



California Water Service (CWT)

Updated June 4th, 2019 by Jonathan Weber

Key Metrics

| | | | | | |
|-----------------------------|------|--|--------|---------------------------------|-------|
| Current Price: | \$49 | 5 Year CAGR Estimate: | -4.9% | Volatility Percentile: | 32.4% |
| Fair Value Price: | \$28 | 5 Year Growth Estimate: | 4.0% | Momentum Percentile: | 88.5% |
| % Fair Value: | 175% | 5 Year Valuation Multiple Estimate: | -10.5% | Growth Percentile: | 23.8% |
| Dividend Yield: | 1.6% | 5 Year Price Target | \$34 | Valuation Percentile: | 2.0% |
| Dividend Risk Score: | A | Retirement Suitability Score: | C | Total Return Percentile: | 0.9% |

Overview & Current Events

California Water Service is the 3rd largest publicly-owned water utility in the U.S., with a market capitalization of \$2.4 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 first quarter earnings results on April 25. The company reported that its revenues totaled \$126 million during the quarter, which was 6.3% less than the revenues that California Water Service generated during the previous year's quarter. California Water Service missed the analyst consensus estimate for its revenues widely, by more than \$12 million, or roughly 10%.

California Water Service generated a net loss of \$0.16 per share during the first quarter, which missed the analyst consensus widely. California Water Service's loss-per-share during the first quarter of fiscal 2019 was 8 times as large as the net loss during the previous year's first quarter. This can be explained by the fact that revenues were down year-over-year, while operating expenses and interest expenses were higher than during the previous year's quarter. Net interest expenses rose by 18% year over year, which was a key factor for California Water Service's surprisingly large net losses during the first quarter, which usually is the weakest quarter for the company.

Growth on a Per-Share Basis

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

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. 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 | 34.8 | 20.0 |
| Avg. Yld. | 3.1% | 3.2% | 3.4% | 3.5% | 3.1% | 2.8% | 2.9% | 2.3% | 1.9% | 1.6% | 1.6% | 2.7% |

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 for a low-growth company like California Water Service. 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% | 56.0% | 54.7% |

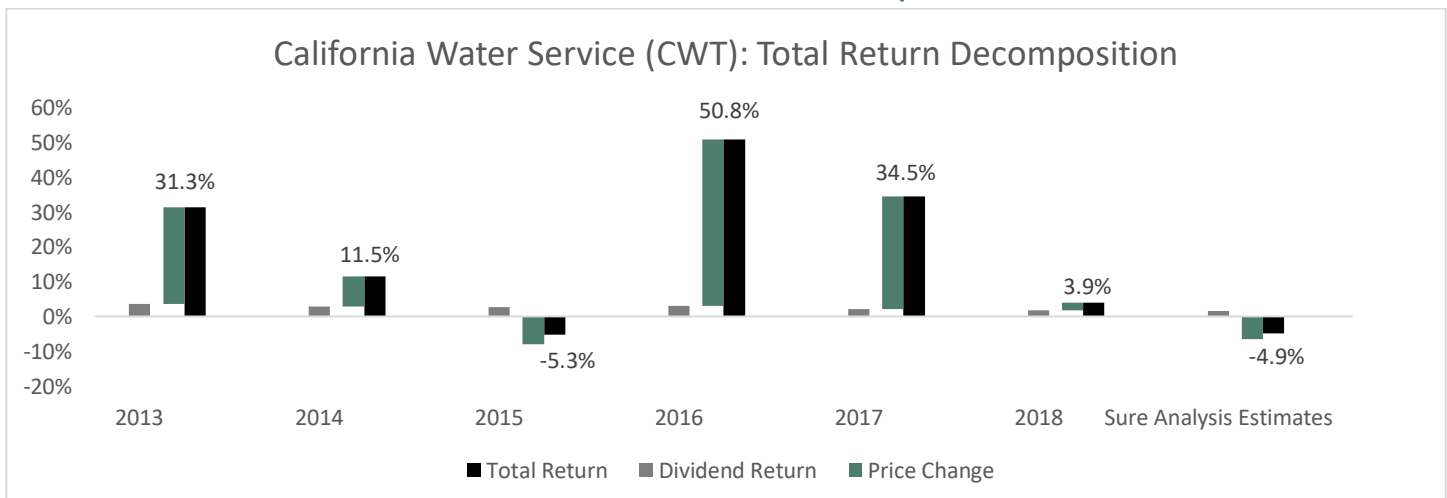
California Water Service has paid out between 55% and 70% of its net profits throughout most of the last decade. Overall, the dividend payout ratio has declined slightly over that time frame, as the company's dividend growth rate was lower than its earnings-per-share growth rate. The predictable nature 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

As a regulated utility, California Water Service operates in an unspectacular industry. This is not necessarily a negative for investors, as businesses like these can be strong investments. California Water Service does not look like an attractive investment right here, though, due to its overly high valuation. Due to negative projected total returns, we rate California Water Service a sell at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 449 | 460 | 502 | 560 | 584 | 597 | 588 | 609 | 676 | 698 |
| Gross Profit | 233 | 277 | 299 | 338 | 341 | 354 | 359 | 366 | 412 | 421 |
| Gross Margin | 51.9% | 60.1% | 59.7% | 60.4% | 58.3% | 59.2% | 61.0% | 60.1% | 60.9% | 60.3% |
| SG&A Exp. | 75 | 75 | 86 | 94 | 98 | 97 | 113 | 88 | 93 | 101 |
| D&A Exp. | 42 | 45 | 52 | 57 | 60 | 63 | 63 | 65 | 79 | 86 |
| Operating Profit | 58 | 85 | 90 | 93 | 93 | 109 | 96 | 112 | 142 | 129 |
| Operating Margin | 12.9% | 18.4% | 18.0% | 16.6% | 15.9% | 18.2% | 16.3% | 18.4% | 21.1% | 18.5% |
| Net Profit | 41 | 38 | 38 | 49 | 47 | 57 | 45 | 49 | 73 | 66 |
| Net Margin | 9.0% | 8.2% | 7.5% | 8.7% | 8.1% | 9.5% | 7.7% | 8.0% | 10.8% | 9.4% |
| Free Cash Flow | -38 | -48 | -7 | 4 | 1 | -4 | -32 | -68 | -111 | -93 |
| Income Tax | 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 |
|---------------------------------|------|------|------|------|------|------|------|------|------|------|
| Total Assets | 1526 | 1692 | 1855 | 1996 | 1960 | 2187 | 2241 | 2412 | 2745 | 2838 |
| Cash & Equivalents | 10 | 42 | 27 | 39 | 28 | 20 | 9 | 25 | 95 | 47 |
| Accounts Receivable | 45 | 46 | 28 | 30 | 31 | 26 | 32 | 30 | 32 | 30 |
| Inventories | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 7 |
| Goodwill & Int. Ass. | 3 | 3 | 15 | 17 | 15 | 14 | 15 | 14 | 25 | 27 |
| Total Liabilities | 1105 | 1257 | 1405 | 1522 | 1361 | 1561 | 1599 | 1752 | 2045 | 2108 |
| Accounts Payable | 44 | 40 | 49 | 47 | 55 | 59 | 66 | 78 | 94 | 96 |
| Long-Term Debt | 399 | 505 | 535 | 571 | 481 | 505 | 548 | 655 | 807 | 880 |
| Shareholder's Equity | 421 | 436 | 450 | 474 | 599 | 627 | 642 | 659 | 699 | 730 |
| D/E Ratio | 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 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 2.8% | 2.3% | 2.1% | 2.5% | 2.4% | 2.7% | 2.0% | 2.1% | 2.8% | 2.3% |
| Return on Equity | 9.8% | 8.8% | 8.5% | 10.6% | 8.8% | 9.3% | 7.1% | 7.5% | 10.7% | 9.2% |
| ROIC | 5.2% | 4.3% | 3.9% | 4.8% | 4.4% | 5.1% | 3.9% | 3.9% | 5.2% | 4.2% |
| Shares Out. | 42 | 42 | 42 | 42 | 48 | 48 | 48 | 48 | 48 | 48 |
| Revenue/Share | 10.82 | 11.06 | 12.01 | 13.37 | 12.58 | 12.49 | 12.29 | 12.71 | 14.08 | 14.53 |
| FCF/Share | -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.

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