up in California Water Service's share price has resulted in its stock trading at ~150% of fair value right now, which will be a major headwind for total returns going forward. We rate its shares a sell right here.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	410	449	460	502	560	584	597	588	609	667
Gross Profit	213	233	277	299	338	341	354	359	366	402
Gross Margin	51.8%	51.9%	60.1%	59.7%	60.4%	58.3%	59.2%	61.0%	60.1%	60.4%
SG&A Exp.	59	75	75	86	94	98	97	113	98	103
D&A Exp.	39	42	45	52	57	60	63	63	65	79
Operating Profit	57	58	85	90	93	93	109	96	101	124
Operating Margin	14.0%	12.9%	18.4%	18.0%	16.6%	15.9%	18.2%	16.3%	16.6%	18.5%
Net Profit	40	41	38	38	49	47	57	45	49	67
Net Margin	9.7%	9.0%	8.2%	7.5%	8.7%	8.1%	9.5%	7.7%	8.0%	10.1%
Free Cash Flow	-12	-38	-48	-7	4	1	-4	-32	-68	-111

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	1418	1526	1692	1855	1996	1960	2187	2241	2412	2740
Cash & Equivalents	14	10	42	27	39	28	20	9	25	95
Accounts Receivable	35	45	46	28	30	31	26	32	30	32
Inventories	5	6	6	6	6	6	6	6	6	6
Goodwill & Int. Ass.	4	3	3	15	17	15	14	15	14	14
Total Liabilities	1015	1105	1257	1405	1522	1361	1561	1599	1752	2047
Accounts Payable	42	44	40	49	47	55	59	66	78	94
Long-Term Debt	330	399	505	535	571	481	505	548	655	807
Shareholder's Equity	403	421	436	450	474	599	627	642	659	693
D/E Ratio	0.82	0.95	1.16	1.19	1.20	0.80	0.81	0.85	0.99	1.16

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	3.1%	2.8%	2.3%	2.1%	2.5%	2.4%	2.7%	2.0%	2.1%	2.6%
Return on Equity	10.1%	9.8%	8.8%	8.5%	10.6%	8.8%	9.3%	7.1%	7.5%	9.9%
ROIC	5.6%	5.2%	4.3%	3.9%	4.8%	4.4%	5.1%	3.9%	3.9%	4.8%
Shares Out.	41	42	42	42	42	48	48	48	48	48
Revenue/Share	9.89	10.82	11.06	12.01	13.37	12.58	12.49	12.29	12.71	13.89
FCF/Share	-0.29	-0.92	-1.16	-0.17	0.10	0.03	-0.08	-0.67	-1.43	-2.32

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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