

CALIFORNIA WATER SERVICE GROUP

Form 10-Q

November 06, 2013

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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, 2013**

**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**

(State or other jurisdiction  
of incorporation or organization)

**77-0448994**

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

**1720 North First Street, San Jose, CA.**

(Address of principal executive offices)

**95112**

(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 ☐

(Do not check if a smaller reporting company)

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 October 31, 2013 47,739,024



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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, 2013	December 31, 2012
<b>ASSETS</b>		
<b>Utility plant:</b>		
Utility plant	\$ 2,190,573	\$ 2,096,363
Less accumulated depreciation and amortization	(685,351)	(639,307)
Net utility plant	1,505,222	1,457,056
<b>Current assets:</b>		
Cash and cash equivalents	48,847	38,790
Receivables: net of allowance for doubtful accounts of \$815 as of September 30, 2013 and \$714 as of December 31, 2012		
Customers	42,979	29,958
Regulatory balancing accounts	27,047	34,020
Other	9,802	11,943
Unbilled revenue	25,815	15,394
Materials and supplies at weighted average cost	5,689	5,874
Taxes, prepaid expenses and other assets	10,373	10,585
Total current assets	170,552	146,564
<b>Other assets:</b>		
Regulatory assets	354,879	344,419
Goodwill	2,615	2,615
Other assets	50,165	45,270
Total other assets	407,659	392,304
	\$ 2,083,433	\$ 1,995,924
<b>CAPITALIZATION AND LIABILITIES</b>		

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**Capitalization:**

Common stock, \$.01 par value; 68,000,000 shares authorized, 47,739,024 and 41,908,218 outstanding in 2013 and 2012, respectively

	\$	477	\$	419
Additional paid-in capital		327,890		221,013
Retained earnings		271,887		252,280
Total common stockholders' equity		600,254		473,712
Long-term debt, less current maturities		430,227		434,467
Total capitalization		1,030,481		908,179

**Current liabilities:**

Current maturities of long-term debt		48,013		46,783
Short-term borrowings		11,515		89,475
Accounts payable		60,414		47,199
Regulatory balancing accounts		1,699		5,018
Accrued interest		10,656		4,705
Accrued expenses and other liabilities		64,716		49,887
Total current liabilities		197,013		243,067

Unamortized investment tax credits		2,180		2,180
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Deferred income taxes, net		168,091		158,846
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Pension and postretirement benefits other than pensions		247,335		244,901
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Regulatory and other liabilities		91,185		92,593
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Advances for construction		184,879		187,584
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Contributions in aid of construction		162,269		158,574
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Commitments and contingencies				
	\$	2,083,433	\$	1,995,924

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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

Unaudited

(In thousands, except per share data)

For the three months ended	September 30, 2013	September 30, 2012
<b>Operating revenue</b>	\$ 184,404	\$ 178,135
<b>Operating expenses:</b>		
Operations:		
Water production costs	70,614	66,489
Administrative and general	24,670	23,925
Other operations	17,657	17,658
Maintenance	4,575	4,377
Depreciation and amortization	14,505	13,720
Income taxes	11,165	10,387
Property and other taxes	5,414	5,218
Total operating expenses	148,600	141,774
Net operating income	35,804	36,361
<b>Other income and expenses:</b>		
Non-regulated revenue	3,649	3,756
Non-regulated expenses, net	(2,825)	(2,697)
Income tax (expense) on other income and expenses	(330)	(422)
Net other income	494	637
<b>Interest expense:</b>		
Interest expense	7,687	8,024
Less: capitalized interest	(540)	(798)
Net interest expense	7,147	7,226
<b>Net income</b>	\$ 29,151	\$ 29,772
<b>Earnings per share</b>		
Basic	\$ 0.61	\$ 0.71
Diluted	\$ 0.61	\$ 0.71
<b>Weighted average shares outstanding</b>		
Basic	47,737	41,905
Diluted	47,770	41,905
<b>Dividends declared per share of common stock</b>	\$ 0.16000	\$ 0.15750

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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

Unaudited

(In thousands, except per share data)

For the nine months ended	September 30, 2013	September 30, 2012
<b>Operating revenue</b>	\$ 450,403	\$ 438,436
<b>Operating expenses:</b>		
Operations:		
Water production costs	171,956	158,119
Administrative and general	73,106	69,110
Other operations	50,332	59,213
Maintenance	12,896	14,742
Depreciation and amortization	43,625	41,383
Income taxes	19,567	19,477
Property and other taxes	16,564	13,802
Total operating expenses	388,046	375,846
Net operating income	62,357	62,590
<b>Other income and expenses:</b>		
Non-regulated revenue	10,386	11,943
Non-regulated expenses, net	(8,482)	(8,491)
Income tax (expense) on other income and expenses	(765)	(1,383)
Net other income	1,139	2,069
<b>Interest expense:</b>		
Interest expense	23,527	23,484
Less: capitalized interest	(1,619)	(2,647)
Net interest expense	21,908	20,837
<b>Net income</b>	\$ 41,588	\$ 43,822
<b>Earnings per share</b>		
Basic	\$ 0.91	\$ 1.05
Diluted	\$ 0.90	\$ 1.05
<b>Weighted average shares outstanding</b>		
Basic	45,927	41,886
Diluted	45,957	41,886
<b>Dividends declared per share of common stock</b>	\$ 0.4800	\$ 0.47250

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements



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

Unaudited

(In thousands)

	September 30, 2013	September 30, 2012
<b>For the nine months ended:</b>		
<b>Operating activities</b>		
Net income	\$ 41,588	\$ 43,822
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	45,067	42,722
Change in value of life insurance contracts	(1,147)	(2,244)
Other changes in noncurrent assets and liabilities	13,501	28,411
Changes in operating assets and liabilities:		
Receivables	(24,636)	(34,462)
Accounts payable	7,719	13,066
Other current assets	(751)	(2,491)
Other current liabilities	20,558	10,581
Net cash provided by operating activities	101,899	99,405
<b>Investing activities:</b>		
Utility plant expenditures	(94,782)	(99,600)
Purchase of life insurance	(3,204)	(3,199)
Restricted cash decrease	1,148	1,553
Net cash (used in) investing activities	(96,838)	(101,246)
<b>Financing activities:</b>		
Short-term borrowings	35,315	65,565
Repayment of short-term borrowing	(113,275)	(52,030)
Proceeds from long-term debt	48	123
Repayment of long-term debt	(3,058)	(2,123)
Advances and contributions in aid of construction	7,577	5,491
Refunds of advances for construction	(5,230)	(5,632)
Issuance of common stock	110,688	
Common stock issuance cost	(5,088)	
Dividends paid	(21,981)	(19,785)
Net cash provided by (used in) financing activities	4,996	(8,391)
Change in cash and cash equivalents	10,057	(10,232)
Cash and cash equivalents at beginning of period	38,790	27,203
Cash and cash equivalents at end of period	\$ 48,847	\$ 16,971
<b>Supplemental information</b>		
Cash paid for interest (net of amounts capitalized)	\$ 15,141	\$ 13,721
Cash paid for income taxes	\$	\$
Refund for income taxes	\$	\$ (3,498)
<b>Supplemental disclosure of non-cash activities:</b>		
Accrued payables for investments in utility plant	\$ 11,739	\$ 9,654
Utility plant contribution by developers	\$ 10,196	\$ 11,868

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, 2013

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

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 100% 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, 2012, included in its annual report on Form 10-K as filed with the SEC on February 28, 2013.

The preparation of the Company's condensed consolidated 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 financial statements reflect all adjustments, consisting of normal recurring accruals 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 lower in the winter months when cooler temperatures and rainfall curtail water usage and sales.

The Company evaluated its operations through the time these financials were issued and determined there were no subsequent events requiring adjustments or disclosures as of the time these financial statements were issued.

## 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 it operates. The revenue requirements are intended to provide the Company a reasonable opportunity to recover its operating costs and earn a return on investments.

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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 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 billed 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) provides 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 cost related to water conservation programs and certain other operation expenses adopted by the CPUC. Variances (which include the effects of changes in both rate and volume 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 our customers at a later date. There is no markup for return or profit for cost-recovery expenses and they are generally recognized when expenses are incurred.

The balances in the WRAM and MCBA assets and liabilities accounts will fluctuate on a monthly basis depending upon the variance between adopted and actual results. The recovery or refund of the WRAM is netted against the MCBA over- or under-recovery for the corresponding district and is 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. Most undercollected net WRAM and MCBA receivable balances are collected over 12 and 18 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 it was recognized. The deferred net WRAM and MCBA revenues and associated costs were determined using forecasts of rate payer 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 collection is within twenty-four months of the respective reporting period.

The change to deferred net WRAM and MCBA balances during the nine months ended September 30, 2013 was:

	Operating Revenues	Operating Costs	Income Before Income Taxes
Net WRAM and MCBA deferral as of December 31, 2012	\$ 882	\$ 719	\$ 163
Less: reversal of prior year deferral during the nine months ended September 30, 2013	(1,911)	(1,603)	(308)
Add: net WRAM and MCBA deferral during the nine months ended September 30, 2013	2,764	2,375	389
Net amount during the nine months ended September 30, 2013	853	772	81
Net WRAM and MCBA deferral as of September 30, 2013	\$ 1,735	\$ 1,491	\$ 244

The change to deferred net WRAM and MCBA balances during the nine months ended September 30, 2012 was:

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	Operating Revenues	Operating Costs	Income Before Income Taxes
Net WRAM and MCBA deferral as of December 31, 2011	\$ 12,864	\$ 10,492	\$ 2,372
Less: reversal of prior year deferral during the nine months ended September 30, 2012	(12,295)	(10,027)	(2,268)
Add: net WRAM and MCBA deferral during the nine months ended September 30, 2012	939	766	173
Net amount during the nine months ended September 30, 2012	(11,356)	(9,261)	(2,095)
Net WRAM and MCBA deferral as of September 30, 2012	\$ 1,508	\$ 1,231	\$ 277

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The net WRAM and MCBA under- or overcollected balances are:

	September 30, 2013	December 31, 2012
Net short-term regulatory balancing accounts (receivable)	\$ 27,047	\$ 34,020
Net long-term regulatory assets (receivable)	21,925	12,051
Total regulatory assets	\$ 48,972	\$ 46,071
Net short-term regulatory balancing accounts (liability)	\$ 174	\$ 371
Net long-term regulatory liability	108	119
Total regulatory liabilities	\$ 282	\$ 490

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. Unearned revenue liability was \$1.5 million and \$1.7 million as of September 30, 2013 and December 31, 2012, 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 \$48.8 million and \$38.8 million as of September 30, 2013 and December 31, 2012, respectively. Restricted cash is included in taxes, prepaid expenses and other assets and was \$1.1 million and \$2.3 million as of September 30, 2013 and December 31, 2012, respectively.

## Adoption of New Accounting Standards

On February 1, 2013, the Financial Accounting Standards Board issued an accounting standards update (ASU) for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements. The ASU would impact the Company's recognition, measurement, and disclosure requirements for guarantees of third party debt. The ASU effective date for the Company's interim and annual reporting is January 1, 2014. The Company has completed a review of all contracts and has not identified any joint and several liability arrangements.

## Note 3. Stock-based Compensation

## Equity Incentive Plan

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The Company's equity incentive plan was approved by stockholders on April 27, 2005. The Company is authorized to issue awards up to 2,000,000 shares of common stock.

During the nine months ended September 30, 2013 and 2012, the Company granted annual Restricted Stock Awards (RSAs) of 72,891 and 98,422 shares, respectively, of common stock to officers and directors of the Company and no RSAs were cancelled. Employee RSAs granted in 2013 vest over 36 months and RSAs granted in 2012 vest over 48 months. Director RSAs generally vest at the end of 12 months. During the first nine months of 2013 and 2012, the shares granted were valued at \$20.66 and \$17.96 per share, respectively, based upon the fair market value of the Company's common stock on the date of grant.

On March 1, 2013, the Company granted performance-based Restricted Stock Unit Awards (RSUs) of 50,267 shares of common stock to officers. Each award reflects a target number of shares that may be issued to the award recipient. The awards may be earned upon the completion of the three-year performance period ending February 28, 2016. Whether RSUs are earned at the end of the performance period will be determined based on the achievement of certain performance objectives set by the Board of Director Compensation Committee in connection with the issuance of the RSUs. The performance objectives are based on the Company's business plan covering the performance period. The performance objectives include achieving the budgeted return on equity, budgeted investment in utility plant, customer service standards, and water quality standards. Depending on the results achieved during the three-year performance period, the actual number of shares that a grant recipient receives at the end of the performance period may range from 0% to 200% of the target shares granted, provided that the grantee is continuously employed by the Company through the vesting date. If prior to the vesting date employment is terminated by reason of death, disability or normal retirement, then a pro rata portion of this award will vest. RSUs are not included in diluted shares for financial reporting until earned. The RSUs are recognized as expense ratably over the three year performance period using a fair market value of \$20.62 per share and an estimate of RSUs earned during the performance period.



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The Company has recorded compensation costs for the RSAs and RSUs which are included in operating expense in the amount of \$1.3 million and \$1.1 million for the nine months ended September 30, 2013 and September 30, 2012, respectively. The Company has recorded compensation costs for the RSAs and RSUs in operating expense in the amount of \$0.5 million and \$0.3 million for the three months ended September 30, 2013 and September 30, 2012, respectively.

## Note 4. Equity

The Company's changes in equity for the nine months ended September 30, 2013 were as follows:

	Total Stockholders	Equity
Balance at December 31, 2012	\$	473,712
Common stock issued, net		105,600
Share-based compensation expense		1,335
Common stock dividends declared		(21,981)
Net income		41,588
Balance at September 30, 2013	\$	600,254

On March 26, 2013, the Company sold 5,750,000 shares of its common stock in an underwritten public offering for cash proceeds of \$105.6 million, net of \$5.1 million underwriting discounts and commissions and offering expenses. The net proceeds from the sale of common stock were added to our general funds to be used for general corporate purposes. In April 2013, the Company used a portion of the net proceeds from the offering to repay outstanding borrowings on the Company and Cal Water lines of credit of \$68.3 million and \$25.0 million, respectively.

## Note 5. Earnings Per Share Calculations

The computations of basic and diluted earnings per share are noted below. Basic earnings per share are computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts were exercised or converted into common stock. RSAs are included in the common shares outstanding because the shares have all the same voting and dividend rights as issued and unrestricted common stock.

A total of 283,856 shares of Stock Appreciation Rights were vested and outstanding and all were dilutive as of September 30, 2013 and anti-dilutive as of September 30, 2012 as shown in the tables below.

	Three months Ended September 30	
	2013	2012
Net income available to common stockholders	\$ 29,151	\$ 29,772
Weighted average common shares, basic	47,737	41,905
Dilutive common stock appreciation rights (treasury method)	33	
Shares used for dilutive computation	47,770	41,905

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Net income per share - basic	\$	0.61	\$	0.71
Net income per share - diluted	\$	0.61	\$	0.71

	Nine months Ended September 30			
	2013		2012	
Net income available to common stockholders	\$	41,588	\$	43,822
Weighted average common shares, basic		45,927		41,886
Dilutive common stock appreciation rights (treasury method)		30		
Shares used for dilutive computation		45,957		41,886
Net income per share - basic	\$	0.91	\$	1.05
Net income per share - diluted	\$	0.90	\$	1.05

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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 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 payments by the Company related to pension plans and other postretirement benefit plans were \$28.1 million for the nine months ended September 30, 2013 and \$25.5 million for the nine months ended September 30, 2012. The 2013 estimated cash contribution to the pension plans is \$31.1 million and to the other postretirement benefit plans is \$7.2 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		
	2013	2012	2013	2012	
Service cost	\$ 4,019	\$ 3,863	\$ 1,636	\$ 1,374	
Interest cost	4,140	3,822	1,121	986	
Expected return on plan assets	(3,559)	(2,890)	(600)	(458)	
Recognized net initial APBO (1)	N/A	N/A	3	69	
Amortization of prior service cost	1,542	1,571	21	29	
Recognized net actuarial loss	2,404	2,000	961	793	
Net periodic benefit cost	\$ 8,546	\$ 8,366	\$ 3,142	\$ 2,793	

Nine months Ended September 30					
	Pension Plan		Other Benefits		
	2013	2012	2013	2012	
Service cost	\$ 13,335	\$ 11,588	\$ 5,025	\$ 4,121	
Interest cost	12,266	11,465	3,339	2,958	
Expected return on plan assets	(10,689)	(8,669)	(1,796)	(1,374)	
Recognized net initial APBO (1)	N/A	N/A	7	207	
Amortization of prior service cost	4,624	4,712	61	87	
Recognized net actuarial loss	6,852	6,001	2,794	2,379	
Net periodic benefit cost	\$ 26,388	\$ 25,097	\$ 9,430	\$ 8,378	

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(1) APBO - Accumulated postretirement benefit obligation

Note 7. Short-term and Long-term Borrowings

On June 29, 2011, the Company and Cal Water entered into Syndicated Credit Facilities, which provide for unsecured revolving credit facilities of up to an initial aggregate amount of \$400 million. The Syndicated Credit Facilities amend, expand, and replace the Company's and its subsidiaries' existing credit facilities originally entered into on October 27, 2009. The new credit facilities extended the terms until June 29, 2016, increased the Company's and Cal Water's unsecured revolving lines of credit, and lowered interest rates and fees. The Company and subsidiaries which it designates may borrow up to \$100 million under the Company's revolving credit facility. Cal Water may borrow up to \$300 million under its revolving credit facility; however, all borrowings need to be repaid within 12-months unless otherwise authorized by the CPUC. The proceeds from the revolving credit facilities may be used for working capital purposes, including the short-term financing of capital projects. The base loan rate may vary from LIBOR plus 72.5 basis points to LIBOR plus 95 basis points, depending on the Company's total capitalization ratio. Likewise, the unused commitment fee may vary from 8 basis points to 12.5 basis points based on the same ratio.

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. As of September 30, 2013, the Company and Cal Water have met all borrowing covenants for both credit agreements.

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As of September 30, 2013 and December 31, 2012, the outstanding borrowings on the Company lines of credit were \$11.5 million and \$64.5 million, respectively, and the outstanding borrowings on the Cal Water lines of credit were zero million and \$25.0 million, respectively. For the nine months ended September 30, 2013, the average borrowing rate was 2.2% compared to 1.7% for the same period last year.

#### Note 8. Income Taxes

The Company accounts for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Measurement of the deferred tax assets and liabilities is at enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date.

The Company anticipates that future rate actions by the regulatory commissions will reflect revenue requirements for the tax effects of temporary differences recognized, which have previously been passed through to customers. The regulatory commissions have granted us rate increases to reflect the normalization of the tax benefits of the federal accelerated methods and available Investment Tax Credits (ITCs) for all assets placed in service after 1980. ITCs are deferred and amortized over the lives of the related properties for book purposes.

During the third quarter of 2013, the Company recorded \$4.4 million of State of California enterprise zone (EZ) credits for sales and use taxes and hiring incentives for the period from 2008 to 2013 based on an analysis of all district operations. The Company filed amended state income tax returns for tax years 2008, 2009, 2010 and 2011. The State of California EZ credits were included on the Company's 2012 state income tax returns filed during the fourth quarter of 2013. Unused State of California EZ credits, if any, can be carried-forward ten years. The Company estimates the carried-forward portion of its State of California EZ credits at \$2.3 million. The Company's analysis of State of California EZ credits as of September 30, 2013 resulted in the recognition of a \$0.6 million liability for unrecognized tax benefits.

During 2012, the Company filed an application for a change in accounting method (section 481 adjustment) with the Internal Revenue Service (IRS) to implement the repairs and maintenance deduction. These tax regulations allowed the Company to deduct a significant amount of water main costs previously capitalized for book and tax purposes. The 2012 repairs and maintenance deductions resulted in a federal net operating loss (NOL) of \$38.8 million and state NOL of \$58.4 million. On September 19, 2013, the U. S. Department of the Treasury and IRS issued final and re-proposed tangible property regulations with an effective date of January 1, 2014. An application for a change in accounting method can be filed to adopt the new tax regulations before January 1, 2014. The final and re-proposed tangible property regulations will provide the Company with additional repairs and maintenance deductions for equipment such as fire hydrants, pumps, meters, and carbon filters. The Company does not expect any material changes to the previous filed method change as a result of the early adoption. The Company estimated 2013 equipment repairs and maintenance deductions of \$5.0 million and recorded the estimate as of September 30, 2013. The 2012 federal and state income tax NOLs were carried-forward to reduce 2013 income tax payments. The NOL carry-forward amounts are more likely than not to be recovered and therefore require no valuation allowance. The NOL carry-forward does not begin to expire until 2033.

The American Taxpayer Relief Act of 2012 provided the Company with additional 50% first-year bonus depreciation for assets placed in service from December 31, 2012 to December 31, 2013. The federal income tax bonus deduction was estimated at \$10.0 million in 2013 and was \$14.5 million in 2012.

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On October 24, 2013, the IRS completed an audit of the Company's 2010 and 2011 federal income tax returns with no changes to our previously reported taxes.

### Note 9. Regulatory Assets and Liabilities

During 2011, the CPUC issued a decision regarding the \$34.2 million of litigation proceeds previously received by Cal Water during 2008 which is being used to replace infrastructure damaged by the gasoline additive Methyl tert-butyl ether (MTBE). The decision requires use of these proceeds for costs incurred as a result of MTBE contamination with any related benefits to be provided to Cal Water customers. Such usage includes transfer of the amount to contributions in aid of construction (CIAC) for remediation or replacement project costs once complete. Usage of the proceeds is reported to the CPUC through an Advice Letter or General Rate Case filing. As of December 31, 2012, \$22.4 million of the proceeds was recorded as CIAC. Cal Water used \$0.8 million of the net proceeds to replace damaged infrastructure during the third quarter of 2013. The remaining balance of \$9.8 million at September 30, 2013 is included in regulatory and other liabilities.

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During 2011, Cal Water added balancing accounts for its pension plans and conservation program. Both balancing account effective dates were January 1, 2011. The pension plans balancing account is a two-way balancing account that tracks the differences between actual expenses and adopted rate recovery which will result in either a regulatory asset or liability. The conservation program is a one-way balancing account that tracks the differences between actual expenses and adopted rate recovery which may result in a regulatory liability if actual conservation expenses are less than adopted over the three year period ending December 31, 2013. As of September 30, 2013 and December 31, 2012, the pension balancing account was a regulatory asset of \$2.3 million and \$2.4 million, respectively. The conservation balancing account was a regulatory liability of \$7.7 million and \$6.5 million as of September 30, 2013 and December 31, 2012, respectively.

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, 2012. As of September 30, 2013, there were no significant changes from December 31, 2012.

Contingencies

Groundwater Contamination

The Company has undertaken litigation against third parties to recover past and future costs related to ground water contamination in our service areas. The cost of litigation is expensed as incurred and any settlement is first offset against such costs. The Company records gain contingencies as a regulatory liability when the net litigation proceeds are received. The Commission's general policy requires all proceeds from contamination litigation to be used first to pay transactional expenses, then to make ratepayers whole for water treatment costs to comply with the Commission's water quality standards. The Commission 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 Commission 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 Commission'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

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will materially affect the Company's financial position, results of operations, or cash flows. The Company has recognized a liability of \$1.1 million for all known legal matters as of September 30, 2013 and December 31, 2012. 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, dependant 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 hierarchal 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 - Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. The types of assets and liabilities included in Level 1 are highly liquid and actively traded instruments with quoted prices.
- Level 2 - Pricing inputs are other than quoted prices in active markets, but are either directly or indirectly observable as of the reporting date. The types of assets and liabilities included in Level 2 are typically either comparable to actively traded securities or contracts, or priced with discounted cash flow or option pricing models using highly observable inputs.



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Level 3 - Significant inputs to pricing have little or no observability as of the reporting date. The types of assets and liabilities included in Level 3 are those valued with models requiring significant management judgment or estimation.

Specific valuation methods include the following:

Cash equivalents, accounts receivable, accounts payable, and short-term borrowings 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 1.19%.

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

September 30, 2013					
	Cost	Level 1	Level 2	Level 3	Total
Money Market Investment	\$ 48,847	\$ 48,847			\$ 48,847
Total	\$ 48,847	\$ 48,847			\$ 48,847
Long-term debt, including current maturities					
	\$ 478,240	\$	\$ 570,058	\$	\$ 570,058
Advances for construction	184,879		71,242		71,242
Total	\$ 663,119	\$	\$ 641,300	\$	\$ 641,300

December 31, 2012					
	Cost	Level 1	Level 2	Level 3	Total
Long-term debt, including current maturities	\$ 481,250	\$	\$ 613,211	\$	\$ 613,211
Advances for construction	187,584		70,914		70,914
Total	\$ 668,834	\$	\$ 684,125	\$	\$ 684,125

## Note 12. Condensed Consolidating Financial Statements

On April 17, 2009, Cal Water issued \$100 million aggregate principal amount of 5.875% First Mortgage Bonds due 2019, and on November 17, 2010, Cal Water issued \$100 million aggregate principal amount of 5.500% First Mortgage Bonds due 2040. Each series of Cal Water's First Mortgage Bonds is fully and unconditionally guaranteed by the Company. As a result of these guarantee arrangements, we are required to present the following condensed consolidating financial information.

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The tables below present the condensed consolidating balance sheets as of September 30, 2013 and December 31, 2012, the condensed consolidating statements of income for the three and nine months ended September 30, 2013 and 2012 and the condensed consolidating statements of cash flow for the nine months ended September 30, 2013 and 2012 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 subsidiary of California Water Service Group; and (iii) the other 100% owned subsidiaries of California Water Service Group.

[Table of Contents](#)**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING BALANCE SHEET****As of September 30, 2013****(In thousands)**

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
<b>ASSETS</b>					
<b>Utility plant:</b>					
Utility plant	\$ 1,246	\$ 2,013,475	\$ 183,049	\$ (7,197)	\$ 2,190,573
Less accumulated depreciation and amortization	(150)	(650,679)	(36,109)	1,587	(685,351)
Net utility plant	1,096	1,362,796	146,940	(5,610)	1,505,222
<b>Current assets:</b>					
Cash and cash equivalents	4,272	42,545	2,030		48,847
Receivables and unbilled revenue, net		100,810	4,833		105,643
Receivables from affiliates	28,964	5,539	181	(34,684)	
Other current assets	73	15,038	951		16,062
Total current assets	33,309	163,932	7,995	(34,684)	170,552
<b>Other assets:</b>					
Regulatory assets		352,232	2,647		354,879
Investments in affiliates	546,123			(546,123)	
Long-term affiliate notes receivable	30,252			(30,252)	
Other assets	1,196	44,610	7,179	(205)	52,780
Total other assets	577,571	396,842	9,826	(576,580)	407,659
	\$ 611,976	\$ 1,923,570	\$ 164,761	\$ (616,874)	\$ 2,083,433
<b>CAPITALIZATION AND LIABILITIES</b>					
<b>Capitalization:</b>					
Common stockholders' equity	\$ 600,254	\$ 500,359	\$ 51,271	\$ (551,630)	\$ 600,254
Affiliate long-term debt			30,252	(30,252)	
Long-term debt, less current maturities		428,878	1,349		430,227
Total capitalization	600,254	929,237	82,872	(581,882)	1,030,481
<b>Current liabilities:</b>					
Current maturities of long-term debt		46,129	1,884		48,013
Short-term borrowings	11,515				11,515
Payables to affiliates	24	180	34,480	(34,684)	
Accounts payable		57,434	2,980		60,414
Accrued expenses and other liabilities	762	75,168	1,059	82	77,071
Total current liabilities	12,301	178,911	40,403	(34,602)	197,013
Unamortized investment tax credits		2,180			2,180
Deferred income taxes, net	(579)	164,716	4,344	(390)	168,091
Pension and postretirement benefits other than pensions		247,335			247,335
Regulatory and other liabilities		82,416	8,769		91,185
Advances for construction		184,110	769		184,879
Contributions in aid of construction		134,665	27,604		162,269
	\$ 611,976	\$ 1,923,570	\$ 164,761	\$ (616,874)	\$ 2,083,433



Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING BALANCE SHEET**

As of December 31, 2012

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
<b>ASSETS</b>					
<b>Utility plant:</b>					
Utility plant	\$ 606	\$ 1,927,190	\$ 175,764	\$ (7,197)	\$ 2,096,363
Less accumulated depreciation and amortization	(108)	(607,992)	(32,710)	1,503	(639,307)
Net utility plant	498	1,319,198	143,054	(5,694)	1,457,056
<b>Current assets:</b>					
Cash and cash equivalents	1,470	34,609	2,711		38,790
Receivables, net		87,482	3,833		91,315
Receivables from affiliates	19,367	3,195	1,152	(23,714)	
Other current assets		15,535	924		16,459
Total current assets	20,837	140,821	8,620	(23,714)	146,564
<b>Other assets:</b>					
Regulatory assets		341,877	2,542		344,419
Investments in affiliates	492,188			(492,188)	
Long-term affiliate notes receivable	31,218	7,781		(38,999)	
Other assets	1,023	40,005	7,062	(205)	47,885
Total other assets	524,429	389,663	9,604	(531,392)	392,304
	\$ 545,764	\$ 1,849,682	\$ 161,278	\$ (560,800)	\$ 1,995,924
<b>CAPITALIZATION AND LIABILITIES</b>					
<b>Capitalization:</b>					
Common stockholders equity	\$ 473,712	\$ 442,923	\$ 54,774	\$ (497,697)	\$ 473,712
Affiliate long-term debt	7,781		31,218	(38,999)	
Long-term debt, less current maturities		431,433	3,034		434,467
Total capitalization	481,493	874,356	89,026	(536,696)	908,179
<b>Current liabilities:</b>					
Current maturities of long-term debt		46,104	679		46,783
Short-term borrowings	64,475	25,000			89,475
Payables to affiliates	77	1,152	22,485	(23,714)	
Accounts payable		41,352	5,847		47,199
Accrued expenses and other liabilities	298	58,293	1,019		59,610
Total current liabilities	64,850	171,901	30,030	(23,714)	243,067
<b>Unamortized investment tax credits</b>		2,180			2,180
<b>Deferred income taxes, net</b>	(579)	155,481	4,334	(390)	158,846
<b>Pension and postretirement benefits other than pensions</b>		244,901			244,901
<b>Regulatory and other liabilities</b>		83,942	8,651		92,593
<b>Advances for construction</b>		186,753	831		187,584
<b>Contributions in aid of construction</b>		130,168	28,406		158,574
	\$ 545,764	\$ 1,849,682	\$ 161,278	\$ (560,800)	\$ 1,995,924



Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING STATEMENT OF INCOME**

For the three months ended September 30, 2013

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
<b>Operating revenue</b>	\$	\$ 174,699	\$ 9,705	\$	\$ 184,404
<b>Operating expenses:</b>					
Operations:					
Water production costs		67,981	2,633		70,614
Administrative and general		22,354	2,316		24,670
Other operations		15,883	1,900	(126)	17,657
Maintenance		4,382	193		4,575
Depreciation and amortization	14	13,714	805	(28)	14,505
Income tax (benefit) expense	(17)	10,721	107	354	11,165
Property and other taxes		4,680	734		5,414
<b>Total operating (income) expenses</b>	(3)	139,715	8,688	200	148,600
<b>Net operating income (loss)</b>	3	34,984	1,017	(200)	35,804
<b>Other Income and Expenses:</b>					
Non-regulated revenue	572	3,385	475	(783)	3,649
Non-regulated expense, net		(2,515)	(310)		(2,825)
Income tax (expense) benefit on other income and expense	(232)	(355)	(85)	342	(330)
Net other income (expense)	340	515	80	(441)	494
<b>Interest:</b>					
Interest expense	30	7,608	707	(658)	7,687
Less: capitalized interest		(495)	(45)		(540)
Net interest expense	30	7,113	662	(658)	7,147
<b>Equity earnings of subsidiaries</b>	28,838			(28,838)	
<b>Net income (loss)</b>	\$ 29,151	\$ 28,386	\$ 435	\$ (28,821)	\$ 29,151

[Table of Contents](#)**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING STATEMENT OF INCOME****For the nine months ended September 30, 2013****(In thousands)**

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
<b>Operating revenue</b>	\$	\$ 425,860	\$ 24,543	\$	\$ 450,403
<b>Operating expenses:</b>					
Operations:					
Water production costs		164,524	7,432		171,956
Administrative and general		65,423	7,683		73,106
Other operations		45,490	5,220	(378)	50,332
Maintenance		12,376	520		12,896
Depreciation and amortization	42	41,168	2,499	(84)	43,625
Income tax (benefit) expense	(246)	19,807	(1,064)	1,070	19,567
Property and other taxes		14,549	2,015		16,564
<b>Total operating (income) expenses</b>	(204)	363,337	24,305	608	388,046
<b>Net operating income (loss)</b>	204	62,523	238	(608)	62,357
<b>Other Income and Expenses:</b>					
Non-regulated revenue	1,739	9,572	1,415	(2,340)	10,386
Non-regulated expense, net		(7,308)	(1,174)		(8,482)
Income tax (expense) on other income and expense	(708)	(923)	(169)	1,035	(765)
Net other income (expense)	1,031	1,341	72	(1,305)	1,139
<b>Interest:</b>					
Interest expense	563	22,966	1,961	(1,963)	23,527
Less: capitalized interest		(1,279)	(340)		(1,619)
Net interest expense	563	21,687	1,621	(1,963)	21,908
<b>Equity earnings of subsidiaries</b>	40,916			(40,916)	
<b>Net income (loss)</b>	\$ 41,588	\$ 42,177	\$ (1,311)	\$ (40,866)	\$ 41,588



Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING STATEMENT OF INCOME****For the three months ended September 30, 2012****(In thousands)**

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
<b>Operating revenue</b>	\$	\$ 168,680	\$ 9,455	\$	\$ 178,135
<b>Operating expenses:</b>					
Operations:					
Water production costs		63,647	2,842		66,489
Administrative and general		21,639	2,286		23,925
Other operations		16,177	1,607	(126)	17,658
Maintenance		4,238	139		4,377
Depreciation and amortization		13,051	699	(30)	13,720
Income tax (benefit) expense	(150)	9,831	372	334	10,387
Property and other taxes		4,552	666		5,218
<b>Total operating expenses</b>	(150)	133,135	8,611	178	141,774
<b>Net operating income</b>	150	35,545	844	(178)	36,361
<b>Other Income and Expenses:</b>					
Non-regulated revenue	474	3,372	617	(707)	3,756
Non-regulated expense, net		(2,217)	(483)	3	(2,697)
Income tax (expense) on other income and expense	(193)	(469)	(82)	322	(422)
Net other income	281	686	52	(382)	637
<b>Interest:</b>					
Interest expense	368	7,702	535	(581)	8,024
Less: capitalized interest		(505)	(293)		(798)
Net interest expense	368	7,197	242	(581)	7,226
<b>Equity earnings of subsidiaries</b>	29,709			(29,709)	
<b>Net income (loss)</b>	\$ 29,772	\$ 29,034	\$ 654	(29,688)	\$ 29,772

Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING STATEMENT OF INCOME****For the nine months ended September 30, 2012****(In thousands)**

	<b>Parent Company</b>	<b>Cal Water</b>	<b>All Other Subsidiaries</b>	<b>Consolidating Adjustments</b>	<b>Consolidated</b>
<b>Operating revenue</b>	\$	\$ 413,796	\$ 24,640	\$	\$ 438,436
<b>Operating expenses:</b>					
Operations:					
Water production costs		150,396	7,723		158,119
Administrative and general		62,043	7,067		69,110
Other operations		54,584	5,008	(379)	59,213
Maintenance		14,247	495		14,742
Depreciation and amortization		39,393	2,079	(89)	41,383
Income tax (benefit) expense	(416)	19,094	(198)	997	19,477
Property and other taxes		11,819	1,983		13,802
<b>Total operating expenses</b>	(416)	351,576	24,157	529	375,846
<b>Net operating income (loss)</b>	416	62,220	483	(529)	62,590
<b>Other Income and Expenses:</b>					
Non-regulated revenue	1,429	10,867	1,805	(2,158)	11,943
Non-regulated expense, net		(7,072)	(1,422)	3	(8,491)
Income tax (expense) on other income and expense	(582)	(1,545)	(216)	960	(1,383)
<b>Net other income</b>	847	2,250	167	(1,195)	2,069
<b>Interest:</b>					
Interest expense	1,022	22,648	1,594	(1,780)	23,484
Less: capitalized interest		(1,785)	(862)		(2,647)
<b>Net interest expense</b>	1,022	20,863	732	(1,780)	20,837
<b>Equity earnings of subsidiaries</b>	43,581			(43,581)	
<b>Net income (loss)</b>	\$ 43,822	\$ 43,607	\$ (82)	\$ (43,525)	\$ 43,822

Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS****For the nine months ended September 30, 2013****(In thousands)**

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
<b>Operating activities:</b>					
Net income (loss)	\$ 41,588	\$ 42,177	\$ (1,311)	\$ (40,866)	\$ 41,588
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Equity earnings of subsidiaries	(40,916)			40,916	
Dividends received from affiliates	21,981			(21,981)	
Depreciation and amortization	42	42,509	2,600	(84)	45,067
Change in value of life insurance contracts		(1,147)			(1,147)
Other changes in noncurrent assets and liabilities	1,164	12,415	(29)	(49)	13,501
Changes in operating assets and liabilities	390	4,220	(1,803)	83	2,890
Net cash provided by (used in) operating activities	24,249	100,174	(543)	(21,981)	101,899
<b>Investing activities:</b>					
Utility plant expenditures	(640)	(84,688)	(9,454)		(94,782)
Investment in affiliates	(35,000)			35,000	
Net changes in affiliate advances	(9,583)	(2,359)	1,141	10,801	
Repayment of affiliates long-term debt	913	7,797		(8,710)	
Purchase of life insurance		(3,204)			(3,204)
Restricted cash and other changes, net		1,148			1,148
Net cash provided by (used in) investing activities	(44,310)	(81,306)	(8,313)	37,091	(96,838)
<b>Financing Activities:</b>					
Short-term borrowings	15,315	20,000			35,315
Repayment of short-term borrowings	(68,275)	(45,000)			(113,275)
Proceeds from long-term debt			48		48
Repayment of long-term debt		(2,531)	(527)		(3,058)
Net changes in affiliate advances		(972)	11,773	(10,801)	
Repayment of affiliates long-term debt	(7,796)		(914)	8,710	
Advances and contributions in aid for construction		7,545	32		7,577
Refunds of advances for construction		(5,184)	(46)		(5,230)
Dividends paid to non-affiliates	(21,981)				(21,981)
Dividends paid to affiliates		(19,790)	(2,191)	21,981	
Issuance of common stock	105,600				105,600
Investment from affiliates		35,000		(35,000)	
Net cash (used in) provided by financing activities	22,863	(10,932)	8,175	(15,110)	4,996
Change in cash and cash equivalents	2,802	7,936	(681)		10,057
	1,470	34,609	2,711		38,790

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Cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period	\$	4,272	\$	42,545	\$	2,030	\$	48,847
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Table of Contents**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS****For the nine months ended September 30, 2012****(In thousands)**

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
<b>Operating activities:</b>					
Net income (loss)	\$ 43,822	\$ 43,607	\$ (82)	\$ (43,525)	\$ 43,822
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Equity earnings of subsidiaries	(43,581)			43,581	
Dividends received from affiliates	19,785			(19,785)	
Depreciation and amortization		40,604	2,207	(89)	42,722
Change in value of life insurance contracts		(2,244)			(2,244)
Other changes in noncurrent assets and liabilities	1,180	30,928	(3,815)	118	28,411
Changes in operating assets and liabilities	(247)	(10,557)	(2,417)	(85)	(13,306)
Net cash provided by (used in) operating activities	20,959	102,338	(4,107)	(19,785)	99,405
<b>Investing activities:</b>					
Utility plant expenditures		(88,593)	(11,007)		(99,600)
Investment in affiliates					
Net changes in affiliate advances	(13,975)	2,708		11,267	
Repayment of affiliates long-term debt	411	36		(447)	
Purchase of life insurance		(3,199)			(3,199)
Restricted cash and other changes, net		1,553			1,553
Net cash provided by (used in) investing activities	(13,564)	(87,495)	(11,007)	10,820	(101,246)
<b>Financing Activities:</b>					
Short-term borrowings	14,535	51,030			65,565
Repayment of short-term borrowings	(1,000)	(51,030)			(52,030)
Proceeds from long-term debt			123		123
Repayment of long-term debt		(1,573)	(550)		(2,123)
Net changes in affiliate advances		524	10,743	(11,267)	
Repayment of affiliates long-term debt	(36)		(411)	447	
Advances and contributions in aid for construction		5,416	75		5,491
Refunds of advances for construction		(5,575)	(57)		(5,632)
Dividends paid to non-affiliates	(19,785)				(19,785)
Dividends paid to affiliates		(17,671)	(2,114)	19,785	
Issuance of common stock					
Investment from affiliates					
Net cash (used in) provided by financing activities	(6,286)	(18,879)	7,809	8,965	(8,391)
Change in cash and cash equivalents	1,109	(4,036)	(7,305)		(10,232)
	89	18,475	8,639		27,203

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Cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period	\$	1,198	\$	14,439	\$	1,334	\$	16,971
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Item 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollar amounts in thousands, except where otherwise noted and per share amounts)

FORWARD LOOKING STATEMENTS

This quarterly report, including all documents incorporated by reference, contains forward-looking statements within the meaning established by the Private Securities Litigation Reform Act of 1995 (Act). Forward-looking statements in this quarterly report are based on currently available information, expectations, estimates, assumptions and projections, and our management's beliefs, assumptions, judgments and expectations about us, the water utility industry and general economic conditions. These statements are not statements of historical fact. When used in our documents, statements that are not historical in nature, including words like expects, intends, plans, believes, may, estimates, assumes, anticipates, projects, predicts, forecasts, should, seeks, or variations of these words or similar expressions are intended to identify forward-looking statements. The forward-looking statements are not guarantees of future performance. They are based on numerous assumptions that we believe are reasonable, but they are open to a wide range of uncertainties and business risks. Consequently, actual results may vary materially from what is contained in a forward-looking statement.

Factors which may cause actual results to be different than those expected or anticipated include, but are not limited to:

- governmental and regulatory commissions' decisions, including decisions on proper disposition of property;
- changes in regulatory commissions' policies and procedures;
- the timeliness of regulatory commissions' actions concerning rate relief;
- changes in the capital markets and access to sufficient capital on satisfactory terms;
- new legislation;

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- changes in California Department of Public Health water quality standards;
- changes in environmental compliance and water quality requirements;
- changes in accounting valuations and estimates;
- changes in accounting treatment for regulated companies, including adoption of International Financial Reporting Standards, if required;
- electric power interruptions;
- increases in suppliers' prices and the availability of supplies including water and power;
- fluctuations in interest rates;
- litigation that may result in damages or costs not recoverable from third parties;
- acquisitions and the ability to successfully integrate acquired companies;
- the ability to successfully implement business plans;
- civil disturbances or terrorist threats or acts, or apprehension about the possible future occurrences of acts of this type;
- the involvement of the United States in war or other hostilities;
- our ability to attract and retain qualified employees;



- labor relations matters as we negotiate with the unions;

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- federal health care law changes could result in increases to Company health care costs and additional income tax expenses in future years;
- changes in federal and state income tax regulations and treatment of such by regulatory commissions;
- implementation of new information technology systems;
- changes in operations that result in an impairment to acquisition goodwill;
- restrictive covenants in or changes to the credit ratings on current or future debt that could increase financing costs or affect the ability to borrow, make payments on debt, or pay dividends;
- general economic conditions, including changes in customer growth patterns and our ability to collect billed revenue from customers;
- changes in customer water use patterns and the effects of conservation;
- the impact of weather on water sales and operating results;
- the ability to satisfy requirements related to the Sarbanes-Oxley Act and other regulations on internal controls; and
- the risks set forth in Risk Factors included elsewhere in this quarterly report.

In light of these risks, uncertainties and assumptions, investors are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this quarterly report. When considering forward-looking statements, investors should keep in mind the cautionary statements in this quarterly report and the documents incorporated by reference. We are not under any obligation, and we expressly disclaim any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise.

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### CRITICAL ACCOUNTING POLICIES

We maintain our accounting records in accordance with accounting principles generally accepted in the United States of America (GAAP) and as directed by the Commissions to which our operations are subject. The process of preparing financial statements in accordance with GAAP requires the use of estimates on the part of management. The estimates used by management are based on historic experience and an understanding of current facts and circumstances. Management believes that the following accounting policies are critical because they involve a higher degree of complexity and judgment, and can have a material impact on our results of operations, financial condition, and cash flows of the business. These policies and their key characteristics are discussed in detail in the 2012 Form 10-K. They include:

- revenue recognition and the water revenue adjustment mechanism;
- modified cost balancing accounts;
- expense balancing and memorandum accounts;
- regulatory utility accounting;
- income taxes;
- pension benefits;
- workers' compensation and other claims;
- goodwill accounting and evaluation for impairment; and
- contingencies.

For the nine month period ended September 30, 2013, there were no changes in the methodology for computing critical accounting estimates, no additional accounting estimates met the standards for critical accounting policies, and there were no material changes to the important assumptions underlying the critical accounting estimates.



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RESULTS OF THIRD QUARTER 2013 OPERATIONS COMPARED TO  
THIRD QUARTER 2012 OPERATIONS

Amounts in thousands except share data

Overview

Third quarter of 2013 net income was \$29.2 million or \$0.61 per diluted common share compared to net income of \$29.8 million or \$0.71 per diluted common share in the third quarter of 2012. The \$0.6 million decrease to net income was mostly due to a smaller income tax benefit realized during the third quarter of 2013 as compared to the prior year. During the third quarter of 2013, State of California EZ credits and equipment repairs and maintenance state income tax deductions increased 2013 net income \$4.1 million. During the third quarter of 2012, mains repairs and maintenance state income tax deductions increased net income \$6.2 million. In addition, 2013 rate increases offset water production and depreciation cost increases and partially offset employee wage and benefit cost increases.

Operating Revenue

Operating revenue increased \$6.3 million or 4% to \$184.4 million in the third quarter of 2013. As disclosed in the following table, the increase was primarily due to increases in rates and the net effect of WRAM.

The factors impacting operating revenue for the third quarter of 2013 as compared to 2012, are as follows:

Rate increases	\$	3,544
Conservation balancing account		863
Deferral of net WRAM and MCBA revenue		(2,800)
Pension balancing account		(2,147)
Usage and other		(1,019)
Net effect of WRAM		7,829
Net operating revenue increase	\$	6,270

The deferral of net WRAM and MCBA revenue in the table above occurs whenever a district net receivable balance is estimated to be collected more than 24 months after the respective reporting period in which it was recognized. The deferrals are reversed when district net receivable balances are estimated to be collected within 24-months. The \$2.8 million net revenue decrease during the third quarter of 2013 as compared to the third quarter of 2012 was mostly due to a larger deferral of net WRAM and MCBA revenues during the third quarter of 2013 as compared to the third quarter of 2012. The deferral in 2013 has increased because of a decrease in actual consumption relative to adopted consumption, which has caused an increase in the net receivables that are expected to be collected more than 24 months after the respective reporting period in which it was recognized.

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The net change in usage and other in the above table refers primarily to the difference between actual metered customer consumption during the three months ended September 30, 2013 and the three months ended September 30, 2012. The \$1.0 million usage and other revenue decrease was due to a decrease in customer consumption during the third quarter of 2013 compared to the prior year. This was partially offset by an increase in accrued unbilled operating revenue which is not a component of the WRAM. The WRAM is a cash basis mechanism which records changes in billed operating revenue. The quarterly changes in the accrued unbilled operating revenue usually vary year over year. These changes are usually most variable in the first and third quarters due to weather conditions and have not had a significant impact on annual revenue in past years.

The net effect of WRAM in the above table refers primarily to the revenue changes recognized by the WRAM and MCBA. The WRAM is impacted by changes in consumption patterns from our historical trends as well as an increase in conservation efforts. The MCBA, which records the differences in production costs from the adopted costs, is recorded as an element of revenue as it represents pass through costs which are billed to customers. The MCBA is impacted by changes in total production quantities, the production mix of the source of water, the price paid for purchased water and power, and the amount of pump taxes paid. The net change during the three months ended September 30, 2013 compared to the three months ended September 30, 2012 resulted in an increase to revenue of \$7.8 million

The pension balancing account in the above table refers to the difference between actual expenses and adopted rate recovery. The decrease of \$2.1 million is due to a smaller benefit from the difference between actual pension expenses as compared to adopted rate recovery in 2013.

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The components of the rate increases are listed in the following table:

Purchased water offset increases	\$	2,268
Step rate increases		3,152
General rate case (GRC) increases		160
Cost of capital adjustment mechanism and other		(2,036)
Total increase in rates	\$	3,544

## Total Operating Expenses

Total operating expenses were \$148.6 million for the third quarter of 2013, compared to \$141.8 million for the same period in 2012, a 5% increase.

Water production expense consists of purchased water, purchased power, and pump taxes. It represents the largest component of total operating expenses, accounting for approximately 48% of total operating expenses in the third quarter of 2013. Water production expenses increased \$4.1 million, or 6%, during the third quarter of 2013 compared to the same period last year due to purchased water price increases. Purchased water costs increased due to price increases from water wholesalers. Washington Water, New Mexico Water, and Hawaii Water obtained all of their water supply from wells during the third quarter of 2013.

Sources of water as a percent of total water production are listed in the following table:

	Three Months Ended September 30	
	2013	2012
Well production	49%	50%
Purchased	47%	44%
Surface	4%	6%
Total	100%	100%

The components of water production costs are shown in the table below:

	Three Months Ended September 30		
	2013	2012	Change
Purchased water	\$ 55,586	\$ 51,428	\$ 4,158
Purchased power	11,599	11,440	159
Pump taxes	3,429	3,621	(192)
Total	\$ 70,614	\$ 66,489	\$ 4,125

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Administrative and general expense and other operations expense increased \$0.7 million, or 2%. Employee wage and benefit cost increases of \$1.6 million were partially offset by reductions to conservation program expenses during the third quarter of 2013 as compared to the third quarter of 2012. Wage increases became effective January 1, 2013. At September 30, 2013, there were 1,121 employees and at September 30, 2012, there were 1,129 employees.

Maintenance expenses increased by 5% to \$4.6 million in the third quarter of 2013 compared to \$4.4 million in the third quarter of 2012, due to an increase in main and service repairs.

Depreciation and amortization expense increased \$0.8 million, or 6%, mostly due to 2012 capital additions.

Federal and state income taxes charged to operating expenses and other income and expenses increased \$0.7 million mostly due to a smaller income tax benefit realized during the third quarter of 2013 as compared to the prior year. During the third quarter of 2013, the State of California EZ credits and equipment repairs and maintenance income tax deductions reduced state income tax expense \$4.1 million. During the third quarter of 2012, the mains repairs and maintenance deductions reduced state income tax expense \$6.2 million. We expect the 2013 effective tax rate to be between 32% and 35% for fiscal year 2013.

### Other Income and Expense

Net other (expense) income decreased during the third quarter of 2013 mostly due to costs incurred to develop new business opportunities.



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Interest Expense

Total interest expense, net of interest capitalized, decreased \$0.1 million to \$7.1 million for the third quarter of 2013 compared to the same period last year. This decrease was attributable to lower short-term and long-term borrowing, and was partially offset by a decrease in capitalized interest charged to construction projects during the third quarter of 2013 compared to the same period last year.

Company Health Care Benefits

In March 2010, both the federal Patient Protection and Affordable Care Act (P.L. 111-148) and Health Care and Education Reconciliation Act (H.R. 4872) were enacted. We anticipate that the Company's health care and other costs will increase as a result of the new federal health care laws and based on available information; however, we have not quantified the impact of this legislation on the Company's health care costs during 2013 and in future years. A new memorandum account was established for Cal Water, effective January 1, 2011, to account for health care cost changes due to federal legislation, as these costs were not included in the 2009 GRC decision.

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## RESULTS OF THE NINE MONTHS ENDED SEPTEMBER 2013 COMPARED TO

## THE NINE MONTHS ENDED SEPTEMBER 2012 OPERATIONS

Amounts in thousands except per share data

Overview

Net income for the nine month period ended September 30, 2013 was \$41.6 million or \$0.90 per diluted common share as compared to net income of \$43.8 million or \$1.05 per diluted common share for the nine month period ended September 30, 2012. The \$2.2 million decrease to net income was mostly due to a smaller income tax benefit, an increase in net interest expense, and a lower unrealized gain on our benefit plan insurance investments during the nine month period ended September 30, 2013 as compared to the prior year. During the nine month period ended September 30, 2013, the State of California EZ credits and repairs and maintenance state income tax deductions increased net income \$4.8 million. During the nine month period ended September 30, 2012, the repairs and maintenance state income tax deductions increased net income \$6.2 million. The increase to net interest expense for the nine month period ended September 30, 2013 as compared to the prior year was mostly due to a decrease in capitalized interest charged to construction projects. The unrealized gain on our benefit plan insurance investments during the nine month periods ended September 30, 2013 and September 30, 2012 was \$1.1 million and \$2.2 million, respectively. Also, the reversal of 2011 deferred WRAM operating revenue of \$11.4 million and MCBA associated costs of \$9.3 million during the first nine months of 2012, added net income of \$1.5 million during the first nine months of 2012, which was a benefit in the prior year. In addition, 2013 rate increases offset water production and depreciation cost increases and partially offset employee wage and benefit cost increases.

Operating Revenue

Operating revenue increased \$12.0 million or 3% to \$450.4 million in the nine month period ended September 30, 2013. As disclosed in the following table, the increase was due to increases in rates and the net effect of WRAM.

The factors impacting operating revenue for the nine months ended September 30, 2013 as compared to 2012 are as follows:

Usage and other	\$	4,621
Rate increases		9,870
Deferral of net WRAM and MCBA revenue		(12,206)
Conservation balancing account		1,159
Pension balancing account		(3,920)
Net effect of WRAM		12,443
Net operating revenue increase	\$	11,967

The deferral of net WRAM and MCBA revenue in the table above occurs whenever a district net receivable balance is estimated to be collected more than 24 months after the respective reporting period in which it was recognized. The deferrals are reversed when district net receivable balances are estimated to be collected within 24-months. The \$12.2 million net revenue decrease during the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012 was mostly due to a decrease in the net receivable expected to be collected within

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24-months in 2013 as compared to 2012. The net receivable expected to be collected within 24-months in 2013 has decreased because of a decrease in actual consumption relative to adopted consumption, which has caused an increase in net receivables with longer amortizations periods.

The net change in usage and other in the above table refers primarily to the difference between actual metered customer consumption during the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012. The \$4.6 million usage and other revenue increase was due to an increase in customer consumption during the first nine months of 2013 compared to the prior year. In part, this reflects a \$1.8 million increase in accrued unbilled operating revenue which is not a component of the WRAM. The WRAM is a cash basis mechanism which records changes in billed operating revenue. The changes in the accrued unbilled operating revenue usually vary year over year. These changes are usually most variable in the first and third quarters due to weather conditions and have not had a significant impact on annual revenues in past years.

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The net effect of WRAM in the above table refers primarily to the revenue changes recognized by the WRAM and MCBA. The WRAM is impacted by changes in consumption patterns from our historical trends as well as an increase in conservation efforts. The MCBA, which records the differences in production costs from the adopted costs, is recorded as an element of revenue as it represents pass through costs which are billed to customers. The MCBA is impacted by changes in total production quantities, the production mix of the source of water, the price paid for purchased water and power, and the amount of pump taxes paid. The net change during the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012 resulted in an increase to revenue of \$12.4 million.

The pension balancing account in the above table refers to the difference between actual expenses and adopted rate recovery. The decrease of \$3.9 million is due to a smaller benefit from the difference between actual pension expenses as compared to adopted rate recovery in 2013.

The components of the rate increases are as follows:

Purchased water offset increases	\$	6,904
Step rate increases		7,382
General rate case (GRC) increases		704
Cost of capital adjustment mechanism and other		(5,120)
Total increase in rates	\$	9,870

## Total Operating Expenses

Total operating expenses were \$388.0 million for the nine month period ended September 30, 2013, compared to \$375.8 million for the same period in 2012, a 3% increase.

Water production expense consists of purchased water, purchased power, and pump taxes. It represents the largest component of total operating expenses, accounting for approximately 44% of total operating expenses in the nine month period ended September 30, 2013. Water production expenses increased 9% compared to the same period last year mostly due to increased costs for purchased water and increased customer usage. Our 100% owned operating subsidiaries, Washington Water, New Mexico Water, and Hawaii Water obtain all of their water supply from wells.

Sources of water as a percent of total water production are listed in the following table:

	Nine months Ended September 30	
	2013	2012
Well production	47%	47%
Purchased	48%	47%
Surface	5%	6%
Total	100%	100%

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The components of water production costs are shown in the table below:

	Nine months Ended September 30		
	2013	2012	Change
Purchased water	\$ 138,315	\$ 125,218	\$ 13,097
Purchased power	25,228	24,577	651
Pump taxes	8,413	8,324	89
Total	\$ 171,956	\$ 158,119	\$ 13,837

Purchased water costs increased primarily due to price increases from water wholesalers and an increase in customer usage.

Administrative and general expense and other operations expense decreased 4.0% to \$123.4 million. The decrease during the first nine months of 2013 was partially due to the reversal of December 31, 2011 deferred MCBA associated costs of \$10.0 million during the first nine months of 2012 which was partially offset by employee wage and benefit costs increases and conservation program expense increases during the nine month period ended September 30, 2013 as compared to the nine month period ended September 30, 2012. Wage increases became effective January 1, 2013.

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Maintenance expense decreased by 13% to \$12.9 million during the nine month period ended September 30, 2013 compared to \$14.7 million during the nine month period ended September 30, 2012, due to a decrease in transmission and distribution mains repairs.

Depreciation and amortization expense increased \$2.2 million, or 5%, mostly due to 2012 capital additions.

Federal and state income taxes charged to operating expenses and other income and expenses decreased \$0.5 million mostly due to a reduction in pre-tax income and a smaller income tax benefit realized during the third quarter of 2013 as compared to the prior year. The 2013 State of California EZ credits and state repairs and maintenance income tax deductions reduced state income tax expense \$4.8 million. The 2012 repairs and maintenance deductions reduced state income tax expense \$6.2 million. We expect the 2013 effective tax rate to be between 32% and 35% for fiscal year 2013.

Other Income and Expense

Net other (expense) income decreased \$0.9 million mostly due to an unrealized gain on our benefit plan insurance investments of \$1.1 million for the nine months ended September 30, 2013, as compared to an unrealized gain of \$2.2 million for the nine months ended September 30, 2012.

Interest Expense

Net interest expense, net of interest capitalized, increased \$1.1 million, or 5%, to \$21.9 million for the nine month period ended September 30, 2013 compared to the same period last year. The increase was mostly due to a decrease in capitalized interest charged to construction projects.

REGULATORY MATTERS

Rates and Regulation

State regulatory utility commissions have plenary powers over investor-owned utilities to set rates and operating standards. As such, state commission decisions significantly impact the Company's revenues, earnings, and cash flows. The amounts discussed herein are generally annual amounts, unless specifically stated, and the financial impact to recorded revenue is expected to occur over a 12-month period from the effective date of a decision. In California, water utilities are required to make several different types of filings. Most filings result in rate changes that remain in place until new rates are adopted in the next General Rate Case (GRC). As explained below, surcharges and surcredits to recover amounts in balancing and memorandum accounts, as well as interim GRC rate relief, are temporary rate changes for specific time frames. GRC applications, escalation rate increase filings, and offset filings change rates to amounts that will remain in effect until the next GRC.

The CPUC adopted a Rate Case Plan for Class A water utilities that requires Cal Water to file a GRC application for its regulated operating districts every three years. In a GRC proceeding, the CPUC not only considers the utility's rate setting requests, but may also consider other issues that affect the utility's rates and operations. The CPUC is generally required to issue its GRC decision prior to the first day of the test year, or alternatively, to authorize interim rates. Cal Water's 2009 GRC application was resolved in the fourth quarter of 2010, and new rates effective became effective January 1, 2011. As discussed in greater detail below, Cal Water filed a GRC application on July 5, 2012 requesting rate increases in all regulated operating districts in California beginning January 1, 2014.

Between GRC filings, utilities may request escalation rate increases that allow the utility to recover cost increases, primarily from inflation and incremental investment, during the second and third years of the rate case cycle. However, escalation rate increases are subject to a weather-normalized earnings test on a district-by-district basis. Under the earnings test, the CPUC may reduce the requested escalation increase in a district if, in the most recent 12-month period, applying the earnings test indicates that earnings in the district exceed what the CPUC authorized for that district.

In addition, California water utilities are entitled to file "offset" requests to increase rates between GRCs. Cal Water files two kinds of rate offset requests: ratebase offsets allow a revenue increase after a previously-authorized construction project is placed in service, and; expense offsets are for higher fees charged to the Company for purchased water, purchased power, and pump taxes (referred to as "offsettable expenses"). Such rate changes approved in offset filings remain in effect until the next GRC is approved.

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In pursuit of the CPUC's water conservation goals, the CPUC decoupled Cal Water's revenue requirement from customer consumption levels in 2008 by authorizing Water Revenue Adjustment Mechanisms (WRAMs) and Modified Cost Balancing Accounts (MCBAs) for each ratemaking area. The WRAMs/MCBAs ensure that Cal Water recovers all of the quantity revenues authorized by the CPUC, and no more, regardless of customer consumption. This removes the Company's historical disincentive against the promotion of lower water usage among customers. Through an annual advice letter filing, Cal Water recovers any uncollected quantity revenue amounts authorized, or refunds over-collected quantity revenues, via surcharges and surcredits. The advice letters are filed between February and April of each year and address the net WRAM/MCBA balances collected for the previous calendar year. Most WRAM/MCBA balances have been revenue under-collections that are amortized through surcharges for a period of 12 or 18 months. The WRAM and MCBA amounts are cumulative, so if they are not amortized in a given calendar year, the balance will be carried forward and included with the following year balance.

**2013 Regulatory Activity**

California GRC filing

On October 30, 2013, Cal Water entered into a settlement agreement with the California Public Utilities Commission's Office of Ratepayer Advocates (ORA) and other parties to its 2012 General Rate Case. The Commission may or may not adopt the settlement agreement as proposed by the parties.

If the settlement agreement is approved as proposed, Cal Water would be authorized to invest \$447.0 million in districts throughout California over the three-year period from January 1, 2013 through December 31, 2015 in order to provide a safe and reliable water supply to its customers. Included in the \$447.0 million in water system infrastructure improvements is \$126.0 million that would be recovered through the Commission's advice letter procedure upon completion of qualified projects. Under the terms of the settlement, the Company would be authorized to increase revenue by approximately \$45.0 million in 2014, \$10.0 million in 2015, \$10.0 million in 2016, and \$19.0 million upon completion and approval of the company's advice letter projects.

Building Renovation on General Office Campus

On March 4, 2013, Cal Water and the CPUC's Division of Ratepayer Advocates submitted a proposed settlement that would allow Cal Water to recover \$5.7 million in capital costs for renovating a building on Cal Water's San Jose campus that houses the information technology, human resources, and customer service departments. Cal Water originally requested recovery of \$6.0 million for the renovation, which included reconfiguration and expansion of the old building. While the substantive issues are being evaluated in a separate proceeding, the revenue increase Cal Water proposed in its 2012 GRC filing already includes the \$6.0 million requested for the renovation. The level of cost recovery the CPUC authorizes for the renovation in the separate proceeding will be incorporated into the final rates adopted in the 2012 GRC proceeding that are expected to be effective on January 1, 2014 (or, if a decision is delayed, retroactive back to January 1, 2014).

Federal Income Tax Bonus Depreciation



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In 2011, Cal Water filed for and received approval to track the benefits from federal income tax accelerated depreciation in a memorandum account due to the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. Additional federal income tax deductions for assets placed in service after September 8, 2010, and before December 31, 2011, were \$0.1 million for 2010 and \$12.2 million for 2011. The memorandum account may result in a surcredit because of the impact to Cal Water's revenue requirement for changes to working cash estimates, reductions to federal income tax qualified U.S. production activities deductions (QPAD), and changes to contributions-in-aid-of-construction. As of September 30, 2013, the estimated surcredit range is between \$0.6 million and \$1.1 million. The CPUC will determine the disposition of amounts recorded in the memorandum account in Cal Water's next GRC proceeding.

### Expense Offset filings

Expense offsets are dollar-for-dollar increases in revenue to match increased expenses, and therefore do not affect net operating income. In August 2013, Cal Water filed advice letters to offset increased purchased water and/or pump tax rates in five of its regulated districts totaling \$2.8 million in annual revenue.

### **Regulatory Activity   Other States**

### Pukalani (Hawaii) GRC Filing

In August 2011, Hawaii Water filed a general rate case for the Pukalani wastewater system requesting \$1.3 million in additional annual revenues. Hawaii Water reached a comprehensive and conceptual settlement with the Consumer Advocate during the fourth quarter of 2012. This settlement would result in an increase of \$0.2 million in 2013, another increase of \$0.2 million in 2014, and another increase of \$0.2 million in 2015. Each increase is separated by one year. A Decision and Order from the Commission approving this stipulated settlement is currently pending.

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Waikoloa (Hawaii) GRC Filings

In August 2012, Hawaii Water filed general rate cases for the Waikoloa water, wastewater, and irrigation systems in Waikoloa Village and Waikoloa Resort requesting \$6.3 million in additional annual revenues. Hawaii Water reached a comprehensive and conceptual settlement with the Consumer Advocate for Waikoloa Village Water during the third quarter of 2013. This settlement would result in an increase of \$0.15 million in 2014. A Decision and Order from the Commission approving this stipulated settlement is currently pending. Hawaii Water and the Consumer Advocate are currently engaged in settlement discussions for the remaining Waikoloa filings; Waikoloa Village Wastewater and Waikoloa Resort Utilities.

LIQUIDITY

Cash flow from Operations

Cash flow from operations was \$101.9 million during the nine months ended September 30, 2013, compared to \$99.4 million for the same period of 2012. The increase in cash flow from operations during the current year was mostly due to an increase in collections of receivables and the timing of third party payments.

During the nine months ended September 30, 2013, we made contributions of \$28.1 million to our pension and retiree health care plans compared to \$25.5 million for the same period of 2012. The net WRAM and MCBA undercollected balances increased \$2.9 million to \$49.0 million as of September 30, 2013 compared to December 31, 2012 due to an increase in the difference between adopted amounts and actual amounts for WRAM and MCBA.

The water business is seasonal. Billed revenue is lower in the cool, wet winter months when less water is used compared to the warm, dry summer months when water use is highest. This seasonality results in the possible need for short-term borrowings under the bank lines of credit in the event cash is not available to cover operating and capital costs during the winter period. The increase in cash flows during the summer allows short-term borrowings to be paid down. Customer water usage can be lower than normal in years when more than normal precipitation falls in our service areas or temperatures are lower than normal, especially in the summer months. The reduction in water usage reduces cash flows from operations and increases the need for short-term bank borrowings. In addition, short-term borrowings are used to finance capital expenditures until long-term financing is arranged.

Investing Activities

During the nine months ended September 30, 2013 and 2012, we used \$94.8 million and \$99.6 million, respectively, of cash for both Company-funded and developer-funded capital expenditures. For 2013, our capital budget is approximately \$110 million to \$130 million. Annual expenditures fluctuate due to the availability of construction resources and our ability to obtain construction permits in a timely manner.

Financing Activities

On March 26, 2013, the Company sold 5,750,000 shares of its common stock in an underwritten public offering for cash proceeds of approximately \$105.6 million, net of underwriting discounts and commissions and offering expenses. The net proceeds from the sale of common stock were added to our general funds to be used for general corporate purposes. In April 2013, the Company used a portion of the net proceeds from the offering to repay outstanding borrowings on the Company and Cal Water lines of credit of \$68.3 million and \$25.0 million, respectively.

During the nine months ended September 30, 2013, there were new borrowings of \$35.3 million on our unsecured revolving credit facilities.

The undercollected net WRAM and MCBA receivable balances were \$49.0 million as of September 30, 2013 and \$46.1 million as of December 31, 2012, respectively. The CPUC shortened the amortization periods for undercollected net WRAM and MCBA balances such that most balances will be collected within 18-months. This change is expected to improve cash flows during 2013. The undercollected balances were primarily financed by Cal Water using short-term and long-term financing arrangements to meet operational cash requirements. Interest on the undercollected balances, the interest recoverable from ratepayers, is limited to the current 90-day commercial paper rates which is significantly lower than Cal Water's short and long-term financing rates.

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#### Short-Term and Long-Term Debt

Short-term liquidity is provided by our unsecured revolving credit facilities, which were amended and replaced on June 29, 2011, and internally generated funds. Long-term financing is accomplished through the use of both debt and equity. As of September 30, 2013, there were short-term borrowings of \$11.5 million outstanding on the unsecured revolving credit facilities compared to \$89.5 million as of December 31, 2012.

Given our ability to access our lines of credit on a daily basis, cash balances are managed to levels required for daily cash needs and excess cash is invested in short-term or cash equivalent instruments. Minimal operating levels of cash are maintained for Washington Water, New Mexico Water, and Hawaii Water.

Both short-term 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 not to exceed 66.7% and an interest coverage ratio of three or more. As of September 30, 2013, the Company's total capitalization ratio was 52.7% (trade payable is included as debt for this calculation) and interest ratio slightly exceeds five. As of September 30, 2013, we have met all of the covenant requirements and are eligible to use the full amount of the commitment.

Bond principal and other long-term debt payments were \$3.1 million during the nine months ended September 30, 2013, compared to \$2.1 million during the same period of 2012. In addition, Cal Water has \$40 million of first mortgage bonds maturing during the fourth quarter of 2013.

Long-term financing, which includes senior notes, other debt securities, and common stock, has typically been used to replace short-term borrowings and fund capital expenditures. Internally generated funds, after making dividend payments, provide positive cash flow, but have not been at a level to meet the needs of our capital expenditure requirements. Management expects this trend to continue given our capital expenditures plan for the next five years. Some capital expenditures are funded by payments received from developers for contributions in aid of construction or advances for construction. Funds received for contributions in aid of construction are non-refundable, whereas funds classified as advances in construction are refundable. Management believes long-term financing is available to meet our cash flow needs through issuances in both debt and equity instruments.

On September 23, 2010, the CPUC authorized Cal Water to issue \$350 million of debt and common stock to finance capital projects and operations. During the nine months ended September 30, 2013, we utilized cash generated from the equity offering, operations, and borrowings on the unsecured revolving credit facilities. In future periods, management anticipates funding our capital needs and repayment of long-term debt through a relatively balanced approach between long-term debt and equity.

#### Dividends, Book Value and Shareholders

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The third quarter of 2013 common stock dividend of \$0.16 per share was paid on August 23, 2013, compared to a quarterly dividend in the third quarter of 2012 of \$0.1575. This was our 274th consecutive quarterly dividend. Annualized, the 2013 dividend rate is \$0.64 per common share, compared to \$0.63 in 2012. For the full year 2012, the payout ratio was 54% of net income. On a long-term basis, our goal is to achieve a dividend payout ratio of 60% of net income accomplished through future earnings growth.

At its October 30, 2013 meeting, the Board declared the fourth quarter dividend of \$0.16 per share payable on November 25, 2013, to stockholders of record on November 12, 2013. This was our 275th consecutive quarterly dividend.

### 2013 Financing Plan

We intend to fund our capital needs in future periods through a relatively balanced approach between long-term debt and equity. The Company and Cal Water have a three-year syndicated unsecured revolving line of credit of \$100 million and \$300 million, respectively for short-term borrowings. As of September 30, 2013, the Company's availability on these unsecured revolving lines of credit was \$388.5 million.

### Book Value and Stockholders of Record

Book value per common share was \$12.57 at September 30, 2013 compared to \$11.30 at December 31, 2012.

There were approximately 2,278 stockholders of record for our common stock as of October 30, 2013.

### Utility Plant Expenditures

For the nine month period ended September 30, 2013, capital expenditures totaled \$94.8 million for Company-funded and developer-funded projects. The planned 2013 Company-funded capital expenditure budget is approximately \$110 million to \$130 million. The actual amount may vary from the budget number due to timing of actual payments related to current year and prior year projects. Also, potential changes in California Department of Public Health (CDPH) water quality standards for chromium-6 may require significant capital and operating expenditures in certain operating Districts.

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We do not control third-party-funded capital expenditures and therefore are unable to estimate the amount of such projects for 2013.

At September 30, 2013, construction work in progress was \$156.6 million compared to \$132.4 million at December 31, 2012. Work in progress includes projects that are under construction but not yet complete and placed in service.

WATER SUPPLY

Our source of supply varies among our operating districts. Certain districts obtain all of their supply from wells; some districts purchase all of their supply from wholesale suppliers; and other districts obtain supply from a combination of wells and wholesale suppliers. A small portion of supply comes from surface sources and is processed through Company-owned water treatment plants. To the best of management's knowledge, we are meeting water quality, environmental, and other regulatory standards for all company-owned systems.

California's normal weather pattern yields little precipitation between mid-spring and mid-fall. The Washington Water service areas receive precipitation in all seasons, with the heaviest amounts during the winter. New Mexico Water's rainfall is heaviest in the summer monsoon season. Hawaii Water receives precipitation throughout the year, with the largest amounts in the winter months. Water usage in all service areas is highest during the warm and dry summers and declines in the cool winter months. Rain and snow during the winter months replenish underground water aquifers and fill reservoirs, providing the water supply for subsequent delivery to customers. As of October 1, 2013, the State of California snowpack water content and rainfall accumulation during the 2012-2013 water year was 92% of normal (per the California Department of Water Resources, Northern Sierra Precipitation Accumulation report). Precipitation during the nine months ended September 30, 2013 was below average. Management believes that supply pumped from underground aquifers and purchased from wholesale suppliers will be adequate to meet customer demand during 2013 and beyond. Long-term water supply plans are developed for each of our districts to help assure an adequate water supply under various operating and supply conditions. Some districts have unique challenges in meeting water quality standards, but management believes that supplies will meet current standards using current treatment processes.

CONTRACTUAL OBLIGATIONS

During the nine months ended September 30, 2013, there were no material changes in contractual obligations outside the normal course of business.

Item 3.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

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We do not hold, trade in or issue derivative financial instruments and therefore are not exposed to risks these instruments present. Our market risk to interest rate exposure is limited because the cost of long-term financing and short-term bank borrowings, including interest costs, is covered in consumer water rates as approved by the commissions. We do not have foreign operations; therefore, we do not have a foreign currency exchange risk. Our business is sensitive to commodity prices and is most affected by changes in purchased water and purchased power costs.

Historically, the CPUC's balancing account or offsetable expense procedures allowed for increases in purchased water and purchased power costs to be passed on to consumers. Traditionally, a significant percentage of our net income and cash flows comes from California regulated operations; therefore the CPUC's actions have a significant impact on our business. See Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies -Expense Balancing and Memorandum Accounts" and "Regulatory Matters".

Item 4.

### CONTROLS AND PROCEDURES

#### (a) Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow for timely decisions regarding required disclosure.

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In designing and evaluating the disclosure controls and procedures, management recognized any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Accordingly, our disclosure controls and procedures have been designed to provide reasonable assurance of achieving their objectives.

Our management, with the participation of our CEO and our CFO, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2013. Based on that evaluation, we concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

(b) Changes to Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1.

LEGAL PROCEEDINGS

From time to time, the Company has been named as a co-defendant in asbestos-related lawsuits. Several of these cases against the Company have been dismissed without prejudice. In other cases the Company's contractors and insurance policy carriers have settled the cases with no effect on the Company's financial statements. As such, the Company does not currently believe there is any potential loss that is probable to occur related to these matters and therefore no additional accrual has been recorded as of September 30, 2013.

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. In the future, we may be involved in disputes and litigation related to a wide range of matters, including employment, construction, environmental issues and operations. Litigation can be time consuming and expensive and could divert management's time and attention from our business. In addition, if we are subject to additional lawsuits or disputes, we might incur significant legal costs and it is uncertain whether we would be able to recover the legal costs from ratepayers or other third parties. As such, the Company does not currently believe there is any potential loss that is probable to occur related to these matters and therefore no additional accrual has been recorded as of September 30, 2013.



Item 1A.

## RISK FACTORS

*New and more stringent water quality regulations could increase our operating costs.*

We are subject to water quality standards set by federal, state and local authorities that have the power to issue new regulations. Compliance with new regulations that are more stringent than current regulations could increase our operating costs.

On August 22, 2013, the CDPH issued a draft standard of 10 parts per billion for chromium-6. The standard is expected to be finalized in 2014. There can be no assurance that our existing operations will comply with the drinking water quality standards for chromium-6 proposed by the CDPH. More stringent drinking water quality standards could require us to develop new quality control procedures which could increase our operating costs, restrict our available water supplies, or increase future capital expenditures in certain operating Districts. Although we would likely seek permission to recover additional costs of compliance through rate increases, we can give no assurance that the CPUC would approve rate increases to enable us to recover these additional compliance costs.

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Other than the additional risk factor above, there have been no material changes to the Company's risk factors set forth in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year-ended December 31, 2012, filed with the SEC on February 28, 2013.

Item 5.

OTHER INFORMATION

Item 6.

EXHIBITS

Exhibit	Description
31.1	Chief Executive Officer certification of financial statements pursuant to Section 302 of the Sarbanes- Oxley Act of 2002
31.2	Chief Financial Officer certification of financial statements pursuant to Section 302 of the Sarbanes- Oxley Act of 2002
32	Chief Executive Officer and Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes- Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURES

Pursuant to the requirement of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CALIFORNIA WATER SERVICE GROUP  
Registrant

November 6, 2013

By: /s/ Thomas F. Smegal III  
THOMAS F. SMEGAL III  
Vice President,  
Chief Financial Officer and Treasurer

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