

CALIFORNIA WATER SERVICE GROUP

Form 10-Q

July 28, 2016

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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 June 30, 2016

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

of incorporation or organization)

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 check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated Filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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 June 30, 2016 — 47,970,931

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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.

CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATED BALANCE SHEETS

Unaudited (In thousands, except per share data)

	June 30, 2016	December 31, 2015
<b>ASSETS</b>		
Utility plant:		
Utility plant	\$2,621,322	\$ 2,506,946
Less accumulated depreciation and amortization	(836,245 )	(805,178 )
Net utility plant	1,785,077	1,701,768
Current assets:		
Cash and cash equivalents	30,826	8,837
Receivables:		
Customers	36,635	31,512
Regulatory balancing accounts	26,453	35,052
Other	11,901	14,760
Unbilled revenue	33,535	23,181
Materials and supplies at weighted average cost	6,393	6,339
Taxes, prepaid expenses, and other assets	13,257	7,897
Total current assets	159,000	127,578
Other assets:		
Regulatory assets	363,321	361,893
Goodwill	2,615	2,615
Other assets	48,110	47,399
Total other assets	414,046	411,907
<b>TOTAL ASSETS</b>	<b>\$2,358,123</b>	<b>\$ 2,241,253</b>
<b>CAPITALIZATION AND LIABILITIES</b>		
Capitalization:		
Common stock, \$0.01 par value; 68,000 shares authorized, 47,971 and 47,875 outstanding in 2016 and 2015, respectively	\$480	\$ 479
Additional paid-in capital	333,561	333,135
Retained earnings	302,719	308,541
Total common stockholders' equity	636,760	642,155
Long-term debt, less current maturities	555,787	508,002
Total capitalization	1,192,547	1,150,157
Current liabilities:		
Current maturities of long-term debt	6,133	6,043
Short-term borrowings	75,100	33,615
Accounts payable	77,604	66,380
Regulatory balancing accounts	2,702	2,227

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Accrued interest	5,820	5,088
Accrued expenses and other liabilities	34,654	34,545
Total current liabilities	202,013	147,898
Unamortized investment tax credits	1,872	1,872
Deferred income taxes	271,407	264,897
Pension and postretirement benefits other than pensions	238,823	236,266
Regulatory liabilities and other	92,141	82,414
Advances for construction	180,429	180,172
Contributions in aid of construction	178,891	177,577
Commitments and contingencies (Note 10)	—	—
<b>TOTAL CAPITALIZATION AND LIABILITIES</b>	<b>\$2,358,123</b>	<b>\$2,241,253</b>
See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements		

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Unaudited (In thousands, except per share data)

For the three months ended	June 30, 2016	June 30, 2015
Operating revenue	\$152,445	\$144,414
Operating expenses:		
Operations:		
Water production costs	57,589	53,022
Administrative and general	23,366	26,637
Other operations	18,903	17,512
Maintenance	5,934	5,326
Depreciation and amortization	15,842	15,354
Income taxes	6,870	5,102
Property and other taxes	5,407	4,968
Total operating expenses	133,911	127,921
Net operating income	18,534	16,493
Other income and expenses:		
Non-regulated revenue	3,764	3,479
Non-regulated expenses	(2,809)	(3,504)
Income tax (expense) benefit on other income and expenses	(384)	10
Net other income (loss)	571	(15)
Interest expense:		
Interest expense	8,434	7,061
Less: capitalized interest	(837)	(428)
Net interest expense	7,597	6,633
Net Income	\$11,508	\$9,845
Earnings per share:		
Basic	\$0.24	\$0.21
Diluted	0.24	0.21
Weighted average shares outstanding:		
Basic	47,972	47,880
Diluted	47,972	47,892
Dividends declared per share of common stock	\$0.1725	\$0.1675

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Unaudited (In thousands, except per share data)

For the six months ended	June 30, 2016	June 30, 2015
Operating revenue	\$274,172	\$266,399
Operating expenses:		
Operations:		
Water production costs	98,658	98,224
Administrative and general	51,193	54,332
Other operations	38,205	33,355
Maintenance	11,997	9,783
Depreciation and amortization	31,888	30,673
Income taxes	5,945	5,715
Property and other taxes	11,482	10,327
Total operating expenses	249,368	242,409
Net operating income	24,804	23,990
Other income and expenses:		
Non-regulated revenue	7,192	6,726
Non-regulated expenses	(5,789)	(5,747)
Income tax expense on other income and expenses	(565)	(393)
Net other income	838	586
Interest expense:		
Interest expense	16,499	14,130
Less: capitalized interest	(1,567)	(974)
Net interest expense	14,932	13,156
Net Income	\$10,710	\$11,420
Earnings per share:		
Basic	\$0.22	\$0.24
Diluted	0.22	0.24
Weighted average shares outstanding:		
Basic	47,938	47,853
Diluted	47,943	47,873
Dividends declared per share of common stock	\$0.3450	\$0.3350

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 Unaudited (In thousands)

	June 30, 2016	June 30, 2015
For the six months ended:		
Operating activities:		
Net income	\$10,710	\$11,420
Adjustments to reconcile net income to net cash:		
Depreciation and amortization	32,701	31,652
Change in value of life insurance contracts	(336 )	50
Changes in operating assets and liabilities:		
Receivables and unbilled revenue	(561 )	(7,511 )
Accounts payable	4,745	1,458
Other current assets	(4,760 )	(1,014 )
Other current liabilities	355	3,664
Other changes in noncurrent assets and liabilities	16,209	8,630
Net cash provided by operating activities	59,063	48,349
Investing activities:		
Utility plant expenditures	(116,155)	(75,827 )
Life insurance proceeds	495	—
Purchase of life insurance contracts	(1,065 )	(214 )
Change in restricted cash	(653 )	46
Net cash used in investing activities	(117,378)	(75,995 )
Financing activities:		
Short-term borrowings	103,100	52,500
Repayment of short-term borrowings	(61,615 )	(5,000 )
Proceeds from long-term debt, net of issuance costs of \$177 for 2016, \$0 for 2015	49,823	50
Repayment of long-term debt	(2,463 )	(2,554 )
Advances and contributions in aid of construction	11,463	6,921
Refunds of advances for construction	(3,472 )	(3,316 )
Dividends paid	(16,532 )	(16,027 )
Net cash provided by financing activities	80,304	32,574
Change in cash and cash equivalents	21,989	4,928
Cash and cash equivalents at beginning of period	8,837	19,587
Cash and cash equivalents at end of period	\$30,826	\$24,515
Supplemental information:		
Cash paid for interest (net of amounts capitalized)	\$13,572	\$12,664
Supplemental disclosure of non-cash activities:		
Accrued payables for investments in utility plant	\$25,397	\$21,890
Utility plant contribution by developers	7,198	3,246
See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements		



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CALIFORNIA WATER SERVICE GROUP

Notes to Unaudited Condensed Consolidated Financial Statements

June 30, 2016

Dollar amounts in thousands unless otherwise stated

Note 1. Organization and Operations and Basis of Presentation

California Water Service Group (the Company) is a holding company that provides water utility and other related services in California, Washington, New Mexico and Hawaii through its wholly-owned subsidiaries. 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 (jointly referred to herein as the Commissions). CWS Utility Services and HWS Utility Services LLC provide non-regulated water utility and utility-related services.

The Company operates in one reportable segment, providing water and related utility services.

Basis of Presentation

The unaudited interim financial information has been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission (SEC) and therefore do not contain all of the information and footnotes required by GAAP and the SEC for annual financial statements. The condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2015, included in its annual report on Form 10-K as filed with the SEC on February 25, 2016.

The preparation of the Company's condensed consolidated unaudited interim financial statements in accordance with GAAP 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 balance sheet dates and the reported amounts of revenues and expenses for the periods presented. These include, but are not limited to, estimates and assumptions used in determining the Company's regulatory asset and liability balances based upon probability assessments of regulatory recovery, revenues earned but not yet billed, asset retirement obligations, allowance for doubtful accounts, pension and other employee benefit plan liabilities, and income tax-related assets and liabilities. Actual results could differ from these estimates.

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

Due to the seasonal nature of the water business, the results for interim periods are not indicative of the results for a 12-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 generally lower in the winter months when cooler temperatures and rainfall curtail water usage and sales.

Note 2. Summary of Significant Accounting Policies

Revenue

Revenue generally includes monthly cycle customer billings for regulated water and wastewater services at rates authorized by regulatory commissions (plus an estimate for water used between the customer's last meter reading and the end of the accounting period) and billings to certain non-regulated customers at rates authorized by contract with government agencies.

The Company's regulated water and waste water revenue requirements are authorized by the Commissions in the states in which they operate. The revenue requirements are intended to provide the Company a reasonable opportunity to recover its operating costs and earn a return on investments.

For metered customers, Cal Water recognizes revenue from rates which are designed and authorized by the California Public Utilities Commission (CPUC). Under the Water Revenue Adjustment Mechanism (WRAM), Cal Water records the adopted level of volumetric revenues, which would include recovery of cost of service and a return on investments, as

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established by the CPUC for metered accounts (adopted volumetric revenues). In addition to volumetric-based revenues, the revenue requirements approved by the CPUC include service charges, flat rate charges, and other items not subject to the WRAM. The adopted volumetric revenue considers the seasonality of consumption of water based upon historical averages. The variance between adopted volumetric revenues and actual billed volumetric revenues for metered accounts is recorded as a component of revenue with an offsetting entry to a regulatory asset or liability balancing account (tracked individually for each Cal Water district) subject to certain criteria under the accounting for regulated operations being met. The variance amount may be positive or negative and represents amounts that will be recovered from or refunded to customers in the future.

Cost-recovery rates are designed to permit full recovery of certain costs allowed to be recovered by the Commissions. Cost-recovery rates such as the Modified Cost Balancing Account (MCBA) provide for recovery of adopted expense levels for purchased water, purchased power and pump taxes, as established by the CPUC. In addition, cost-recovery rates include recovery of costs related to water conservation programs and certain other operating expenses adopted by the CPUC. Variances (which include the effects of changes in both rates and volumes for the MCBA) between adopted and actual costs are recorded as a component of revenue, as the amount of such variances will be recovered from or refunded to customers in the future. Cost-recovery expenses are generally recognized when expenses are incurred with no markup for return on investments or profit.

The balances in the WRAM and MCBA asset and liability accounts will fluctuate on a monthly basis depending upon the variance between adopted and actual results. The recovery or refund of WRAM is netted against the recovery or refund of MCBA for the corresponding district. The recovery or refund of net WRAM and MCBA balances are interest bearing at the current 90 day commercial paper rate. At the end of any calendar year, Cal Water files with the CPUC to refund or collect the balance in the accounts. Undercollected net WRAM and MCBA receivable balances are collected over 12, 18, 20+ months. Cal Water defers net WRAM and MCBA operating revenues and associated costs whenever the net receivable balances are estimated to be collected more than 24 months after the respective reporting periods in which they were recognized. The deferred net WRAM and MCBA revenues and associated costs were determined using forecasts of customer consumption trends in future reporting periods and the timing of when the CPUC will authorize Cal Water's filings to recover the undercollected balances. Deferred net WRAM and MCBA revenues and associated costs will be recognized as revenues and costs in future periods when the net receivable balances are estimated to be collected within 24 months of the respective reporting period.

Customer meter reads occur on various business days throughout the month. As a result, there is unmetered or unbilled customer usage each month. The estimated unbilled revenue for monthly unmetered customer usage is recorded using the number of unbilled days for that month and average daily customer billing rate for the previous month. The average daily customer billing rate for the previous month fluctuates depending on customer usage. Estimated unbilled revenue is not included in the WRAM until it is billed.

Flat rate customers are billed in advance at the beginning of the service period. The revenue is prorated so that the portion of revenue applicable to the current period is included in that period's revenue, with the balance recorded as unearned revenue on the balance sheet and recognized as revenue when earned in the subsequent accounting period. The unearned revenue liability was \$1.0 million and \$1.3 million as of June 30, 2016 and December 31, 2015, respectively. This liability is included in "accrued expenses and other liabilities" on the condensed consolidated balance sheets.

## Cash and Cash Equivalents

Cash equivalents include highly liquid investments with maturities of three months or less. Cash and cash equivalents was \$30.8 million and \$8.8 million as of June 30, 2016 and December 31, 2015, respectively. Restricted cash was presented on the condensed consolidated balance sheet in "taxes, prepaid expenses and other assets" and was \$1.2

million and \$0.5 million as of June 30, 2016 and December 31, 2015, respectively.

#### Adoption of New Accounting Standards

In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which amends the existing guidance relating to the presentation of debt issuance costs. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The Company adopted this guidance effective January 1, 2016 and applied the requirements retrospectively for all periods presented. The adoption of this guidance did not have a material impact on the Company's condensed consolidated financial statements. The long term debt unamortized

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debt issuance costs were \$4.8 million as of June 30, 2016 and December 31, 2015, respectively. The following table shows the effect of the accounting change to the condensed consolidated balance sheet as of December 31, 2015:

Balance Sheet Classification	December 31, 2015		
	As Reported on Form 10-K	Adjusted on Form 10-Q	Decrease from Retrospective Adoption
Other Assets	\$52,241	\$47,399	\$ 4,842
Long-term debt, less current maturities	512,287	508,002	4,285
Current maturities of long-term debt	6,600	6,043	557

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers. This update creates a single, principles based framework for revenue recognition and is based on principles that govern the recognition of revenue at an amount an entity expects to be entitled when goods or services are transferred to customers. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, deferring the effective date of this amendment for public companies by one year to January 1, 2018, with early adoption permitted as of the original effective date of January 1, 2017. In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which clarifies guidance relating to principal-versus-agent implementation contained in ASU 2014-09. In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, which clarifies guidance relating to identifying performance obligations and licensing implementation contained in ASU 2014-09. In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, which clarifies implementation guidance around collectability, sales taxes collected from customers, noncash considerations, contract modifications at transition, and completed contracts at transition. The effective dates of ASU 2016-08, ASU 2016-10, and ASU 2016-12 are the same as ASU 2015-14 discussed above. The Company is currently evaluating the impact of adopting the new revenue standard on its consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, Leases. This update changes the accounting treatment of operating leases for lessees and related disclosure requirements. ASU 2016-2 is effective for annual reporting periods beginning after December 15, 2018 and early adoption is permitted. The Company is currently evaluating the impact of adopting the new lease standard on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The amendments in ASU 2016-09 involve multiple aspects of the accounting for share-based payment transactions, including income tax consequences, classification of awards as either equity or liabilities, and classification on the Statement of Cash Flows. ASU 2016-09 is effective for annual periods beginning after December 15, 2016 and early adoption is permitted. The Company is currently evaluating the impact on its consolidated financial statements and related disclosures.

### Note 3. Stock-based Compensation

#### Equity Incentive Plan

During the six months ended June 30, 2016 and 2015, the Company granted annual Restricted Stock Awards (RSAs) of 72,317 and 60,997 shares, respectively, of common stock to officers and directors of the Company and 10,600 and 13,220 shares of RSAs were canceled during the six months ended June 30, 2016 and 2015, respectively. The Company did not grant any shares of RSAs and 2,869 shares of RSAs were canceled during the three months ended

June 30, 2016. During the three months ended June 30, 2015, the Company granted 1,846 shares of RSAs and 2,573 shares of RSAs were canceled. Employee RSAs granted in 2016 and 2015 vest over 36 months. Director RSAs generally vest at the end of 12 months. During the first six months of 2016 and 2015, the RSAs granted were valued at \$25.17 and \$24.29 per share, respectively, based upon the fair market value of the Company's common stock on the date of grant.

During the six months ended June 30, 2016 and 2015, the Company granted performance-based Restricted Stock Unit Awards (RSUs) of 43,659 shares and 38,983 shares of common stock, respectively, to officers. The Company did not grant any shares of RSUs during the three months ended June 30, 2016 and granted 1,846 shares of RSUs during the three months ended June 30, 2015. Each award reflects a target number of shares that may be issued to the award recipient. The 2016 and 2015 awards may be earned upon the completion of the three year performance period ending on March 1, 2019

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and March 3, 2018, respectively. During the six months ended June 30, 2016, the Company issued 28,424 RSU shares and no RSU shares were canceled. There were no RSU shares issued or canceled during the six months ended June 30, 2015. There were no RSU shares issued or canceled during the three months ended June 30, 2016 and the three months ended June 30, 2015, respectively. The 2016 and 2015 RSUs are recognized as expense ratably over the 3 year performance period using a fair market value of \$25.17 per share and \$24.28 per share, respectively, and an estimate of RSUs earned during the performance period.

The Company has recorded compensation costs for the RSAs and RSUs in administrative and general operating expenses in the amount of \$1.4 million and \$1.0 million for the six months ended June 30, 2016 and June 30, 2015 respectively.

## Note 4. Equity

The Company's changes in total common stockholders' equity for the six months ended June 30, 2016 were as follows:

	Total Common Stockholders' Equity
Balance at December 31, 2015	\$ 642,155
Common stock issued	1
Share-based compensation expense	426
Common stock dividends declared	(16,532 )
Net income	10,710
Balance at June 30, 2016	\$ 636,760

## Note 5. Earnings Per Share

The computations of basic and diluted earnings per share are noted below. Basic earnings per share is computed by dividing the net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts were exercised or converted into common stock. RSAs are included in the weighted average common shares outstanding because the shares have all the same voting and dividend rights as issued and unrestricted common stock. RSUs are not included in diluted shares for financial reporting until authorized by the Compensation & Organization Committee of the Board of Directors.

There were no shares of Stock Appreciation Rights (SARs) outstanding as of June 30, 2016, and a total of 65,436 shares of SARs were vested and outstanding as of June 30, 2015. All the SARs were dilutive when they were outstanding during the period, as shown in the tables below.

	Three Months Ended June 30	
	2016	2015
	(In thousands, except per share data)	
Net income available to common stockholders	\$11,508	\$9,845
Weighted average common shares outstanding, basic	47,972	47,880
Dilutive SARs (treasury method)	—	12
Weighted average common shares outstanding, dilutive	47,972	47,892
Earnings per share - basic	\$0.24	\$0.21

Earnings per share - diluted	\$0.24	\$0.21
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	Six Months Ended June 30	
	2016	2015
	(In thousands, except per share data)	
Net income available to common stockholders	\$10,710	\$11,420
Weighted average common shares outstanding, basic	47,938	47,853
Dilutive SARs (treasury method)	5	20
Weighted average common shares outstanding, dilutive	47,943	47,873
Earnings per share - basic	\$0.22	\$0.24
Earnings per share - diluted	\$0.22	\$0.24

## 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 in 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 or are capitalized in utility plant as appropriate.

The Company offers medical, dental, vision, and life insurance benefits for retirees and their spouses and dependents. Participants are required to pay a premium, which offsets a portion of the cost.

Cash contributions by the Company related to pension plans were \$14.0 million and \$14.1 million for the six months ended June 30, 2016 and June 30, 2015, respectively. Cash contributions by the Company related to other postretirement benefit plans were \$3.3 million and \$3.7 million for the six months ended June 30, 2016 and June 30, 2015, respectively. The 2016 estimated cash contribution to the pension plans is \$27.3 million and to the other postretirement benefit plans is \$13.4 million.

The following table lists components of net periodic benefit costs for the pension plans and other postretirement benefits. The data listed under "pension plan" includes the qualified pension plan and the non-qualified supplemental executive retirement plan. The data listed under "other benefits" is for all other postretirement benefits.

	Three Months Ended June 30			
	Pension Plan		Other Benefits	
	2016	2015	2016	2015
Service cost	\$5,067	\$5,632	\$2,304	\$2,500
Interest cost	5,453	5,003	1,800	1,614
Expected return on plan assets	(5,454 )	(4,792 )	(1,046 )	(876 )
Amortization of prior service cost	1,555	1,502	11	11
Recognized net actuarial loss	1,293	2,400	1,261	1,458
Net periodic benefit cost	\$7,914	\$9,745	\$4,330	\$4,707

  

	Six Months Ended June 30			
	Pension Plan		Other Benefits	
	2016	2015	2016	2015
Service cost	\$10,134	\$11,265	\$4,608	\$5,001
Interest cost	10,906	10,006	3,600	3,227
Expected return on plan assets	(10,908 )	(9,584 )	(2,092 )	(1,752 )

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Amortization of prior service cost	3,109	3,004	22	22
Recognized net actuarial loss	2,586	4,800	2,523	2,917
Net periodic benefit cost	\$15,827	\$19,491	\$8,661	\$9,415

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Note 7. Short-term and Long-term Borrowings

On October 13, 2015, Cal Water agreed to sell \$150.0 million in aggregate principal amount of First Mortgage Bonds in a private placement. Pursuant to the agreement, Cal Water issued \$100.0 million of First Mortgage Bonds on October 13, 2015, consisting of \$50.0 million of 3.33% series QQQ maturing October 15, 2025 and \$50.0 million of 4.31% series RRR maturing October 16, 2045.

In March 2016, Cal Water issued the remaining \$50.0 million of First Mortgage Bonds, consisting of \$40.0 million of 4.41% series SSS maturing April 16, 2046 and \$10.0 million of 4.61% series TTT maturing April 14, 2056. Cash proceeds of approximately \$49.7 million, net of \$0.3 million debt issuance costs, were received. Cal Water used a portion of the net proceeds from the offering to repay outstanding borrowings on the Company and Cal Water lines of credit of \$48.6 million.

Both short-term unsecured credit agreements contain affirmative and negative covenants and events of default customary for credit facilities of this type including, among other things, limitations and prohibitions relating to additional indebtedness, liens, mergers, and asset sales. Also, these unsecured credit agreements contain financial covenants governing the Company and its subsidiaries' consolidated total capitalization ratio and interest coverage ratio.

The outstanding borrowings on the Company lines of credit were \$55.1 million and \$33.6 million as of June 30, 2016 and December 31, 2015, respectively. The outstanding borrowings on the Cal Water lines of credit were \$20.0 million as of June 30, 2016 and there were no borrowings as of December 31, 2015. The average borrowing rate for borrowings on the Company and Cal Water lines of credit during the six months ended June 30, 2016 was 1.30% compared to 1.07% for the same period last year.

Note 8. Income Taxes

As of June 30, 2016 and December 31, 2015, the Company had unrecognized tax benefits of approximately \$9.8 million and \$10.3 million, respectively. Included in the balance of unrecognized tax benefits as of June 30, 2016 and December 31, 2015 is approximately \$2.2 million and \$2.1 million, respectively, of tax benefits that, if recognized, would result in an adjustment to the Company's effective tax rate. The Company does not expect its unrecognized tax benefits to change significantly within the next 12 months.

The Company's fiscal year 2016 effective tax rate is estimated to be 37%.

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## Note 9. Regulatory Assets and Liabilities

Regulatory assets and liabilities were comprised of the following as of June 30, 2016 and December 31, 2015:

	June 30, 2016		December 31, 2015
Regulatory Assets			
Pension and retiree group health	\$ 205,285		\$ 205,614
Property-related temporary differences (tax benefits flowed through to customers)	81,522		81,522
Other accrued benefits	28,058		27,327
Net WRAM and MCBA long-term accounts receivable	14,716		15,410
Asset retirement obligations, net	15,329		14,682
Interim rates long-term accounts receivable	4,697		5,238
Tank coating	8,036		6,829
Health care balancing account	3,809		3,503
Other regulatory assets	1,869		1,768
Total Regulatory Assets	\$ 363,321		\$ 361,893
Regulatory Liabilities			
Future tax benefits due to customers	\$ 29,505		\$ 29,505
Conservation program	2,673		2,317
Pension balancing account	3,159		792
Net WRAM and MCBA long-term payable	5,656		488
Other regulatory liabilities	2,955		2,162
Total Regulatory Liabilities	\$ 43,948		\$ 35,264

Short-term regulatory assets and liabilities are excluded from the above table. The short-term regulatory assets were \$26.5 million as of June 30, 2016 and \$35.1 million as of December 31, 2015. The short-term regulatory assets were primarily interim rate memorandum account receivable and net WRAM and MCBA accounts receivable as of June 30, 2016 and December 31, 2015. The short-term portions of regulatory liabilities were \$2.7 million as of June 30, 2016 and \$2.2 million as of December 31, 2015. The short-term regulatory liabilities were primarily short term net WRAM payables as of June 30, 2016. The short-term regulatory liabilities were primarily short term net WRAM payables and net refund balances to rate payers for the water conservation program from the 2009 General Rate Case (GRC) as of December 31, 2015.

## Note 10. Commitment and Contingencies

Commitments

The Company has significant commitments to lease certain office spaces and water systems and to purchase water from water wholesalers. These commitments are described in Form 10-K for the year ended December 31, 2015. As of June 30, 2016, there were no significant changes from December 31, 2015.

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Contingencies

Groundwater Contamination

The Company has undertaken litigation against third parties to recover past and anticipated costs related to groundwater contamination in our service areas. The cost of litigation is expensed as incurred and any settlement is first offset against such costs. The CPUC's general policy requires all proceeds from groundwater contamination litigation to be used first to pay transactional expenses, then to make ratepayers whole for water treatment costs to comply with the CPUC's water quality standards. The CPUC allows for a risk-based consideration of contamination proceeds which exceed the costs of the remediation described above and may result in some sharing of proceeds with the shareholder, determined on a case by case basis. The CPUC has authorized various memorandum accounts that allow the Company to track significant litigation costs to request recovery of these costs in future filings and uses of proceeds to comply with CPUC's general policy.

Legal Proceedings

From time to time, the Company is involved in various disputes and litigation matters that arise in the ordinary course of business. The status of each significant matter is reviewed and assessed for potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount of the range of loss can be estimated, a liability is accrued for the estimated loss in accordance with the accounting standards for contingencies. Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, accruals are based on the best information available at the time. While the outcome of these disputes and litigation matters cannot be predicted with any certainty, management does not believe when taking into account existing reserves the ultimate resolution of these matters will materially affect the Company's financial position, results of operations, or cash flows. The Company recognized a liability of \$3.4 million and \$3.5 million for known legal matters as of June 30, 2016 and December 31, 2015, respectively. The cost of litigation is expensed as incurred and any settlement is first offset against such costs. Any settlement in excess of the cost to litigate is accounted for on a case by case basis, dependent on the nature of the settlement.

On July 21, 2016, the San Francisco Bay Area Regional Water Quality Control Board (the Water Control Board) approved a settlement between Cal Water and the Water Control Board and California Department of Fish and Wildlife (Fish and Wildlife) to resolve purported complaints from the Water Control Board and Fish and Wildlife alleging Cal Water discharged approximately 8,207,560 gallons of drinking water into Polhemus Creek that was caused by an undetected crack in a large water main located 10 feet below ground in a remote area. The water was disinfected as required to meet all federal and state water quality standards and make it safe for human consumption. Drinking water, however, can be harmful to fish and the environment.

As part of the settlement, Cal Water will replace 2,000 feet of 18-inch cast iron water main with new ductile iron main along Polhemus Road and Polhemus Creek in San Mateo. Cal Water will also conduct a streambed restoration project in San Mateo Creek to improve conditions in the creek for native fish. This work will be performed in coordination with the California Department of Fish and Wildlife. In addition to investing in these improvement projects, Cal Water will pay \$504,519 to the Water Control Board and \$20,000 to Fish and Wildlife.

Under the terms of the settlement, Cal Water will be released from all claims unless it fails to complete the projects. The agreement contains no admission of wrongdoing.

Note 11. Fair Value of Financial Assets and Liabilities

The accounting guidance for fair value measurements and disclosures provides a single definition of fair value and requires certain disclosures about assets and liabilities measured at fair value. A hierarchical framework for disclosing the observability of the inputs utilized in measuring assets and liabilities at fair value is established by this guidance. The three levels in the hierarchy are as follows:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Plan has the ability to access.

Level 2 - Inputs to the valuation methodology include:

Quoted market prices for similar assets or liabilities in active markets;

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Quoted prices for identical or similar assets or liabilities in inactive markets;  
 Inputs other than quoted prices that are observable for the asset or liability; and  
 Inputs that are derived principally from or corroborated by observable market data by correlation or other means.  
 If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Specific valuation methods include the following:

Accounts receivable and accounts payable carrying amounts approximated the fair value because of the short-term maturity of the instruments.

Long-term debt fair values were estimated using the published quoted market price, if available, or the discounted cash flow analysis, based on the current rates available using a risk-free rate (a U.S. Treasury securities yield curve) plus a risk premium of 1.70%.

Advances for construction fair values were estimated using broker quotes from companies that frequently purchase these investments.

	June 30, 2016				
	Cost	Fair Value		Total	
		Level 1	Level 2	Level 3	
Long-term debt, including current maturities	\$561,920	—	\$685,413	—	\$685,413
Advances for construction	180,429	—	74,483	—	74,483
Total	\$742,349	\$—	\$759,896	\$—	—\$759,896

	December 31, 2015				
	Cost	Fair Value		Total	
		Level 1	Level 2	Level 3	
Long-term debt, including current maturities	\$514,045	\$—	\$600,440	\$—	—\$600,440
Advances for construction	180,172	—	72,866	—	72,866
Total	\$694,217	—	\$673,306	\$—	—\$673,306

#### Note 12. Condensed Consolidating Financial Statements

On April 17, 2009, Cal Water issued \$100.0 million aggregate principal amount of 5.875% First Mortgage Bonds due 2019, and on November 17, 2010, Cal Water issued \$100.0 million aggregate principal amount of 5.500% First Mortgage Bonds due 2040, all of which are fully and unconditionally guaranteed by the Company. As a result of these guarantee arrangements, the Company is required to present the following condensed consolidating financial information. The investments in affiliates are accounted for and presented using the “equity method” of accounting.

The following tables present the condensed consolidating balance sheets as of June 30, 2016 and December 31, 2015, the condensed consolidating statements of income for the three months ended June 30, 2016 and 2015, condensed consolidating statements of income for the six months ended June 30, 2016 and 2015, and the condensed consolidating statements of cash flows for the six months ended June 30, 2016 and 2015 of (i) California Water Service Group, the guarantor of the First Mortgage Bonds and the parent company; (ii) California Water Service Company, the issuer of the First Mortgage Bonds and a 100% owned consolidated subsidiary of California Water Service Group; and (iii) the other 100% owned non-guarantor consolidated subsidiaries of California Water Service Group. The condensed consolidating balance sheet as of December 31, 2015 reflects the retrospective adoption of



ASU 2015-03 (refer to Note 2. Summary of Significant Accounting Policies for more details).

Table of ContentsCALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATING BALANCE SHEET

As of June 30, 2016

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
<b>ASSETS</b>					
Utility plant:					
Utility plant	\$ 1,318	\$ 2,425,934	\$ 201,267	\$ (7,197 )	\$ 2,621,322
Less accumulated depreciation and amortization	(719 )	(786,807 )	(50,590 )	1,871	(836,245 )
Net utility plant	599	1,639,127	150,677	(5,326 )	1,785,077
Current assets:					
Cash and cash equivalents	999	24,606	5,221	—	30,826
Receivables and unbilled revenue	—	103,802	4,722	—	108,524
Receivables from affiliates	20,793	3,931	126	(24,850 )	—
Other current assets	279	18,197	1,174	—	19,650
Total current assets	22,071	150,536	11,243	(24,850 )	159,000
Other assets:					
Regulatory assets	—	359,661	3,660	—	363,321
Investments in affiliates	645,349	—	—	(645,349 )	—
Long-term affiliate notes receivable	24,616	—	—	(24,616 )	—
Other assets	484	46,519	4,081	(359 )	50,725
Total other assets	670,449	406,180	7,741	(670,324 )	414,046
<b>TOTAL ASSETS</b>	<b>\$ 693,119</b>	<b>\$ 2,195,843</b>	<b>\$ 169,661</b>	<b>\$ (700,500 )</b>	<b>\$ 2,358,123</b>
<b>CAPITALIZATION AND LIABILITIES</b>					
Capitalization:					
Common stockholders' equity	\$ 636,760	\$ 575,196	\$ 75,492	\$ (650,688 )	\$ 636,760
Affiliate long-term debt	—	—	24,616	(24,616 )	—
Long-term debt, less current maturities	—	554,825	962	—	555,787
Total capitalization	636,760	1,130,021	101,070	(675,304 )	1,192,547
Current liabilities:					
Current maturities of long-term debt	—	5,665	468	—	6,133
Short-term borrowings	55,100	20,000	—	—	75,100
Payables to affiliates	—	1,318	23,532	(24,850 )	—
Accounts payable	—	74,883	2,721	—	77,604
Accrued expenses and other liabilities	84	39,637	3,455	—	43,176
Total current liabilities	55,184	141,503	30,176	(24,850 )	202,013
Unamortized investment tax credits	—	1,872	—	—	1,872
Deferred income taxes	1,175	270,578	—	(346 )	271,407
Pension and postretirement benefits other than pensions	—	238,823	—	—	238,823
Regulatory liabilities and other	—	89,108	3,033	—	92,141
Advances for construction	—	179,869	560	—	180,429
Contributions in aid of construction	—	144,069	34,822	—	178,891
<b>TOTAL CAPITALIZATION AND LIABILITIES</b>	<b>\$ 693,119</b>	<b>\$ 2,195,843</b>	<b>\$ 169,661</b>	<b>\$ (700,500 )</b>	<b>\$ 2,358,123</b>

Table of ContentsCALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATING BALANCE SHEET

As of December 31, 2015

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
<b>ASSETS</b>					
Utility plant:					
Utility plant	\$ 1,318	\$ 2,313,704	\$ 199,121	\$ (7,197 )	\$ 2,506,946
Less accumulated depreciation and amortization	(605 )	(758,362 )	(48,034 )	1,823	(805,178 )
Net utility plant	713	1,555,342	151,087	(5,374 )	1,701,768
Current assets:					
Cash and cash equivalents	582	4,270	3,985	—	8,837
Receivables and unbilled revenue	—	100,777	3,728	—	104,505
Receivables from affiliates	19,677	26,219	—	(45,896 )	—
Other current assets	79	13,077	1,080	—	14,236
Total current assets	20,338	144,343	8,793	(45,896 )	127,578
Other assets:					
Regulatory assets	—	358,254	3,639	—	361,893
Investments in affiliates	651,449	—	—	(651,449 )	—
Long-term affiliate notes receivable	25,099	—	—	(25,099 )	—
Other assets	758	45,544	4,616	(904 )	50,014
Total other assets	677,306	403,798	8,255	(677,452 )	411,907
<b>TOTAL ASSETS</b>	<b>\$ 698,357</b>	<b>\$ 2,103,483</b>	<b>\$ 168,135</b>	<b>\$ (728,722 )</b>	<b>\$ 2,241,253</b>
<b>CAPITALIZATION AND LIABILITIES</b>					
Capitalization:					
Common stockholders' equity	\$ 642,155	\$ 581,792	75,024	\$ (656,816 )	\$ 642,155
Affiliate long-term debt	—	—	25,099	(25,099 )	—
Long-term debt, less current maturities	—	507,034	968	—	508,002
Total capitalization	642,155	1,088,826	101,091	(681,915 )	1,150,157
Current liabilities:					
Current maturities of long-term debt	—	5,654	389	—	6,043
Short-term borrowings	33,615	—	—	—	33,615
Payables to affiliates	21,500	667	23,729	(45,896 )	—
Accounts payable	—	63,814	2,566	—	66,380
Accrued expenses and other liabilities	102	40,173	1,585	—	41,860
Total current liabilities	55,217	110,308	28,269	(45,896 )	147,898
Unamortized investment tax credits	—	1,872	—	—	1,872
Deferred income taxes	985	264,823	—	(911 )	264,897
Pension and postretirement benefits other than pensions	—	236,266	—	—	236,266
Regulatory and other liabilities	—	79,477	2,937	—	82,414
Advances for construction	—	179,630	542	—	180,172
Contributions in aid of construction	—	142,281	35,296	—	177,577
<b>TOTAL CAPITALIZATION AND LIABILITIES</b>	<b>\$ 698,357</b>	<b>\$ 2,103,483</b>	<b>\$ 168,135</b>	<b>\$ (728,722 )</b>	<b>\$ 2,241,253</b>



Table of ContentsCALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATING STATEMENT OF INCOME

For the three months ended June 30, 2016

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	\$ —	\$ 142,342	\$ 10,103	\$ —	\$ 152,445
Operating expenses:					
Operations:					
Water production costs	—	55,643	1,946	—	57,589
Administrative and general	—	20,667	2,699	—	23,366
Other operations	—	17,365	1,622	(84 )	18,903
Maintenance	—	5,692	242	—	5,934
Depreciation and amortization	57	14,735	1,074	(24 )	15,842
Income tax (benefit) expense	(93 )	6,228	497	238	6,870
Property and other taxes	—	4,669	738	—	5,407
Total operating (income) expenses	(36 )	124,999	8,818	130	133,911
Net operating income	36	17,343	1,285	(130 )	18,534
Other income and expenses:					
Non-regulated revenue	462	3,439	423	(560 )	3,764
Non-regulated expenses	—	(2,547 )	(262 )	—	(2,809 )
Income tax expense on other income and expenses	(188 )	(364 )	(60 )	228	(384 )
Total other income	274	528	101	(332 )	571
Interest:					
Interest expense	173	8,263	474	(476 )	8,434
Less: capitalized interest	—	(820 )	(17 )	—	(837 )
Net interest expense	173	7,443	457	(476 )	7,597
Equity earnings of subsidiaries	11,371	—	—	(11,371 )	—
Net income	\$ 11,508	\$ 10,428	\$ 929	\$ (11,357 )	\$ 11,508

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CONDENSED CONSOLIDATING STATEMENT OF INCOME

For the three months ended June 30, 2015

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	\$ —	\$ 135,440	\$ 8,974	\$ —	\$ 144,414
Operating expenses:					
Operations:					
Water production costs	—	51,044	1,978	—	53,022
Administrative and general	—	23,796	2,841	—	26,637
Other operations	—	16,033	1,606	(127 )	17,512
Maintenance	—	5,162	164	—	5,326
Depreciation and amortization	57	14,225	1,098	(26 )	15,354
Income tax (benefit) expense	(119 )	4,886	37	298	5,102
Property and other taxes	—	4,304	664	—	4,968
Total operating (income) expenses	(62 )	119,450	8,388	145	127,921
Net operating income	62	15,990	586	(145 )	16,493
Other income and expenses:					
Non-regulated revenue	455	3,312	392	(680 )	3,479
Non-regulated expenses, net	—	(3,193 )	(311 )	—	(3,504 )
Income tax (expense) benefit on other income and expenses	(183 )	(48 )	(46 )	287	10
Total other income (loss)	272	71	35	(393 )	(15 )
Interest:					
Interest expense	240	6,922	452	(553 )	7,061
Less: capitalized interest	—	(417 )	(11 )	—	(428 )
Net interest expense	240	6,505	441	(553 )	6,633
Equity from subsidiaries	9,751	—	—	(9,751 )	—
Net income	\$ 9,845	\$ 9,556	\$ 180	\$ (9,736 )	\$ 9,845

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CONDENSED CONSOLIDATING STATEMENT OF INCOME

For the six months ended June 30, 2016

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	\$—	\$255,369	\$ 18,803	\$—	\$ 274,172
Operating expenses:					
Operations:					
Water production costs	—	94,888	3,770	—	98,658
Administrative and general	—	45,610	5,583	—	51,193
Other operations	—	35,091	3,324	(210 )	38,205
Maintenance	—	11,532	465	—	11,997
Depreciation and amortization	114	29,650	2,172	(48 )	31,888
Income tax (benefit) expense	(187 )	5,191	446	495	5,945
Property and other taxes	—	10,059	1,423	—	11,482
Total operating (income) expenses	(73 )	232,021	17,183	237	249,368
Net operating income	73	23,348	1,620	(237 )	24,804
Other income and expenses:					
Non-regulated revenue	926	6,635	797	(1,166 )	7,192
Non-regulated expenses	—	(5,252 )	(537 )	—	(5,789 )
Income tax expense on other income and expenses	(377 )	(564 )	(99 )	475	(565 )
Total other income	549	819	161	(691 )	838
Interest:					
Interest expense	346	16,162	947	(956 )	16,499
Less: capitalized interest	—	(1,534 )	(33 )	—	(1,567 )
Net interest expense	346	14,628	914	(956 )	14,932
Equity earnings of subsidiaries	10,434	—	—	(10,434 )	—
Net income	\$10,710	\$9,539	\$ 867	\$ (10,406 )	\$ 10,710

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CONDENSED CONSOLIDATING STATEMENT OF INCOME

For the six months ended June 30, 2015

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	\$ —	\$ 249,947	\$ 16,452	\$ —	\$ 266,399
Operating expenses:					
Operations:					
Water production costs	—	94,420	3,804	—	98,224
Administrative and general	—	48,651	5,681	—	54,332
Other Operations	—	30,303	3,305	(253 )	33,355
Maintenance	—	9,426	357	—	9,783
Depreciation and amortization	114	28,428	2,182	(51 )	30,673
Income tax (benefit) expense	(187 )	5,816	(416 )	502	5,715
Property and other taxes	—	9,054	1,273	—	10,327
Total operating (income) expenses	(73 )	226,098	16,186	198	242,409