



# California Water Service (CWT)

Updated March 7<sup>th</sup>, 2019 by Jonathan Weber

## Key Metrics

<b>Current Price:</b>	\$53	<b>5 Year CAGR Estimate:</b>	-6.4%	<b>Volatility Percentile:</b>	36.4%
<b>Fair Value Price:</b>	\$28	<b>5 Year Growth Estimate:</b>	4.0%	<b>Momentum Percentile:</b>	96.8%
<b>% Fair Value:</b>	189%	<b>5 Year Valuation Multiple Estimate:</b>	-11.9%	<b>Growth Percentile:</b>	23.2%
<b>Dividend Yield:</b>	1.5%	<b>5 Year Price Target</b>	\$34	<b>Valuation Percentile:</b>	0.9%
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	C	<b>Total Return Percentile:</b>	0.3%

## Overview & Current Events

California Water Service is the 3<sup>rd</sup> largest publicly-owned water utility in the U.S., with a market capitalization of \$2.5 billion. It has six subsidiaries that 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 fourth quarter and full year earnings results on February 28. The company reported that its revenues totaled \$167 million during the quarter, which was 1.9% more than the revenues that California Water Service generated during the previous year's quarter. The revenues that the company produced were higher than what the analyst community expected.

California Water Service generated earnings-per-share of \$0.32 during the fourth quarter, which beat the analyst consensus by \$0.03. California Water Service's earnings-per-share during the fourth quarter of fiscal 2018 were up 3.2% versus earnings-per-share of \$0.31 during the fourth quarter of the previous year. California Water Service only grew its revenues at a low-single-digit pace, but thanks to some cost cutting, the company was able to grow its operating profits more meaningfully. Higher interest expenses offset most of these gains, though, which is why net earnings and earnings-per-share grew at a relatively low pace during the most recent quarter.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$0.98	\$0.91	\$0.86	\$1.02	\$1.02	\$1.19	\$0.94	\$1.01	\$1.52	\$1.36	<b>\$1.41</b>	<b>\$1.72</b>
<b>DPS</b>	\$0.59	\$0.60	\$0.62	\$0.63	\$0.64	\$0.65	\$0.67	\$0.69	\$0.72	\$0.75	<b>\$0.79</b>	<b>\$0.94</b>
<b>Shares</b>	42	42	42	42	48	48	48	48	48	48	<b>48</b>	<b>48</b>

Between 2009 and 2018, California Water Service grew its earnings-per-share at an average annual rate of 3.7%. This is a decent pace of earnings growth for a utility. Earnings-per-share are very seasonal for California Water. The second and third quarters 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. California Water Service has relatively cyclical profits as a result, and there are large variances in the company's profitability on a year-over-year basis on occasion, such as in 2016-2017. During the last financial crisis, California Water Service's earnings-per-share did not decline meaningfully, as earnings-per-share dropped by just 4% between 2008 and 2010. This is not surprising, as demand for fresh water is more reliant on the weather than on the strength of the economy.

We believe that California Water Service's earnings-per-share will continue to grow at a mid-single-digits rate going forward, relatively similar to how the company's earnings-per-share grew in the past. Earnings growth in the long run should be achievable thanks to the rate hikes that are approved by the authorities/regulators, as well as California Water Service's investments into its assets/infrastructure. Regulators need to continuously encourage the company to keep investing in the expansion and maintenance of its network. 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. Price/rate increases will allow for moderate earnings growth going forward.

*Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.*



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## Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	19.7	20.3	21.3	17.9	20.1	19.7	24.8	29.6	26.9	35.3	<b>37.6</b>	<b>20.0</b>
Avg. Yld.	3.1%	3.2%	3.4%	3.5%	3.1%	2.8%	2.9%	2.3%	1.9%	1.6%	<b>1.5%</b>	<b>2.7%</b>

California Water Service has never been a high-growth stock, but the resilience during economic downturns and the relatively predictable earnings and dividend growth have made California Water Service somewhat attractive for risk-averse investors. The valuation of the company's shares has expanded significantly over the last couple of years, though, and shares look massively overvalued today. We believe that there is huge downside potential from the current valuation, which does not seem justified at all for a low-growth company like California Water Service. Indeed, California Water Service is one of the most overvalued stocks in our entire coverage universe.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	60.2%	65.9%	72.1%	61.8%	62.7%	54.6%	71.3%	68.3%	51.4%	55.1%	<b>56.0%</b>	<b>54.7%</b>

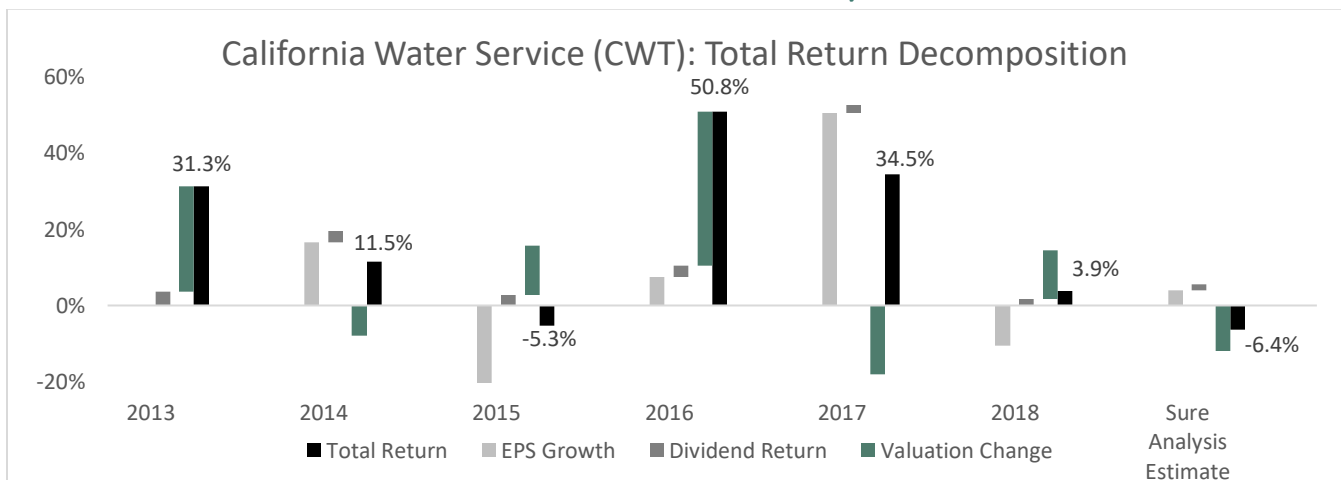
California Water Service has paid out between 55% and 70% of its net profits through most of the last decade. Overall, the dividend payout ratio has declined slightly over that time frame, as the company's dividend growth rate was lower than its earnings-per-share growth rate. The predictable nature of the company's earnings, combined with a payout ratio that is not overly high means that the dividend looks very safe.

California Water Service is a regulated utility, and as such it does not have to worry about competition. The company and its peers are rewarded for investments via increased rates, and they do not have to battle over market share. The company is not vulnerable to recessions or economic downturns, as consumers need fresh water no matter the strength of the economy. Weather conditions/temperature can impact results, though, and are unpredictable.

## Final Thoughts & Recommendation

California Water Service operates in a low-risk, predictable, somewhat boring industry. This is not necessarily a negative for investors, as businesses like these can be strong investments. Due to its absurdly high valuation California Water Service is not an attractive investment today, though. We rate the stock a sell for now until the valuation comes well off of its highs. We are projecting annual returns well below zero for shareholders that purchase the stock today.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Revenue</b>	449	460	502	560	584	597	588	609	676	698
<b>Gross Profit</b>	233	277	299	338	341	354	359	366	412	421
<b>Gross Margin</b>	51.9%	60.1%	59.7%	60.4%	58.3%	59.2%	61.0%	60.1%	60.9%	60.3%
<b>SG&amp;A Exp.</b>	75	75	86	94	98	97	113	88	93	101
<b>D&amp;A Exp.</b>	42	45	52	57	60	63	63	65	79	86
<b>Operating Profit</b>	58	85	90	93	93	109	96	112	142	129
<b>Operating Margin</b>	12.9%	18.4%	18.0%	16.6%	15.9%	18.2%	16.3%	18.4%	21.1%	18.5%
<b>Net Profit</b>	41	38	38	49	47	57	45	49	73	66
<b>Net Margin</b>	9.0%	8.2%	7.5%	8.7%	8.1%	9.5%	7.7%	8.0%	10.8%	9.4%
<b>Free Cash Flow</b>	-38	-48	-7	4	1	-4	-32	-68	-111	-93
<b>Income Tax</b>	N/A	25	23	21	20	28	25	27	37	16

## Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Total Assets</b>	1526	1692	1855	1996	1960	2187	2241	2412	2745	2838
<b>Cash &amp; Equivalents</b>	10	42	27	39	28	20	9	25	95	47
<b>Accounts Receivable</b>	45	46	28	30	31	26	32	30	32	30
<b>Inventories</b>	6	6	6	6	6	6	6	6	6	7
<b>Goodwill &amp; Int. Ass.</b>	3	3	15	17	15	14	15	14	25	27
<b>Total Liabilities</b>	1105	1257	1405	1522	1361	1561	1599	1752	2045	2108
<b>Accounts Payable</b>	44	40	49	47	55	59	66	78	94	96
<b>Long-Term Debt</b>	399	505	535	571	481	505	548	655	807	880
<b>Shareholder's Equity</b>	421	436	450	474	599	627	642	659	699	730
<b>D/E Ratio</b>	0.95	1.16	1.19	1.20	0.80	0.81	0.85	0.99	1.15	1.21

## Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Return on Assets</b>	2.8%	2.3%	2.1%	2.5%	2.4%	2.7%	2.0%	2.1%	2.8%	2.3%
<b>Return on Equity</b>	9.8%	8.8%	8.5%	10.6%	8.8%	9.3%	7.1%	7.5%	10.7%	9.2%
<b>ROIC</b>	5.2%	4.3%	3.9%	4.8%	4.4%	5.1%	3.9%	3.9%	5.2%	4.2%
<b>Shares Out.</b>	42	42	42	42	48	48	48	48	48	48
<b>Revenue/Share</b>	10.82	11.06	12.01	13.37	12.58	12.49	12.29	12.71	14.08	14.53
<b>FCF/Share</b>	-0.92	-1.16	-0.17	0.10	0.03	-0.08	-0.67	-1.43	-2.32	-1.93

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

### Disclaimer

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