

CALIFORNIA WATER SERVICE GROUP

Form 10-Q

November 06, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2007

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 1-13883

CALIFORNIA WATER SERVICE GROUP

(Exact name of registrant as specified in its charter)

Delaware

77-0448994

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer identification No.)

1720 North First Street, San Jose, CA.

95112

(Address of principal executive offices)

(Zip Code)

408-367-8200

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by checkmark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 or the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in rule 12b-2 of the Exchange Act) Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Common shares outstanding as of November 1, 2007 20,666,869.

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PART I FINANCIAL INFORMATION

Item 1.

FINANCIAL STATEMENTS

The condensed consolidated financial statements presented in this filing on Form 10-Q have been prepared by management and are unaudited.

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CONDENSED CONSOLIDATED BALANCE SHEETS**

Unaudited

(In thousands, except per share data)

	September 30, 2007	December 31, 2006
ASSETS		
Utility plant:		
Utility plant	\$ 1,420,585	\$ 1,344,415
Less accumulated depreciation and amortization	(429,319)	(402,940)
Net utility plant	991,266	941,475
Current assets:		
Cash and cash equivalents	26,491	60,312
Receivables:		
Customers	29,514	19,526
Other	7,549	6,700
Unbilled revenue	14,711	11,341
Materials and supplies at average cost	4,789	4,515
Prepaid pension expense		1,696
Taxes and other prepaid expenses	5,300	5,534
Total current assets	88,354	109,624
Other assets		
Regulatory assets	93,907	93,785
Other assets	22,377	20,135
Total other assets	116,284	113,920
	\$ 1,195,904	\$ 1,165,019
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock, \$.01 par value	\$ 207	\$ 207
Additional paid-in capital	211,782	211,513
Retained earnings	171,607	166,582
Total common stockholders' equity	383,596	378,302
Preferred stock	3,475	3,475
Long-term debt, less current maturities	291,051	291,814
Total capitalization	678,122	673,591
Current liabilities:		
Current maturities of long-term debt	1,832	1,778

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Accounts payable	39,086	33,130
Accrued expenses and other liabilities	40,747	35,317
Total current liabilities	81,665	70,225
Unamortized investment tax credits	2,541	2,541
Deferred income taxes, net	69,517	69,503
Pension and postretirement benefits other than pensions	48,584	48,584
Regulatory and other liabilities	33,724	33,411
Advances for construction	167,719	157,660
Contributions in aid of construction	114,032	109,504
Commitments and contingencies		
	\$ 1,195,904	\$ 1,165,019

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

Table of Contents**CALIFORNIA WATER SERVICE GROUP
CONDENSED CONSOLIDATED STATEMENTS OF INCOME****Unaudited**

(In thousands, except per share data)

	September 30, 2007	September 30, 2006
For the three months ended:		
Operating revenue	\$ 113,851	\$ 107,755
Operating expenses:		
Water production costs	45,063	43,998
Other operations	26,495	23,756
Maintenance	4,233	4,173
Depreciation and amortization	8,392	7,717
Income taxes	8,426	8,552
Property and other taxes	3,707	3,477
Total operating expenses	96,316	91,673
Net operating income	17,535	16,082
Other income and expenses:		
Non-regulated revenue	3,418	2,358
Non-regulated expense	(2,136)	(1,610)
Gain (loss) on sale of non-utility property		
Less: income taxes on other income and expenses	(522)	(305)
Total other income and expenses	760	443
Interest expense:		
Interest expense	4,936	5,031
Less: capitalized interest	(450)	(1,125)
Net interest expense	4,486	3,906
Net income	\$ 13,809	\$ 12,619
Earnings per share		
Basic	\$ 0.67	\$ 0.68
Diluted	\$ 0.67	\$ 0.68
Weighted average shares outstanding		
Basic	20,667	18,407

Diluted	20,691	18,424
Dividends per share of common stock	\$ 0.2900	\$ 0.2875

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

Table of Contents**CALIFORNIA WATER SERVICE GROUP
CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

Unaudited

(In thousands, except per share data)

	September 30, 2007	September 30, 2006
For the nine months ended:		
Operating revenue	\$ 281,203	\$ 254,072
Operating expenses:		
Water production costs	108,147	95,637
Other operations	75,425	70,943
Maintenance	13,983	11,503
Depreciation and amortization	25,173	23,066
Income taxes	13,761	12,593
Property and other taxes	10,548	9,698
Total operating expenses	247,037	223,440
Net operating income	34,166	30,632
Other income and expenses:		
Non-regulated revenue	9,883	6,713
Non-regulated expenses	(5,853)	(4,948)
Gain (loss) on sale of non-utility property	(83)	348
Less: income taxes on other income and expenses	(1,608)	(861)
Total other income and expenses	2,339	1,252
Interest expense:		
Interest expense	14,788	14,698
Less: capitalized interest	(1,400)	(1,975)
Total interest expense	13,388	12,723
Net income	\$ 23,117	\$ 19,161
Earnings per share		
Basic	\$ 1.11	\$ 1.03
Diluted	\$ 1.11	\$ 1.03
Weighted average shares outstanding		

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Basic	20,664	18,405
Diluted	20,688	18,426
Dividends per share of common stock	\$ 0.8700	\$ 0.8625

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

Unaudited

(In thousands)

	September 30, 2007	September 30, 2006
For the nine months ended:		
Operating activities		
Net income	\$ 23,117	\$ 19,161
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	25,173	23,065
Amortization of debt	505	496
Deferred income taxes, investment tax credits, regulatory assets and liabilities, net	122	1,120
(Gain) loss on sale of non-utility property	83	(348)
Changes in operating assets and liabilities:		
Receivables	(10,744)	(9,789)
Unbilled revenue	(3,371)	(3,250)
Taxes and other prepaid expenses	(1,283)	(196)
Accounts payable	10,270	8,299
Other current assets	(273)	(254)
Other current liabilities	5,430	17,676
Other changes, net	(1,923)	(621)
Net adjustments	23,989	36,198
Net cash provided by operating activities	47,106	55,359
Investing activities:		
Utility plant expenditures:		
Company funded	(61,660)	(67,065)
Developer funded	(17,904)	(19,258)
Acquisitions	(30)	(509)
Proceeds from sale of non-utility property		353
Net cash used in investing activities	(79,594)	(86,479)
Financing activities:		
Net short-term borrowings		1,750
Net repayment of long-term debt	(905)	(842)
Proceeds from long-term debt, net of expenses	196	19,879
Advances for construction	14,724	18,766
Refunds of advances for construction	(4,665)	(4,647)
Contributions in aid of construction	7,139	6,511

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Issuance of common stock	270	465
Dividends paid	(18,092)	(15,989)
Net cash (used in) provided by financing activities	(1,333)	25,893
Change in cash and cash equivalents	(33,821)	(5,227)
Cash and cash equivalents at beginning of period	60,312	9,533
Cash and cash equivalents at end of period	\$ 26,491	\$ 4,306
Supplemental disclosure of non-cash activities:		
Accrued payables for investments in utility plant	\$ 6,164	\$ 5,288
See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements		

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CALIFORNIA WATER SERVICE GROUP
Notes to Unaudited Condensed Consolidated Financial Statements
September 30, 2007

(Amounts in thousands, except share and per share amounts)

Note 1. Organization and Operations

California Water Service Group (the Company) is a holding company with five wholly owned subsidiaries that provide water utility and other related services in California, Washington, New Mexico and Hawaii. California Water Service Company (Cal Water), Washington Water Service Company (Washington Water), New Mexico Water Service Company (New Mexico Water), and Hawaii Water Service Company, Inc. (Hawaii Water) provide regulated utility services under the rules and regulations of their respective state's regulatory commissions (Commissions). In addition, these entities and CWS Utility Services provide non-regulated water utility and utility-related services. The Company operates primarily in one business segment providing water utility services.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

The interim financial information is unaudited. The condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2006, included in its Form 10-K as filed with the Securities and Exchange Commission (SEC) on March 14, 2007.

In the opinion of management, the accompanying condensed consolidated financial statements reflect all adjustments that are necessary to provide a fair presentation of the results for the periods covered. The adjustments consist only of normal recurring adjustments. The results for interim periods are not necessarily indicative of the results for any future period.

The preparation of the Company's condensed consolidated financial statements necessarily requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the condensed consolidated balance sheet dates, and the reported amounts of revenues and expenses for the periods presented.

Certain prior years amounts have been reclassified, where necessary, to conform to the current presentation as follows: on the income statement, non-regulated income and non-regulated expenses which were previously netted in the income statement have been presented separately; also, prior year amounts for income taxes associated with other income and expenses were reclassified from income taxes included in operating expenses to income taxes on other income and expenses. On the statements of cash flows, prior year amounts for company-funded utility plant expenditures and accounts payable have been reduced for non-cash activities.

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Revenue

Revenue consists of monthly cycle billings for regulated water and wastewater services at rates authorized by the Commissions and billings to certain non-regulated customers. Billings include a fee that is paid to the Commissions. This amount is recorded in revenue and other operations expense. Fees paid to the Commissions for the nine months ending September 30, 2007, and September 30, 2006, were \$3,783 and \$3,454, respectively.

Other Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157 Fair Value Measurements. The statement defines fair value, establishes a framework for measuring fair values in generally accepted accounting principles, and expands disclosures about fair value measurements. The statement is effective for years beginning after November 15, 2007. The adoption of this statement is not expected to have a material impact on the Company's financial position, results of operations or cash flows. In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115. The statement permits entities to choose to measure many financial instruments and certain other items at fair value. The statement is effective for years beginning after November 15, 2007. The adoption of this statement is not expected to have a material impact on the Company's financial position, results of operations, or cash flows.

Note 3. Seasonal Business

Due to the seasonal nature of the water business, the results for interim periods are not indicative of the results for a twelve-month period. Revenue and income are generally higher in the warm, dry summer months when water usage and sales are greater. Revenue and income are lower in the winter months when cooler temperatures and rainfall curtail water usage and sales.

Note 4. Stock-based Compensation

Long-Term Incentive Plan

The Company had a stockholder-approved Long-Term Incentive Plan (which was replaced on April 27, 2005, by a stockholder-approved Equity Incentive Plan) that allowed granting of non-qualified stock options. The Company accounted for options issued under the Long-Term Incentive Plan using the intrinsic value method under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. All outstanding options under the Long-Term Incentive Plan have an exercise price equal to the market price on the date they were granted, and are fully vested. No compensation expense was recorded for the nine-month periods ended September 30, 2007 and 2006 related to stock options issued under the Long-Term Incentive Plan.

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The table below reflects the stock options granted under the Long-Term Incentive Plan.

	Shares		Weighted Average Exercise Price
Stock Options:			
Outstanding at December 31, 2006	90,500	\$	24.94
Exercised	- 0 -		- 0 -
Forfeited	- 0 -		- 0 -
Outstanding at September 30, 2007	90,500	\$	24.94
Exercisable at September 30, 2007	90,500	\$	24.94

Equity Incentive Plan

Pursuant to the Equity Incentive Plan, which was approved by shareholders in April 2005, the Company is authorized to issue up to 1,000,000 shares of common stock. In the first nine months of 2007 and 2006, the Company granted Restricted Stock Awards (RSAs) of 10,170 and 9,467 shares, respectively, of common stock to employees and directors of the Company. Employee awards vest ratably over 48 months, while director awards generally vest at the end of 12 months. The shares were valued at the weighted average price of \$38.20 and \$38.65 per share, respectively, based upon the fair market value of the Company's common stock on the date of grant. In the first nine months of 2007 and 2006, the Company granted Stock Appreciation Rights (SARs) equivalent to 24,140 and 40,000 shares, respectively, to employees, which vest ratably over 48 months and expire at the end of 10 years. The grant-date fair value for SARs was determined using the Black Scholes model, which arrived at a fair value of \$10.41 and \$7.73 per share, respectively. Upon exercise of a SAR, the appreciation is payable in common shares of the Company. The assumptions utilized in calculation of the SAR fair value were:

	2007	2006
Expected dividend yield	2.99%	2.99%
Expected volatility	32.79%	21.90%
Risk-free interest rate	4.48%	4.19%
Expected holding period in years	5.2	6.0

The Company did not apply a forfeiture rate in the expense computation relating to RSAs and SARs issued to employees as they vest monthly and, as a result, the expense is recorded for actual vesting during the period. For outside directors the Company did not apply a forfeiture rate in the expense computation relating to RSAs, as the Company expects 100% to vest at the end of twelve months.

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The table below reflects SARs granted under the Equity Incentive Plan.

	Shares		Weighted Average Exercise Price
Stock Appreciation Rights			
Outstanding at December 31, 2006	37,969	\$	38.77
Granted	24,140		38.30
Exercised	- 0 -		
Forfeited	(469)		38.51
Outstanding at September 30, 2007	61,640	\$	38.59
Exercisable at September 30, 2007	18,220	\$	38.64

The Company has recorded compensation costs for the RSAs and SARs in Operating Expense, net of related tax effects, in the amount of \$101 and \$73 for the quarter ending September 30, 2007, and September 30, 2006, respectively, and \$270 and \$216 for the nine months ending September 30, 2007 and 2006, respectively.

Note 5. Earnings Per Share Calculations

The computations of basic and diluted earnings per share are noted below. RSAs are included in the weighted stock outstanding used to calculate basic and dilutive earnings per share as the shares have all voting and dividend rights as issued and unrestricted common stock. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

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All options are dilutive and for 2007 all SARs are antidilutive. The dilutive effect is shown in the table below.

(In thousands, except per share data)	Three Months Ended September 30,	
	2007	2006
Net income	\$ 13,809	\$ 12,619
Less preferred dividends	38	38
Net income available to common stockholders	\$ 13,771	\$ 12,581
Weighted average common shares, basic	20,667	18,407
Dilutive common stock options and SARs (treasury method)	24	17
Shares used for dilutive computation	20,691	18,424
Net income per share basic	\$ 0.67	\$ 0.68
Net income per share diluted	\$ 0.67	\$ 0.68

	Nine Months Ended September 30,	
	2007	2006
Net income	\$ 23,117	\$ 19,161
Less preferred dividends	115	115
Net income available to common stockholders	\$ 23,002	\$ 19,046
Weighted average common shares, basic	20,664	18,405
Dilutive common stock options and SARs (treasury method)	24	21
Shares used for dilutive computation	20,688	18,426
Net income per share basic	\$ 1.11	\$ 1.03
Net income per share diluted	\$ 1.11	\$ 1.03

Note 6. Pension Plan and Other Postretirement Benefits

The Company provides a qualified, defined-benefit, non-contributory pension plan for substantially all employees. The Company makes annual contributions to fund the amounts accrued for the qualified pension plan. The Company also maintains an unfunded, non-qualified, supplemental executive retirement plan. The costs of the plans are charged to expense and utility plant as appropriate.

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The Company offers medical, dental, vision, and life insurance benefits for retirees and th