California Water Service (CWT)

Updated May 8th, 2020 by Jonathan Weber

Key Metrics

Current Price:	$45	**5 Year CAGR Estimate:**	-3.5%	**Market Cap:**	$2.2B
Fair Value Price:	$27	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	08/03/20[1]
% Fair Value:	167%	**5 Year Valuation Multiple Estimate:**	-9.7%	**Dividend Payment Date:**	08/17/20[2]
Dividend Yield:	1.9%	**5 Year Price Target**	$33	**Years Of Dividend Growth:**	52
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	7.6%

Overview & Current Events

California Water Service is the 3rd largest publicly-owned water utility in the United States. The company has six subsidiaries that provide water to about two million people, mainly in California, with some additional operations in Washington, New Mexico, and Hawaii. California Water Service was founded in 1926 and has increased its dividend for more than 50 consecutive years, which makes the company a Dividend King.

California Water Service reported its first quarter earnings results on April 30. The company reported that its revenues totaled $126 million during the quarter, which was 0.4% less 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 easily. Revenues were down mainly due to the fact that California Water Service was not able to pass higher expenses to customers through higher rates as those have not been approved yet, but management expects this will happen soon.

California Water Service generated earnings-per-share of -$0.42 during the first quarter, which was a surprising net loss. This was due to the aforementioned fact that rate increases have not yet been approved whilst the company's costs had already increased, on top of that, some one-time expenses for its pension plans reduced the bottom line further. For California Water Service, Q1 is always the seasonally weakest quarter, and things will improve drastically in Q2 and Q3.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$0.91	$0.86	$1.02	$1.02	$1.19	$0.94	$1.01	$1.52	$1.36	$1.31	***$1.35***	***$1.64***
DPS	$0.60	$0.62	$0.63	$0.64	$0.65	$0.67	$0.69	$0.72	$0.75	$0.79	***$0.85***	***$1.01***
Shares[3]	42	42	42	48	48	48	48	48	48	48	***48***	***48***

Between 2009 and 2019, California Water Service grew its earnings-per-share at an average annual rate of 4%, 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 consumption behavior and 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. Regulators need to continuously encourage the company to keep investing in the expansion and maintenance of its network, as its customers are dependent on high-quality infrastructure that is reliable.

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[1] Estimated date

[2] Estimated date

[3] In Millions

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	20.3	21.3	17.9	20.1	19.7	24.8	29.6	26.9	35.3	39.7	***33.3***	***20.0***
Avg. Yld.	3.2%	3.4%	3.5%	3.1%	2.8%	2.9%	2.3%	1.9%	1.6%	1.5%	***1.9%***	***3.1%***

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 at almost 170% of fair value.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	65.9%	72.1%	61.8%	62.7%	54.6%	71.3%	68.3%	51.4%	55.1%	60.3%	***63.0%***	***61.5%***

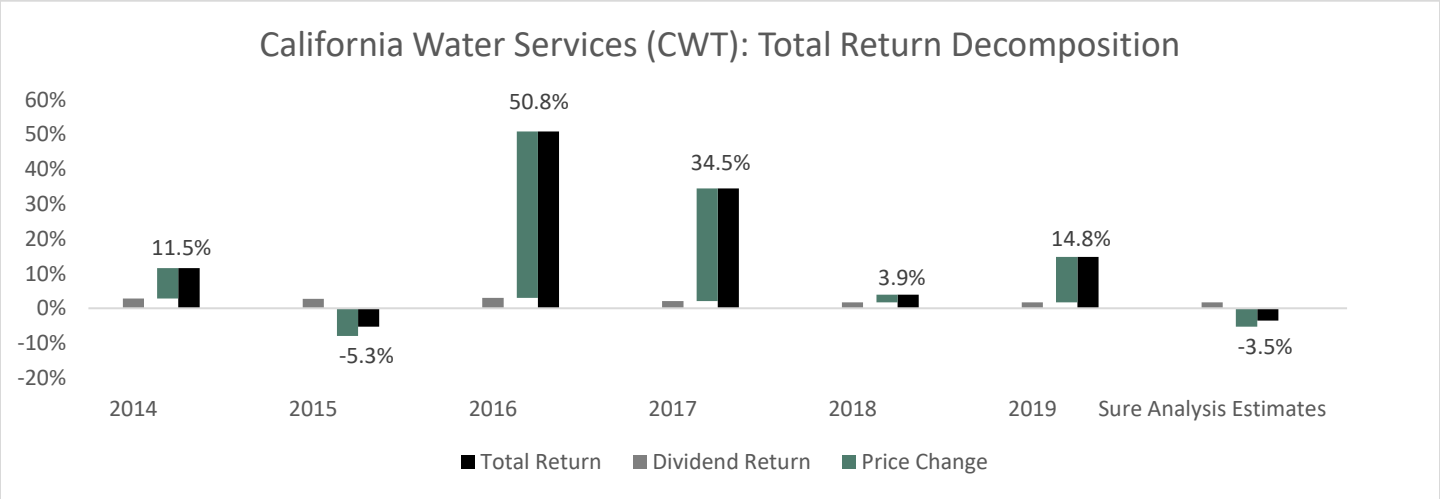
California Water Service has paid out between 55% and 70% of its net profits throughout most of the last decade. Overall, the dividend payout ratio has declined slightly over that time frame, as the company's dividend growth rate was lower than its earnings-per-share growth rate. The predictable nature 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 a lot. 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 still be strong and safe, reliable investments. California Water Service does not look like an attractive investment today, though, due to its very elevated valuation. Due to negative projected total returns, we rate California Water Service a strong sell at current prices, despite the fact that the company is well-positioned to weather the coronavirus crisis, which should not have any impact on its business.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	460	502	560	584	597	588	609	676	698	715
Gross Profit	277	299	338	341	354	359	366	412	421	432
Gross Margin	60.1%	59.7%	60.4%	58.3%	59.2%	61.0%	60.1%	60.9%	60.3%	60.5%
SG&A Exp.	75	86	94	98	97	113	88	93	101	109
D&A Exp.	45	52	57	60	63	63	65	79	86	91
Operating Profit	85	90	93	93	109	96	112	142	129	116
Operating Margin	18.4%	18.0%	16.6%	15.9%	18.2%	16.3%	18.4%	21.1%	18.5%	16.2%
Net Profit	38	38	49	47	57	45	49	73	66	63
Net Margin	8.2%	7.5%	8.7%	8.1%	9.5%	7.7%	8.0%	10.8%	9.4%	8.8%
Free Cash Flow	(48)	(7)	4	1	(4)	(32)	(68)	(111)	(93)	(105)
Income Tax	25	23	21	20	28	25	27	37	16	18

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	1,692	1,855	1,996	1,960	2,187	2,241	2,412	2,745	2,838	3,111
Cash & Equivalents	42	27	39	28	20	9	25	95	47	43
Accounts Receivable	46	28	30	31	26	32	30	32	30	32
Inventories	6	6	6	6	6	6	6	6	7	8
Goodwill & Int. Ass.	3	15	17	15	14	15	14	25	27	27
Total Liabilities	1,257	1,405	1,522	1,361	1,561	1,599	1,752	2,045	2,108	2,331
Accounts Payable	40	49	47	55	59	66	78	94	96	108
Long-Term Debt	505	535	571	481	505	548	655	807	880	984
Shareholder's Equity	436	450	474	599	627	642	659	699	730	780
D/E Ratio	1.16	1.19	1.20	0.80	0.81	0.85	0.99	1.15	1.21	1.26

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.3%	2.1%	2.5%	2.4%	2.7%	2.0%	2.1%	2.8%	2.3%	2.1%
Return on Equity	8.8%	8.5%	10.6%	8.8%	9.3%	7.1%	7.5%	10.7%	9.2%	8.4%
ROIC	4.3%	3.9%	4.8%	4.4%	5.1%	3.9%	3.9%	5.2%	4.2%	3.7%
Shares Out.	42	42	42	48	48	48	48	48	48	48
Revenue/Share	11.06	12.01	13.37	12.58	12.49	12.29	12.71	14.08	14.53	14.83
FCF/Share	(1.16)	(0.17)	0.10	0.03	(0.08)	(0.67)	(1.43)	(2.32)	(1.93)	(2.18)

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

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