



California Water Services (CWT)

Updated November 14th, 2023 by Jonathan Weber

Key Metrics

Current Price:	\$52	5 Year CAGR Estimate:	1.0%	Market Cap:	\$3.0B
Fair Value Price:	\$38	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	02/04/24 ¹
% Fair Value:	137%	5 Year Valuation Multiple Estimate:	-6.1%	Dividend Payment Date:	02/18/24 ²
Dividend Yield:	2.0%	5 Year Price Target	\$48	Years Of Dividend Growth:	55
Dividend Risk Score:	A	Retirement Suitability Score:	B	Rating:	Sell

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 third quarter earnings results on October 26. The company reported that its revenues totaled \$255 million during the quarter, which was 4% less than the revenues that California Water Service generated during the previous year's quarter. This represents a stronger performance compared to the previous quarter, during which California Water Service saw its revenue decline more substantially. The revenue decline was largely driven by lower water usage and a decrease in water revenue adjustment mechanism (WRAM) revenue.

California Water Service generated earnings-per-share of \$0.60 during the third quarter, which was worse than what was expected by the analyst community. Profits improved sequentially, however. California Water Services is always most profitable during the summer quarter, when water demand is way higher than during the winter quarters. Per current estimates, 2023 should be a stronger year compared to 2022.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$1.02	\$1.19	\$0.94	\$1.01	\$1.52	\$1.36	\$1.31	\$1.97	\$1.96	\$1.77	\$1.90	\$2.42
DPS	\$0.64	\$0.65	\$0.67	\$0.69	\$0.72	\$0.75	\$0.79	\$0.85	\$0.92	\$1.00	\$1.04	\$1.39
Shares³	48	48	48	48	48	48	48	50	53	55	56	60

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, as it did in the past. Earnings growth in the long run should be achievable thanks to the rate hikes that are regularly approved by relevant 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 will remain reliable in the future, which is why future rate increases are more or less a given.

¹ Estimated date

² Estimated date

³ 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	20.1	19.7	24.8	29.6	26.9	35.3	39.7	27.4	36.7	34.5	27.4	20.0
Avg. Yld.	3.1%	2.8%	2.9%	2.3%	1.9%	1.6%	1.5%	1.6%	1.3%	1.6%	2.0%	2.9%

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 appropriate for risk-averse investors. The valuation of the company's shares has expanded significantly over the last decade, which is why shares look overvalued today. We believe that there is significant 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's total returns will be negatively impacted by multiple compression, we believe.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	62.7%	54.6%	71.3%	68.3%	51.4%	55.1%	60.3%	43.1%	46.9%	56.5%	54.7%	57.4%

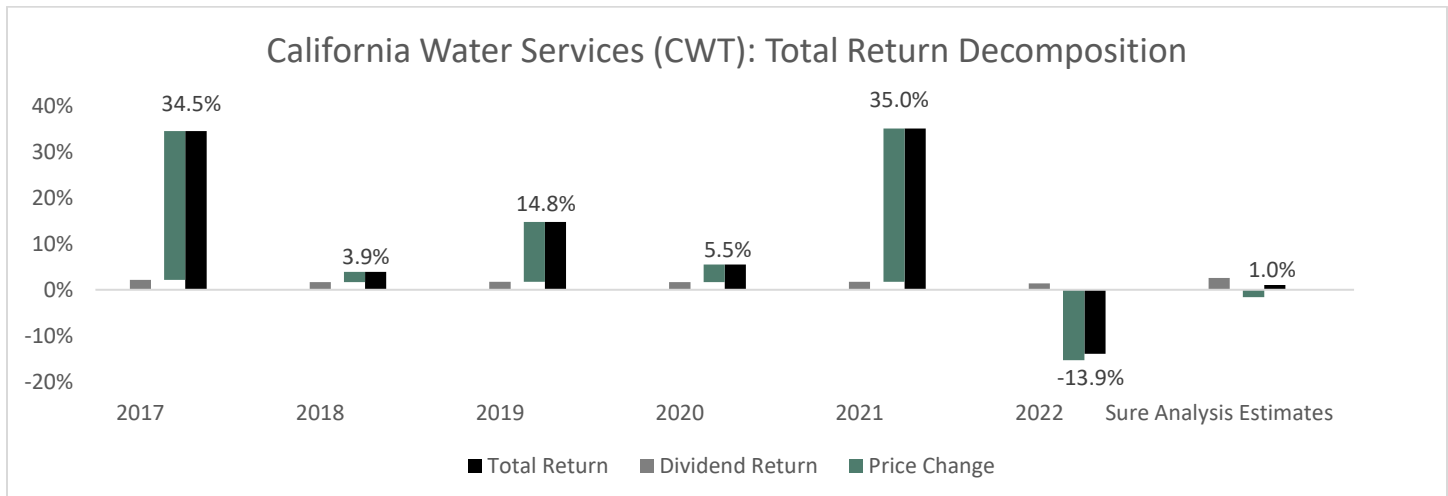
California Water Service has paid out between 40% and 70% of its net profits throughout most of the last decade. Overall, the dividend payout ratio has declined slightly over that time frame, as the company's dividend growth rate was lower than its earnings-per-share growth rate. The predictable nature 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 too much. 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 water utility, California Water Service operates in a relatively unspectacular industry. This is not necessarily a negative for investors, as businesses like these can still be strong and reliable investments when bought at the right price. California Water Service does not look like an attractive investment today, however, due to its elevated valuation. Due to weak projected total returns, we rate California Water Service a sell at current prices. The recession-resistant business model does not justify the current very high valuation, we believe.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	584	597	588	609	676	698	715	794	791	846
Gross Profit	341	354	359	366	412	421	419	476	467	517
Gross Margin	58.3%	59.2%	61.0%	60.1%	60.9%	60.3%	58.6%	59.9%	59.1%	61.1%
SG&A Exp.	98	97	113	88	93	101	109	117	127	133
D&A Exp.	60	63	63	65	79	86	91	101	112	117
Operating Profit	93	109	96	112	142	129	115	146	130	132
Operating Margin	15.9%	18.2%	16.3%	18.4%	21.1%	18.5%	16.1%	18.4%	16.4%	15.6%
Net Profit	47	57	45	49	73	66	63	97	101	96
Net Margin	8.1%	9.5%	7.7%	8.0%	10.8%	9.4%	8.8%	12.2%	12.8%	11.3%
Free Cash Flow	1	(4)	(32)	(68)	(111)	(93)	(105)	(181)	(61)	(84)
Income Tax	20	28	25	27	37	16	18	12	4	6

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1,960	2,187	2,241	2,412	2,745	2,838	3,111	3,394	3,623	3,851
Cash & Equivalents	28	20	9	25	95	47	43	45	78	62
Accounts Receivable	31	26	32	30	32	30	32	53	68	62
Inventories	6	6	6	6	6	7	8	9	10	13
Goodwill & Int. Ass.	15	14	15	14	25	27	27	59	67	65
Total Liabilities	1,361	1,561	1,599	1,752	2,045	2,108	2,331	2,473	2,440	2,528
Accounts Payable	55	59	66	78	94	96	108	132	144	141
Long-Term Debt	481	505	548	655	807	880	984	1,156	1,096	1,126
Shareholder's Equity	599	627	642	659	699	730	780	921	1,178	1,318
LTD/E Ratio	0.80	0.81	0.85	0.99	1.15	1.21	1.26	1.25	0.93	0.85

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	2.4%	2.7%	2.0%	2.1%	2.8%	2.3%	2.1%	3.0%	2.9%	2.6%
Return on Equity	8.8%	9.3%	7.1%	7.5%	10.7%	9.2%	8.4%	11.4%	9.6%	7.7%
ROIC	4.4%	5.1%	3.9%	3.9%	5.2%	4.2%	3.7%	5.0%	4.6%	4.1%
Shares Out.	48	48	48	48	48	48	48	50	53	55
Revenue/Share	12.58	12.49	12.29	12.71	14.08	14.53	14.83	16.12	15.32	15.57
FCF/Share	0.03	(0.08)	(0.67)	(1.43)	(2.32)	(1.93)	(2.18)	(3.67)	(1.19)	(1.54)

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

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