CALIFORNIA WATER SERVICE GROUP
Form 10-Q
November 01, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q
(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
or
o 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 ý No o
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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). Yes ý No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer”, “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated Filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

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 September 30, 2018 — 48,068,000

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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)

	September 30, 2018	December 31, 2017
ASSETS		
Utility plant:		
Utility plant	$ 3,169,726	$ 2,970,179
Less accumulated depreciation and amortization	(983,984)	(922,214)
Net utility plant	2,185,742	2,047,965
Current assets:		
Cash and cash equivalents	66,421	94,776
Receivables:		
Customers	50,785	32,451
Regulatory balancing accounts	37,973	36,783
Other	20,903	16,464
Unbilled revenue	40,318	29,756
Materials and supplies at weighted average cost	6,563	6,463
Taxes, prepaid expenses, and other assets	12,576	11,180
Total current assets	235,539	227,873
Other assets:		
Regulatory assets	388,300	401,147
Goodwill	2,615	2,615
Other assets	64,666	60,775
Total other assets	455,581	464,537
TOTAL ASSETS	$ 2,876,862	$ 2,740,375
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock, $0.01 par value; 68,000 shares authorized, 48,068 and 48,012 outstanding in 2018 and 2017, respectively	$ 481	$ 480
Additional paid-in capital	336,960	336,229
Retained earnings	374,593	356,753
Total common stockholders’ equity	712,034	693,462
Long-term debt, less current maturities	714,310	515,793
Total capitalization	1,426,344	1,209,255
Current liabilities:		
Current maturities of long-term debt	104,812	15,920
Short-term borrowings	75,100	275,100
Accounts payable	102,938	93,955
Regulatory balancing accounts	43,300	59,303
Accrued interest	13,111	6,122
Accrued expenses and other liabilities	42,629	40,559
Total current liabilities	381,890	490,959
Unamortized investment tax credits	1,724	1,724

Deferred income taxes	199,143	192,946
Pension and postretirement benefits other than pensions	235,501	252,141
Regulatory liabilities and other	255,569	224,127
Advances for construction	186,897	182,502
Contributions in aid of construction	189,794	186,721
Commitments and contingencies (Note 10)		
TOTAL CAPITALIZATION AND LIABILITIES	$ 2,876,862	$ 2,740,375

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
Unaudited (In thousands, except per share data)

For the three months ended	September 30, 2018	September 30, 2017
Operating revenue	$ 218,983	$ 211,731
Operating expenses:		
Operations:		
Water production costs	78,818	75,261
Administrative and general	26,493	22,749
Other operations	21,943	21,208
Maintenance	6,768	6,057
Depreciation and amortization	21,009	19,231
Income taxes	11,262	18,219
Property and other taxes	7,142	6,544
Total operating expenses	173,435	169,269
Net operating income	45,548	42,462
Other income and expenses:		
Non-regulated revenue	4,703	3,542
Non-regulated expenses	(4,897)	(2,576)
Other components of net periodic benefit cost	(1,975)	(2,137)
Allowance for equity funds used during construction	1,023	1,105
Income tax benefit on other income and expenses	305	30
Net other loss	(841)	(36)
Interest expense:		
Interest expense	10,875	9,284
Allowance for borrowed funds used during construction	(560)	(707)
Net interest expense	10,315	8,577
Net income	$ 34,392	$ 33,849
Earnings per share:		
Basic	$ 0.72	$ 0.70
Diluted	0.72	0.70
Weighted average shares outstanding:		
Basic	48,070	48,017
Diluted	48,070	48,017
Dividends declared per share of common stock	$ 0.1875	$ 0.1800

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
Unaudited (In thousands, except per share data)

For the nine months ended	September 30, 2018	September 30, 2017
Operating revenue	$ 523,862	$ 504,899
Operating expenses:		
Operations:		
Water production costs	191,797	181,460
Administrative and general	77,195	66,908
Other operations	60,307	55,660
Maintenance	17,596	16,877
Depreciation and amortization	62,677	57,650
Income taxes	15,380	27,941
Property and other taxes	20,253	18,717
Total operating expenses	445,205	425,213
Net operating income	78,657	79,686
Other income and expenses:		
Non-regulated revenue	13,967	10,743
Non-regulated expenses	(16,449)	(6,244)
Other components of net periodic benefit cost	(6,984)	(7,023)
Allowance for equity funds used during construction	2,644	2,763
Income tax benefit (expense) on other income and expenses	1,882	(1,105)
Net other loss	(4,940)	(866)
Interest expense:		
Interest expense	30,207	27,073
Allowance for borrowed funds used during construction	(1,359)	(1,765)
Net interest expense	28,848	25,308
Net income	$ 44,869	$ 53,512
Earnings per share:		
Basic	$ 0.93	$ 1.11
Diluted	0.93	1.11
Weighted average shares outstanding:		
Basic	48,058	48,007
Diluted	48,058	48,007
Dividends declared per share of common stock	$ 0.5625	$ 0.5400

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)

For the nine months ended:	September 30, 2018	September 30, 2017
Operating activities:		
Net income	$ 44,869	$ 53,512
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	64,131	59,016
Change in value of life insurance contracts	124	(1,871)
Allowance for equity funds used during construction	(2,644)	(2,763)
Changes in operating assets and liabilities:		
Receivables and unbilled revenue	(18,471)	(52,951)
Accounts payable	18,133	6,712
Other current assets	(1,392)	(4,643)
Other current liabilities	8,762	10,939
Other changes in noncurrent assets and liabilities	5,991	41,837
Net cash provided by operating activities	119,503	109,788
Investing activities:		
Utility plant expenditures	(212,856)	(180,442)
Life insurance proceeds	3,491	1,558
Purchase of life insurance contracts	(4,925)	(3,948)
Net cash used in investing activities	(214,290)	(182,832)
Financing activities:		
Short-term borrowings	141,000	185,000
Repayment of short-term borrowings	(341,000)	(87,000)
Issuance of long-term debt, net of expenses of $617 for 2018 and $0 for 2017	299,383	—
Repayment of long-term debt	(12,499)	(2,797)
Advances and contributions in aid of construction	13,630	14,964
Refunds of advances for construction	(5,462)	(6,316)
Repurchase of common stock	(1,496)	(1,359)
Dividends paid	(27,029)	(25,920)
Net cash provided by financing activities	66,527	76,572
Change in cash, cash equivalents, and restricted cash	(28,260)	3,528
Cash, cash equivalents, and restricted cash at beginning of period	95,352	25,935
Cash, cash equivalents, and restricted cash at end of period	$ 67,092	$ 29,463
Supplemental information:		
Cash paid for interest (net of amounts capitalized)	$ 19,956	$ 17,287
Income tax refund	—	$ (1,697)
Supplemental disclosure of non-cash activities:		
Accrued payables for investments in utility plant	$ 32,328	$ 31,750
Utility plant contribution by developers	$ 14,807	$ 13,022

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, 2018
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 condensed consolidated 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 unaudited condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2017, included in its annual report on Form 10-K as filed with the SEC on March 1, 2018.

The preparation of the Company's unaudited condensed consolidated 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 unaudited condensed consolidated 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
Operating revenue
The following tables disaggregate the Company's operating revenue by source for the three and nine month periods ended September 30, 2018 and 2017:

	Three Months Ended September

	30	
	2018	2017
Revenue from contracts with customers	$209,541	$197,007
Regulatory balancing account revenue	9,442	14,724
Total operating revenue	$218,983	$211,731

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	Nine Months Ended September 30	
	2018	2017
Revenue from contracts with customers	$515,567	$472,412
Regulatory balancing account revenue	8,295	32,487
Total operating revenue	$523,862	$504,899

Revenue from contracts with customers

The Company principally generates operating revenue from contracts with customers by providing regulated water and wastewater services at tariff-rates authorized by the Commissions in the states in which they operate and non-regulated water and wastewater services at rates authorized by contracts with government agencies. Revenue from contracts with customers reflects amounts billed for the volume of consumption at authorized per unit rates, for a service charge, and for other authorized charges.

The Company satisfies its performance obligation to provide water and wastewater services over time as services are rendered. The Company applies the invoice practical expedient and recognizes revenue from contracts with customers in the amount for which the Company has a right to invoice. The Company has a right to invoice for the volume of consumption, for the service charge, and for other authorized charges.

The measurement of sales to customers is generally based on the reading of their meters, which occurs on a systematic basis throughout the month. At the end of each month, the Company estimates consumption since the date of the last meter reading and a corresponding unbilled revenue is recognized. The estimate is based upon the number of unbilled days that month and the average daily customer billing rate from the previous month (which fluctuates based upon customer usage).

Contract terms are generally short-term and at will by customers and, as a result, no separate financing component is recognized for the Company's collections from customers, which generally require payment within 30 days of billing. The Company applies judgment, based principally on historical payment experience, in estimating its customers' ability to pay.

Certain customers are not billed for volumetric consumption, but are instead billed a flat rate at the beginning of each monthly service period. The amount billed is initially deferred and subsequently recognized over the monthly service period, as the performance obligation is satisfied. The deferred revenue balance, which is included in "accrued expenses and other liabilities" on the consolidated balance sheets, is inconsequential.

In the following tables, revenue from contracts with customers is disaggregated by class of customers for the three and nine month periods ended September 30, 2018 and 2017:

	Three Months Ended September 30	
	2018	2017
Residential	$138,939	$131,608
Business	38,538	35,678
Industrial	8,987	7,919
Public authorities	12,180	11,480
Other	10,897	10,322
Total revenue from contracts with customers	$209,541	$197,007

	Nine Months Ended September 30	
	2018	2017
Residential	$340,107	$309,645
Business	97,720	87,246
Industrial	24,507	21,281
Public authorities	25,875	23,500
Other	27,358	30,740

Total revenue from contracts with customers	$515,567	$472,412

Regulatory balancing account revenue

The Company’s ability to recover revenue requirements authorized by the California Public Utilities Commission (CPUC) in its triennial General Rate Case (GRC), is decoupled from the volume of the sales. Regulatory balancing account revenue

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is revenue related to rate mechanisms authorized in California by the CPUC, which allow the Company to recover the authorized revenue and are not considered contracts with customers.

The Water Revenue Adjustment Mechanism (WRAM) allows the Company to recognize the adopted level of volumetric revenues. The variance between adopted volumetric revenues and actual billed volumetric revenues for metered accounts is recorded as regulatory balancing account revenue.

Cost-recovery rates, such as the Modified Cost Balancing Account (MCBA), provide for recovery of the adopted levels of expenses for purchased water, purchased power, pump taxes, water conservation program costs and certain other operating expenses. Variances between adopted and actual costs are recorded as regulatory balancing account revenue.

Each district's WRAM and MCBA regulatory assets and liabilities are allowed to be netted against one another. The Company recognizes regulatory balancing account revenues that have been authorized for rate recovery, are objectively determinable and probable of recovery, and are expected to be collected within 24 months. To the extent that regulatory balancing account revenue is estimated to be collectible beyond 24 months, recognition is deferred.

Non-regulated Revenue

The following tables disaggregate the Company's non-regulated revenue by source for the three and nine month periods ended September 30, 2018 and 2017:

	Three Months Ended September 30	
	2018	2017
Operating and maintenance revenue	$2,816	$1,903
Other non-regulated revenue	1,328	1,143
Non-regulated revenue from contracts with customers	$4,144	$3,046
Lease revenue	$559	$496
Total non-regulated revenue	$4,703	$3,542

	Nine Months Ended September 30	
	2018	2017
Operating and maintenance revenue	$8,278	$5,870
Other non-regulated revenue	4,053	3,362
Non-regulated revenue from contracts with customers	$12,331	$9,232
Lease revenue	$1,636	$1,511
Total non-regulated revenue	$13,967	$10,743

Operating and maintenance services are provided for non-regulated water and wastewater systems owned by private companies and municipalities. The Company negotiates formal agreements with the customers, under which they provide operating, maintenance and customer billing services related to the customers' water system. The formal agreements outline the fee schedule for the services provided. The agreements typically call for a fee-per-service or a flat-rate amount per month. The Company satisfies its performance obligation of providing operating and maintenance services over time as services are rendered; as a result, the Company employs the invoice practical expedient and recognizes revenue in the amount that it has the right to invoice. Contract terms are generally short-term and, as a result, no separate financing component is recognized for its collections from customers, which generally require payment within 30 days of billing.

Other non-regulated revenue primarily relates to services for the design and installation of water mains and other water infrastructure for customers outside the regulated service areas and insurance program administration. Other non-regulated revenue is inconsequential.

The Company is the lessor in operating lease agreements with telecommunications companies under which cellular phone antennas are placed on the Company's property. Lease revenue is not considered revenue from contracts with customers and is recognized following current operating lease standards.

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Cash, Cash Equivalents, and Restricted Cash

The following table provides a reconciliation of cash, cash equivalents, and restricted cash within the Condensed Consolidated Balance Sheets that sum to the total of the same such amounts shown on the Condensed Consolidated Statements of Cash Flows:

	September 30, 2018	December 31, 2017
Cash and cash equivalents	66,421	94,776
Restricted cash (included in "taxes, prepaid expenses and other assets")	671	576
Total cash, cash equivalents, and restricted cash shown in the statements of cash flows	$ 67,092	$ 95,352

Adoption of New Accounting Standards

In May of 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (codified in ASC 606), which amends the existing revenue recognition guidance. The Company completed an evaluation of the new revenue standard and implemented the standard on January 1, 2018 using the modified retrospective method for all contracts. The reported results for 2018 reflect the application of ASC 606 guidance, while prior period amounts were not adjusted and continue to be reported in accordance with the accounting standards in effect for those periods. Other than increased disclosures regarding revenues related to contracts with customers, the implementation did not have a significant impact on the Company's consolidated financial statements (see "Operating Revenue" section of note 2 above).

In August of 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments. This update adds and clarifies guidance on the classification of certain cash receipts and payments in the statement of cash flows. The Company will continue to classify proceeds from the settlement of insurance claims on the basis of the nature of the loss and from the settlement of Company-owned life insurance policies as cash inflows on the Condensed Consolidated Statements of Cash Flows. The Company implemented the standard on January 1, 2018 and retrospectively applied the standard in the comparative period. The standard does not have a significant impact to the Company's consolidated financial statements.

In November of 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230) - Restricted Cash. The update requires the Company to combine restricted cash with cash and cash equivalents when reconciling the beginning and end of period balances in the Condensed Consolidated Statements of Cash Flows. The Company implemented the standard on January 1, 2018 and retrospectively applied the standard in the comparative period. The following table shows the effect of the accounting change to the Condensed Consolidated Statements of Cash Flows:

	Nine Months Ended September 30, 2017		
Condensed Consolidated Statements of Cash Flows line item	As Reported on Form 10-Q	Adjusted Balance on Form 10-Q	Increase (Decrease) from Retrospective Adoption
Change in restricted cash	$(679)	$—	$ 679
Net cash used in investing activities	$(183,511)	$(182,832)	$ 679
Change in cash, cash equivalents, and restricted cash	$2,849	$3,528	$ 679
Cash, cash equivalents, and restricted cash at beginning of period	$25,492	$25,935	$ 443
Cash, cash equivalents, and restricted cash at end of period	$28,341	$29,463	$ 1,122

In March of 2017, the FASB issued ASU 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The update requires employers to present the service cost component of the net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period. The other components of net benefit cost, including interest cost, expected return on plan assets, amortization of prior service cost/credit and actuarial gain/loss, and settlement and curtailment effects, are to be presented as non-operating items. In addition, the standard only allows the service cost component to be eligible for capitalization.

The standard became effective as of January 1, 2018. The presentation amendments were applied retrospectively and the capitalization amendments were applied prospectively on and after the effective date. The Company applied the practical expedient that permits the Company to use the amounts disclosed in its pension and other postretirement benefit plan footnote from the prior comparative periods as the estimation basis for applying the retrospective presentation

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requirements. The Commissions have authorized the Company to recover the other components of net periodic benefit cost through the Company's capital program and thus on and after the effective date, the other components of net periodic benefit cost that have previously been recorded as part of utility plant have been recognized as a regulatory asset (see note 9). As a result, the changes required by the standard did not have a material impact on the results of operations.

The following tables show the effect of the accounting change to the Condensed Consolidated Statements of Income for the three and nine month periods ended September 30, 2017:

	Three Months Ended September 30, 2017		
Condensed Consolidated Statement of Income line item	As Reported on Form 10-Q	Adjusted Balance on Form 10-Q	Increase (Decrease) from Retrospective Adoption
Administrative and general	$24,886	$22,749	$ (2,137)
Income taxes	$17,348	$18,219	$ 871
Total operating expenses	$170,535	$169,269	$ (1,266)
Net operating income	$41,196	$42,462	$ 1,266
Other components of net periodic benefit cost	$—	$(2,137)	$ 2,137
Income tax benefit (expense) on other income and expenses	$(841)	$30	$ 871
Net other income (loss)	$1,230	$(36)	$ (1,266)

	Nine Months Ended September 30, 2017		
Condensed Consolidated Statement of Income line item	As Reported on Form 10-Q	Adjusted Balance on Form 10-Q	Increase (Decrease) from Retrospective Adoption
Administrative and general	$73,931	$66,908	$ (7,023)
Income taxes	$26,099	$27,941	$ 1,842
Total operating expenses	$430,394	$425,213	$ (5,181)
Net operating income	$74,505	$79,686	$ 5,181
Other components of net periodic benefit cost	$—	$(7,023)	$ 7,023
Income tax expense on other income and expenses	$(2,947)	$(1,105)	$ 1,842
Net other income (loss)	$4,315	$(866)	$ (5,181)

New Accounting Standards Issued But Not Yet Adopted

In February of 2016, the FASB issued ASU 2016-02, Leases, which amends the guidance relating to the definition of a lease, recognition of lease assets and liabilities on the balance sheet, and the related disclosure requirements. In July of 2018, the FASB issued ASU 2018-11, Leases: Targeted Improvements, which amends the new leasing guidance such that entities may elect not to restate their comparative periods in the period of adoption. The guidance requires lessees to recognize an asset and liability on the balance sheet for all of their lease obligations. Operating leases were previously not recognized on the balance sheet. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018 and early adoption is permitted. The Company will adopt the standard using the modified retrospective method for its existing leases and expects this standard to increase lease assets and lease liabilities on the Condensed Consolidated Balance Sheets. The Company intends to elect certain practical expedients and will carry forward historical conclusions related to (1) contracts that contain leases, (2) existing lease classification for any expired or existing leases, and (3) initial direct costs for any existing leases. The Company will also apply the practical expedient that will allow the Company to elect, as an accounting policy, by asset class, to include both lease and nonlease components as a single component and account for it as a lease. The Company will apply the short-term lease exception for lessees which will allow the Company to not have to apply the recognition requirements of the new leasing guidance for short-term leases and to recognize lease payments in net income on a straight line basis over the lease term. The Company does not expect that the guidance will have a material impact on the Condensed Consolidated Statements of Income, Condensed Consolidated Statements of Cash Flows, and lease disclosures.

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Note 3. Stock-based Compensation

Equity Incentive Plan

During the nine months ended September 30, 2018 and 2017, the Company granted annual Restricted Stock Awards (RSAs) of 47,273 and 48,717, respectively, to officers and directors of the Company. During those same periods, 16,520 RSAs and 17,466 RSAs, respectively, were canceled. During the three months ended September 30, 2018 and 2017, 1,138 RSAs and no RSAs, respectively, were granted and 3,214 RSAs and 3,280 RSAs, respectively, were canceled. RSAs granted to officers vest over 36 months with the first year cliff vesting. RSAs granted to directors generally vest at the end of 12 months. During the first nine months of 2018 and 2017, the RSAs granted were valued at $35.40 and $36.75 per share, respectively, based upon the fair value of the Company's common stock on the date of grant.

During the nine months ended September 30, 2018 and 2017, the Company granted 28,594 and 31,389 performance-based Restricted Stock Unit Awards (RSUs), respectively, to officers. During those same periods, the Company issued 48,753 RSUs and 38,709 RSUs, respectively, to officers, and canceled 24,009 RSUs and 19,735 RSUs, respectively. During the three months ended September 30, 2018 and 2017, the Company did not grant, issue or cancel any RSUs. Each RSU award reflects a target number of shares that may be issued to the award recipient. The 2018 and 2017 awards may be earned upon completion of the three-year performance period and are recognized as expense ratably over the period using a fair value of $35.40 per share and $36.75 per share, respectively, and an estimate of RSUs earned during the period. The Company has recorded compensation costs for the RSAs and RSUs in administrative and general operating expenses in the amount of $2.3 million for the nine months ended September 30, 2018 and 2017.

Note 4. Equity

The Company's changes in total common stockholders' equity for the nine months ended September 30, 2018 were as follows:

	Total Common Stockholders' Equity
Balance at December 31, 2017	$ 693,462
Common stock issued	1
Share-based compensation expense	2,227
Repurchase of common stock	(1,496)
Common stock dividends declared	(27,029)
Net income	44,869
Balance at September 30, 2018	$ 712,034

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Note 5. Earnings Per Share

The computations of basic and diluted earnings per share are noted in the table below. Basic earnings per share are 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 Organization & Compensation Committee of the Board of Directors.

	Three Months Ended September 30	
	2018	2017
	(In thousands, except per share data)	
Net income available to common stockholders	$34,392	$33,849
Weighted average common shares outstanding, basic	48,070	48,017
Weighted average common shares outstanding, dilutive	48,070	48,017
Earnings per share - basic	$0.72	$0.70
Earnings per share - diluted	$0.72	$0.70

	Nine Months Ended September 30	
	2018	2017
	(In thousands, except per share data)	
Net income available to common stockholders	$44,869	$53,512
Weighted average common shares outstanding, basic	48,058	48,007
Weighted average common shares outstanding, dilutive	48,058	48,007
Earnings per share - basic	$0.93	$1.11
Earnings per share - diluted	$0.93	$1.11

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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 $42.3 million and $22.2 million for the nine months ended September 30, 2018 and 2017, respectively. Cash contributions by the Company related to other postretirement benefit plans were $8.0 million and $2.3 million for the nine months ended September 30, 2018 and 2017, respectively. The total 2018 estimated cash contribution to the pension plans is $42.3 million and to the other postretirement benefit plans is $9.7 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 September 30			
	Pension Plan		Other Benefits	
	2018	2017	2018	2017
Service cost	$6,966	$6,122	$1,966	$2,169
Interest cost	6,007	5,861	1,183	1,491
Expected return on plan assets	(7,052)	(6,031)	(1,397)	(1,218)
Amortization of prior service cost	1,263	1,445	11	11
Recognized net actuarial loss	2,791	1,881	242	649
Net periodic benefit cost	$9,975	$9,278	$2,005	$3,102

	Nine Months Ended September 30			
	Pension Plan		Other Benefits	
	2018	2017	2018	2017
Service cost	$21,770	$17,851	$7,066	$6,207
Interest cost	17,996	17,442	4,152	4,472
Expected return on plan assets	(20,777)	(18,090)	(4,229)	(3,653)
Amortization of prior service cost	3,789	4,336	32	32
Recognized net actuarial loss	8,386	5,386	1,789	1,947
Net periodic benefit cost	$31,164	$26,925	$8,810	$9,005

Service cost portion of the pension plan and other postretirement benefits is recognized in administrative and general within the Condensed Consolidated Statements of Income. Other components of net periodic benefit costs include interest costs, expected return on plan assets, amortization of prior service costs, and recognized net actuarial loss and are reported together as other components of net periodic benefit cost within the Condensed Consolidated Statements of Income (see note 2).
Note 7. Short-term and Long-term Borrowings
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.

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The outstanding borrowings on the Company line of credit were $75.1 million and $55.1 million as of September 30, 2018 and December 31, 2017, respectively. There were no borrowings on the Cal Water line of credit as of September 30, 2018 and $220.0 million of borrowings as of December 31, 2017. The average borrowing rate for borrowings on the Company and Cal Water lines of credit during the nine months ended September 30, 2018 was 2.88% compared to 1.97% for the same period last year.

On September 13, 2018, Cal Water sold $300.0 million of floating rate First Mortgage Bonds due in September of 2020 in a private placement. The floating interest rate was set at three-month LIBOR plus 70 basis points, will accrue quarterly, and be payable in arrears. The bonds are redeemable at a premium of 102%, or at par after June 13, 2019. The bonds will also rank equally with all of Cal Water's other First Mortgage Bonds and will be secured by liens on Cal Water's properties, subject to certain exceptions and permitted liens.

Note 8. Income Taxes

The Company adjusts its effective tax rate each quarter to be consistent with the estimated annual effective tax rate. The Company also records the tax effect of unusual or infrequently occurring discrete items.

The provision for income taxes is shown in the tables below:

	Three Months Ended September 30	
	2018	2017
Income tax expense	$10,957	$18,189

	Nine Months Ended September 30	
	2018	2017
Income tax expense	$13,498	$29,046

The income tax expense decreased $7.2 million to $11.0 million for the three months ended September 30, 2018 as compared to the three months ended September 30, 2017 mostly due to the federal income tax rate reduction from 35% to 21%, effective January 1, 2018, an increase in tax benefits of $0.9 million, and a decrease in pre-tax income.

The income tax expense decreased $15.5 million to $13.5 million in the first nine months of 2018, as compared to $29.0 million in the first nine months of 2017. The decrease was mainly due to the federal income tax rate reduction from 35% to 21%, effective January 1, 2018, an increase in tax benefits of $0.9 million, and a decrease in pre-tax income.

The Company's 2018 effective tax rate, before discrete items, is estimated to be in the range from 22% to 25%.

For the year ended December 31, 2017, the Company recorded a provisional re-measurement of its deferred tax balances (related mostly to timing differences for plant-related items) which was offset by a change from a net deferred income tax regulatory asset to a net regulatory liability. The Company is continuing to work with state regulators to finalize the customer net refund of $108.0 million to ensure compliance with federal normalization rules. The final transition impacts of the Tax Cuts and Jobs Act (TCJA) may differ from the recorded amounts, possibly materially, due to, among other things, regulatory decisions that could differ from the Company’s determination of how the impacts of the TCJA are allocated between customers and shareholders. In addition, while the Company was able to make reasonable estimates of the impact of the reduction in federal tax rate and the elimination of bonus depreciation due to the enactment of the TCJA, the Company has not completed analysis for areas of the TCJA around Internal Revenue Code Section 162(m), full expensing of fixed assets, and other asset related items of the TCJA. Changes in interpretations, guidance on legislative intent, and any changes in accounting standards for income taxes in response to the TCJA could impact the recorded amounts. The Company will finalize and record any adjustments related to the TCJA within the one year measurement period provided under Staff Accounting Bulletin No. 118. The balances relating to TCJA impact continue to be provisional as of September 30, 2018.

The Company had unrecognized tax benefits of approximately $12.0 million and $10.2 million as of September 30, 2018 and 2017, respectively. Included in the balance of unrecognized tax benefits as of September 30, 2018 and 2017 are approximately $2.3 million 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.

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Note 9. Regulatory Assets and Liabilities

Regulatory assets and liabilities were comprised of the following as of September 30, 2018 and December 31, 2017:

	September 30, 2018	December 31, 2017
Regulatory Assets		
Pension and retiree group health	$213,755	$214,249
Property-related temporary differences (tax benefits flowed through to customers)	81,354	87,323
Other accrued benefits	27,634	28,251
Net WRAM and MCBA long-term accounts receivable	21,826	34,879
Asset retirement obligations, net	18,180	17,126
Interim rates long-term accounts receivable	4,557	4,568
Tank coating	11,490	10,998
Health care balancing account	442	496
Pension balancing account	6,250	2,322
Other components of net periodic benefit cost	2,433	—
Other regulatory assets	379	935
Total Regulatory Assets	$388,300	$401,147
Regulatory Liabilities		
Future tax benefits due to customers	$169,675	$168,343
Health care balancing account	12,124	7,749
Conservation program	6,019	2,273
Pension balancing account	13	364
Net WRAM and MCBA long-term payable	136	513
Tax accounting memorandum account	4,998	—
Cost of capital memorandum account	2,834	—
1,2,3 trichloropropane settlement proceeds	12,841	—
Other regulatory liabilities	50	464
Total Regulatory Liabilities	$208,690	$179,706

Short-term regulatory assets and liabilities are excluded from the above table.

The short-term regulatory assets were $38.0 million as of September 30, 2018 and $36.8 million as of December 31, 2017. As of September 30, 2018 and December 31, 2017, the short-term regulatory assets primarily consist of net WRAM and MCBA receivables.

The short-term portions of regulatory liabilities were $43.3 million as of September 30, 2018 and $59.3 million as of December 31, 2017. The short-term regulatory liabilities as of September 30, 2018, primarily consist of 1,2,3 trichloropropane (TCP) settlement proceeds. As of December 31, 2017, the short-term regulatory liabilities primarily consist of TCP settlement proceeds and net WRAM and MCBA liability balances.

The tax accounting and cost of capital memorandum account regulatory liabilities are related to the estimated customer refunds due to changes in the federal income tax rate and to the cost of capital decision for Cal Water.

The other components of net periodic benefit cost regulatory asset are authorized by the Commissions and are probable for rate recovery through the capital program (see Note 2).

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Note 10. Commitments 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, 2017. Effective April 3, 2018, the City of Commerce has renewed a lease agreement for Cal Water to operate the City of Commerce's water system for the next 15 years. Cal Water has operated the City of Commerce water system since 1985 and is responsible for all operations, maintenance, water quality assurance, and customer service programs to provide a reliable supply of water that meets federal and state standards to customers served by the City of Commerce system. The City of Commerce will remain responsible for financing infrastructure improvements and setting its customers' water rates.
As of September 30, 2018, there were no other significant changes from December 31, 2017.
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 customers 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.
Other Legal Matters
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. As of September 30, 2018 and December 31, 2017, the Company recognized a liability of $3.8 million and $6.1 million, respectively, for known legal matters. The decrease is mainly due to several large claims being resolved in the first nine months of 2018. 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.
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;
- 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.

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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.

	September 30, 2018				
		Fair Value			
	Cost	Level 1	Level 2	Level 3	Total
Long-term debt, including current maturities	$819,122	—	$847,812	—	$847,812
Advances for construction	186,897	—	77,745	—	77,745
Total	$1,006,019	$ —	$925,557	$ —	$925,557

	December 31, 2017				
		Fair Value			
	Cost	Level 1	Level 2	Level 3	Total
Long-term debt, including current maturities	$531,713	$ —	$607,492	$ —	$607,492
Advances for construction	182,502	—	75,083	—	75,083
Total	$714,215	—	$682,575	$ —	$682,575

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 September 30, 2018 and December 31, 2017, the Condensed Consolidating Statements of Income for the three and nine months ended September 30, 2018 and 2017, and the Condensed Consolidating Statements of Cash Flows for the nine months ended September 30, 2018 and 2017 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. No other subsidiary of the Company guarantees the securities. The Condensed Consolidating Statement of Cash Flows for the nine months ended September 30, 2018 and 2017 reflect the retrospective adoption of ASU 2016-18 (refer to Note 2 for more details). The Condensed Consolidating Statements of Income for the three and nine months ended September 30, 2017 reflect the retrospective adoption of ASU 2017-07 (refer to Note 2 for more details).

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CALIFORNIA WATER SERVICE GROUP
CONDENSED CONSOLIDATING BALANCE SHEET
As of September 30, 2018
(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS					
Utility plant:					
Utility plant	$ 1,317	$ 2,963,674	$ 211,931	$ (7,196)	$ 3,169,726
Less accumulated depreciation and amortization	(989)	(926,291)	(58,780)	2,076	(983,984)
Net utility plant	328	2,037,383	153,151	(5,120)	2,185,742
Current assets:					
Cash and cash equivalents	2,445	55,108	8,868	—	66,421
Receivables and unbilled revenue	—	144,340	5,639	—	149,979
Receivables from affiliates	44,671	895	286	(45,852)	—