California Water Services (CWT)

Updated August 5th, 2024 by Jonathan Weber

Key Metrics

Current Price:	$53	**5 Year CAGR Estimate:**	9.5%	**Market Cap:**	$3.1B
Fair Value Price:	$60	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	11/03/24[1]
% Fair Value:	88%	**5 Year Valuation Multiple Estimate:**	2.5%	**Dividend Payment Date:**	11/08/24[2]
Dividend Yield:	2.1%	**5 Year Price Target**	$77	**Years Of Dividend Growth:**	56
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Rating:**	Hold

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 second quarter earnings results on August 1. The company reported that its operating revenues totaled $244 million during the quarter, which was 26% more than the revenues that California Water Service generated during the previous year's quarter. This represents a stronger performance compared to what the analyst community had forecasted. The operating revenue increase was driven by rate increases over the last year as well as by higher accrued unbilled revenue compared to the previous year's quarter.

California Water Service generated earnings-per-share of $0.70 during the second quarter, which was way better than what was expected by the analyst community. California Water Services is generally most profitable during the summer quarter, when water demand is way higher than during the winter quarters, thus healthy profits during the period are in line with historic patterns. Profits during 2024 should hit a new record high per current estimates.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$1.19	$0.94	$1.01	$1.52	$1.36	$1.31	$1.97	$1.96	$1.77	$0.89	***$3.00***	***$3.83***
DPS	$0.65	$0.67	$0.69	$0.72	$0.75	$0.79	$0.85	$0.92	$1.00	$1.04	***$1.12***	***$1.50***
Shares[3]	48	48	48	48	48	48	50	53	55	57	***58***	***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.

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[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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	19.7	24.8	29.6	26.9	35.3	39.7	27.4	36.7	34.5	58.4	***17.7***	***20.0***
Avg. Yld.	2.8%	2.9%	2.3%	1.9%	1.6%	1.5%	1.6%	1.3%	1.6%	2.0%	***2.1%***	***2.0%***

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 through 2023, but due to much higher expected profits in 2024, the earnings multiple for this year is at the lower end of the historic range. For the first time in many years, California Water Service is not overvalued any more, and trades slightly below fair value right now.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	54.6%	71.3%	68.3%	51.4%	55.1%	60.3%	43.1%	46.9%	56.5%	117%	***37.3%***	***39.1%***

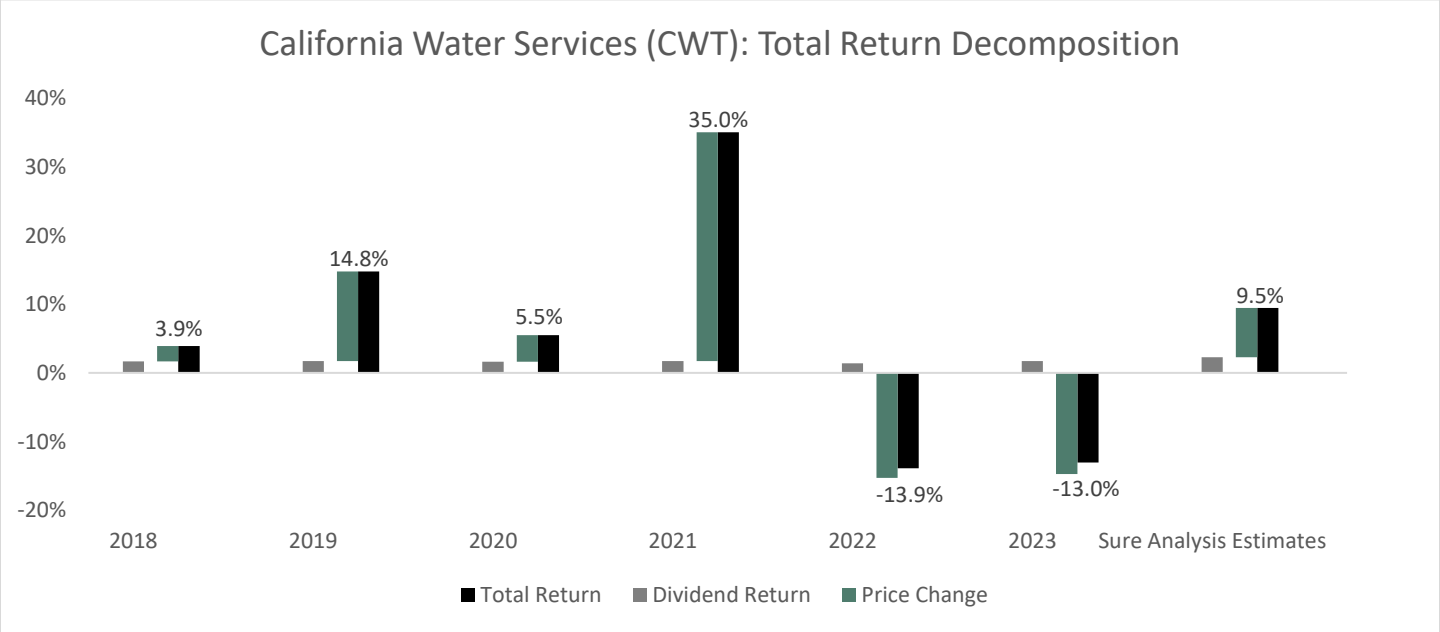
California Water Service has paid out between 40% and 70% of its net profits throughout most of the last decade. Overall, the dividend payout ratio has declined slightly over that time frame, as the company's dividend growth rate was lower than its earnings-per-share growth rate. The predictable nature 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 looks like a solid but not great investment today, trading below fair value and offering high single digits total returns per year from the current level. We thus rate California Water Service a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	597	588	609	676	698	715	794	791	846	795
Gross Profit	288	292	286	337	341	341	392	271	281	221
Gross Margin	48.2%	49.6%	47.0%	49.9%	48.8%	47.7%	49.3%	34.2%	33.3%	27.8%
SG&A Exp.	97	113	88	93	101	109	117	0	0	0
D&A Exp.	63	63	65	79	86	91	101	112	117	123
Operating Profit	109	96	112	146	133	121	151	132	136	69
Operating Margin	18.2%	16.3%	18.4%	21.6%	19.1%	17.0%	19.0%	16.7%	16.1%	8.7%
Net Profit	57	45	49	73	66	63	97	101	96	52
Net Margin	9.5%	7.7%	8.0%	10.8%	9.4%	8.8%	12.2%	12.8%	11.3%	6.5%
Free Cash Flow	(4)	(32)	(68)	(111)	(93)	(105)	(181)	(61)	(84)	(166)
Income Tax	28	25	27	37	16	18	12	4	6	(7)

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	2,187	2,241	2,412	2,745	2,838	3,111	3,394	3,623	4,265	4,596
Cash & Equivalents	20	9	25	95	47	43	45	78	62	40
Accounts Receivable	26	32	30	32	30	32	53	68	62	66
Inventories	6	6	6	6	7	8	9	10	13	16
Goodwill & Int. Ass.	14	15	14	25	27	27	59	67	54	58
Total Liabilities	1,561	1,599	1,752	2,045	2,108	2,331	2,473	2,451	2,942	3,165
Accounts Payable	59	66	78	94	96	108	132	144	141	157
Long-Term Debt	505	548	655	807	880	984	1,156	1,096	1,126	1,233
Shareholder's Equity	627	642	659	699	730	780	921	1,167	1,318	1,427
LTD/E Ratio	0.81	0.85	0.99	1.15	1.21	1.26	1.25	0.94	0.85	0.86

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	2.7%	2.0%	2.1%	2.8%	2.3%	2.1%	3.0%	2.9%	2.4%	1.2%
Return on Equity	9.3%	7.1%	7.5%	10.7%	9.2%	8.4%	11.4%	9.7%	7.7%	3.8%
ROIC	5.1%	3.9%	3.9%	5.2%	4.2%	3.7%	5.0%	4.7%	4.1%	2.0%
Shares Out.	48	48	48	48	48	48	50	53	55	57
Revenue/Share	12.49	12.29	12.71	14.08	14.53	14.83	16.12	15.32	15.57	13.95
FCF/Share	(0.08)	(0.67)	(1.43)	(2.32)	(1.93)	(2.18)	(3.67)	(1.19)	(1.54)	(2.91)

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

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