California Water Service (CWT)

Updated November 9th, 2019 by Jonathan Weber

Key Metrics

Current Price:	$51	**5 Year CAGR Estimate:**	-5.7%	**Volatility Percentile:**	28.9%
Fair Value Price:	$28	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	53.8%
% Fair Value:	185%	**5 Year Valuation Multiple Estimate:**	-11.6%	**Growth Percentile:**	27.9%
Dividend Yield:	1.6%	**5 Year Price Target**	$34	**Valuation Percentile:**	3.8%
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Total Return Percentile:**	1.8%

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 third quarter earnings results on November 1. The company reported that its revenues totaled $233 million during the quarter, which was 5.1% more than the revenues that California Water Service generated during the previous year's quarter. California Water Service beat the analyst consensus estimate for its revenues slightly, by $8 million, or close to 4%.

California Water Service generated earnings-per-share of $0.88 during the third quarter, which missed the analyst consensus by $0.09. California Water Service's earnings-per-share during the third quarter of fiscal 2019 were 17.1% higher than its earnings-per-share during the previous year's quarter, which is a quite attractive growth rate. Growth was fueled by revenues that were up year-over-year, while operating leverage allowed for some additional earnings growth. The company also benefited from lower interest expenses, which drove profits further.

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	***$1.38***	***$1.68***
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[1]	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%, which 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 upon 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 by 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 should allow for moderate earnings growth going forward.

[1] In Millions

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	***37.0***	***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%***	***2.8%***

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 it somewhat attractive for risk-averse investors. The valuation of the company's shares has expanded significantly over the last couple of years, and shares look massively overvalued today. We believe that there is huge downside potential from the current valuation, as the current multiple 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, trading close to twice its fair value.

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%	***57.2%***	***55.9%***

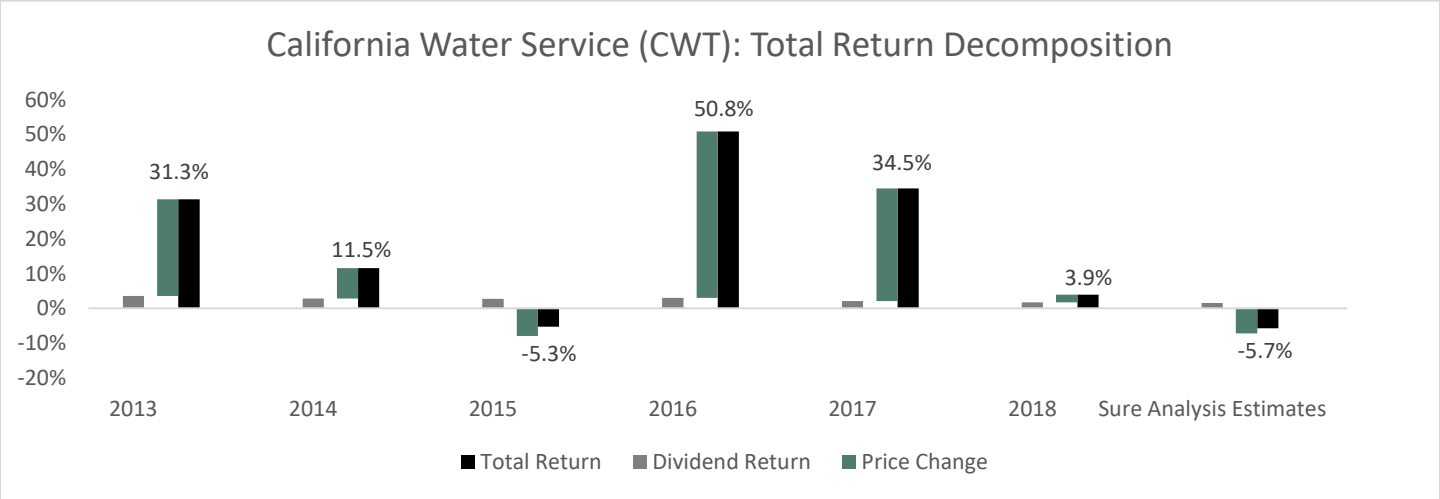
California Water Service has paid out between 55% and 70% of its net profits throughout most of the last decade. Overall, the dividend payout ratio has declined slightly over that time frame, as the company's dividend growth rate was lower than its earnings-per-share growth rate. The predictable nature 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 a somewhat boring industry. This is not necessarily a negative for investors, as businesses like these can be strong and safe investments. California Water Service does not look like an attractive investment today, though, due to its very pronounced overvaluation. Due to negative projected total returns, we rate California Water Service a strong 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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