



COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics

CWT - NYSE - as of	2/22/17	\$35.50
Price Target		--
52-Week Range	\$23.20 -	\$36.85
Shares Outstanding (mm)		48.0
Market Cap. (\$mm)		\$1,702.9
1-Mo. Average Daily Volume		151,174
Institutional Ownership		74.8%
LTD / Total Capital	Q4'15	44.6%
ROE--unadjusted	TTM	7.6%
Book Value / Share	Q4'15	\$13.75
Price / Book Value		2.6x
Dividend Yield		2.0%
EBITDA Margin		--

EPS FY 12/31

		Prior	Current	Prior	Current
	2016A	2017E	2017E	2018E	2018E
1Q	(\$0.02)	--	\$0.07	--	--
2Q	\$0.24	--	\$0.39	--	--
3Q	*\$0.52	--	\$0.70	--	--
4Q	*\$0.23	--	\$0.23	--	--
Year	*\$0.97	\$1.43	\$1.39	\$1.56	\$1.49
P/E	36.6x		25.5x		23.8x

*excludes benefit from non-recurring tax gain

Net Revenue (\$MM; Rev - H2O Production Costs)

		Prior	Current	Prior	Current
	2016A	2017E	2017E	2018E	2018E
1Q	\$80.7	--	\$88.6	--	--
2Q	\$94.9	--	\$107.0	--	--
3Q	\$114.1	--	\$130.5	--	--
4Q	\$99.8	--	\$105.7	--	--
Year	\$389.4	\$427	\$431.7	\$447	\$452

Company Description: *California Water Service Group is the third-largest publicly traded water utility in the United States by market capitalization. Its regulated public utilities serve approximately 500,000 customers. Overall, it provides water services to over two million people in 100 communities in California, Washington, New Mexico, and Hawaii.*

Water Utilities

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California Water Service Group

CWT – NYSE – Neutral-2

Upside Surprise in Q4 to Cap a Wild Year; Reiterating Neutral Rating but Positive Themes Intact for 2017.

Investment Highlights

- CWT reported Q4'16 EPS of \$0.31 versus \$0.18 in the year-ago period; EPS exceeded both our target and consensus at \$0.20, but two separate one-time items from the 2015 rate case finalization in December contributed about +0.09 relative to our model. HL-adjusted FY 2016 EPS rose 2.9% to \$0.97; a favorable unbilled revenue swing and recoup of '15 drought expenses offset higher interest and maintenance.
- Net revenue (rev – production costs) gained 11.9% and 2.3% in Q4 and FY 2016, respectively, although Q4 was impacted by a one-time balancing adjustment. We expect material growth to return across 2017, with new base rates in CA effective January 1.
- Drought memoranda spending totaled ~\$4.4MM in 2016, which equals the total from 2015; however, we expect recovery for this (modeled into Q4) will be higher than \$2.9MM that hit Q4'16. CWT's WRAM balance (revenue to be recovered in the future) ended the year at ~\$37MM, the lowest year-end since 2010.
- Cal Water's CA Cost of Capital filing is scheduled to take place in March; a request to delay by 1 year (as has been recent status quo) was denied. Risk here would be to 2018 allowed returns (and cap structure).
- Our 2017E and 2018E EPS both slide a few cents ahead of our review of CWT's annual 10-K, but we see our targets as fairly conservative at this point.
- We are reiterating our Neutral rating. From our vantage point, CWT is positioned for a very strong year, but we believe this is more/less adequately reflected in the current stock price.

Note Important Disclosures on Pages 6-7
Note Analyst Certifications on Page 6

ADDITIONAL DISCUSSION—Q4/FY RESULTS AND FORWARD OUTLOOK

A litigation gain (reflected in other income) contributed about +\$0.03 of Q4 EPS versus our model, while the adjustment of a couple of regulatory balancing accounts (reflected in revenue) contributed another +\$0.06; each of these items was settled in conjunction with the 2015 CA General Rate Case, and was booked immediately upon acceptance in December. Even after adjusting for these items, we are still pleased with fourth quarter results, based primarily on the fact that the (mostly) in line report leaves our base year intact for 2017.

Projecting into 2017, we eagerly await impact of the oft-mentioned new base rates in California, which statutorily, are designed to generate additional revenue of \$45MM. We expect this benefit to be slightly offset by higher interest expense (normal course of business), a higher effective full year tax rate (37.6% versus 35.5%), and perhaps some delayed O&M, but nonetheless see a clear path for strong earnings growth this year. Revenue increases in 2018/2019 were primarily set along with 2017 rates, but implementation is contingent upon some operational milestones. The more uncertain drivers of the out-years, in our view, will be the upcoming Cost of Capital filing and where normalized results shake out from 2017.

ADDITIONAL DISCUSSION—MULTIPLE ITEMS

CWT management spent considerable time on the conference call this morning discussing recent events at the Oroville Dam. Cal Water services 8,000 customers, or roughly 18,000 people, in the immediate area of the damaged structure; however, CWT holds no ownership stake in the dam itself. Employees of Cal Water were displaced in conjunction with the evacuation, and we expect a few miscellaneous costs could surface in Q1 from setting up temporary ops centers, but we see little risk to the financial health of CWT.

Investor fears tied to the multi-year drought in California peaked some time ago, in our view, but the state continues to grapple with managing through the situation. In February, the drought designation was extended by an additional 270 days, although state-mandated usage restrictions (and penalty surcharges) have been gone since the middle of last year. Separately in January, the State Water Board began the process of evaluating (and ultimately implementing) long-term usage restrictions across the state. This process however, may not even be concluded by the end of this decade, and we are far from reflecting any sort of new regulation into our financial model.

As mentioned in our opening bullet points, Cal Water is scheduled to make a Cost of Capital filing with California regulators in late-March; CWT will be one of four utilities making the joint filing. This particular item has been delayed for several years (with the approval of regulators), with conventional wisdom being that no change is likely necessary given stable interest rates. A request this year to again delay the filing was denied, although we do not immediately make an ominous read through. While it is absolutely possible that CWT's allowed returns are lowered, we view the current ~9.5% ROE as fair, and believe the company could absorb/adjust changes to its capital structure relatively quickly, as necessary. Proceedings should be concluded this year, but under no circumstance, will changes impact 2017.

ADDITIONAL DISCUSSION—FINAL THOUGHTS

Long-term implications from a sustained rise in CWT's Cap Ex plans have not yet entered the mainstream conversation for Cal Water, in our view, obfuscated over the course of the past year by items such as: multi-year drought, the Oroville Dam, Cedar Fire (Kern County), and the here-and-now impacts of the 2015 General Rate case. The potential for California Water to be part of the long-term water solution for the Bay Area (and beyond) in California remains a compelling investment theme for us, and we encourage investors to stay engaged with the story, despite our current Neutral rating.

SUITABILITY

We assign CWT a suitability rating of '2.' A complete description of our suitability scale is on page 6. We view Cal Water as a strong operator, with generally favorable regulatory constructs, and consistent cash flow predictability as an owner of regulated monopoly franchises. Size (smaller than most Utility sector peers) and high sensitivity to a single state (CA) are the primary factors that push CWT comfortably below our most conservative '1' suitability rating. A strong history of returning capital to shareholders, exceedingly low cyclicalities under usual circumstances due to revenue decoupling, and industry-appropriate leverage keep the company above our more aggressive '3' rating.

CONSIDERATIONS AND RISKS

We view all companies in the Water Utilities industry as being subject to significant regulatory and political risk. Utility operations are heavily regulated; negative rate-making climates and/or new environmental restrictions may affect the company's ability to earn a sufficient return on invested capital. Weather, natural disaster, and availability of water supplies could negatively impact sources of water, demand for water services, and a utility's ability to supply water to customers. Risks associated with the collection, treatment, and disposal of wastewater could also impose significant costs.

Significant capital expenditures are required to maintain infrastructure and expand rate base. Should the company suffer from the lack of ability to secure appropriate funding to make investments, or if delays are incurred in completing projects, operating results could be negatively affected. Contamination of water could result in service interruptions or cause enforcement actions. Water assets can be subject to condemnation through eminent domain. The company's non-regulated businesses provide performance guarantees and have long-term contracts. Additionally, the company is subject to all other risks that result from operating as a publicly traded company.

Our Suitability rating is 2 on a 1-to-4 scale (1 = most conservative, 4 = most aggressive).

Additional information is available upon request.

California Water Service Group

Income Statements (000's)	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17E	Q2'17E	Q3'17E	Q4'17E	FY'17E	FY'18E
Operating Revenue	\$597,499	\$588,368	\$121,727	\$152,445	\$184,268	\$150,930	\$609,370						
Water Production Costs	223,941	207,926	41,069	57,589	70,175	51,160	219,993						
Net Revenue--Water Ops	373,558	380,442	80,658	94,856	114,093	99,770	389,377	88,610	106,990	130,450	105,670	431,720	452,360
G & A	97,373	113,110	27,827	23,366	23,844	23,437	98,474	28,244	24,301	21,002	28,041	101,590	103,110
Other Op Exp	65,807	62,848	17,302	17,803	18,261	22,316	75,682	17,650	18,160	18,630	21,700	76,140	80,710
Drought Memorandum Acct		4,400	2,000	1,100	1,300	0	4,400	250	250	250	250	1,000	0
Maintenance	19,854	21,463	6,063	5,934	5,545	5,451	22,993	5,580	5,534	5,270	5,070	21,450	20,390
D & A	61,217	61,381	16,046	15,842	15,884	15,827	63,599	17,530	17,180	17,130	18,170	70,010	75,160
Income Tax	26,727	24,528	(925)	6,870	13,247	5,612	24,804	1,800	9,200	19,700	8,800	39,500	43,300
Property and Other Taxes	20,733	21,559	6,075	5,407	5,957	5,792	23,231	6,140	5,460	6,020	5,850	23,470	23,700
Other Op Exp	291,711	309,289	74,388	76,322	84,038	78,435	313,183	77,190	80,080	88,000	87,880	333,160	346,370
Net Operating Income	81,847	71,153	6,270	18,534	30,055	21,335	76,194	11,420	26,910	42,450	17,790	98,560	105,990
% of Net Rev	21.9%	18.7%	7.8%	19.5%	26.3%	21.4%	19.6%	12.9%	25.2%	32.5%	16.8%	22.8%	23.4%
Other Income and Exp:													
Total Other Inc / (Exp)	1,839	1,134	267	571	531	1,613	2,982	(172)	(36)	(203)	2,096	1,690	1,400
Income Before Interest	83,686	72,287	6,537	19,105	30,586	22,948	79,176	11,248	26,874	42,247	19,886	100,250	107,390
Interest Expense	28,483	29,185	8,065	8,434	8,485	8,482	33,466	8,580	8,860	9,400	9,440	36,280	38,350
Less: Capitalized Interest	1,535	1,915	730	837	774	624	2,965	750	750	750	750	3,000	3,000
Total Interest Expense	26,948	27,270	7,335	7,597	7,711	7,858	30,501	7,830	8,110	8,650	8,690	33,280	35,350
Net Income	\$56,738	\$45,017	(\$798)	\$11,508	\$22,875	\$15,090	\$48,675	\$3,418	\$18,764	\$33,597	\$11,196	\$66,970	\$72,040
EPS (FD)	\$1.19	\$0.94	(\$0.02)	\$0.24	\$0.48	\$0.31	\$1.01	\$0.07	\$0.39	\$0.70	\$0.23	\$1.39	\$1.49
Adjusted EPS (FD)					\$0.52	\$0.23	\$0.97						
Diluted Avg Shares	47,819	47,880	47,905	47,972	47,969	47,969	47,954	48,009	48,049	48,089	48,129	48,069	48,229
Dividend	\$0.650	\$0.670	\$0.1725	\$0.1725	\$0.1725	\$0.1725	\$0.690	\$0.1800	\$0.1800	\$0.1800	\$0.1800	\$0.720	\$0.740
Rate of Change Analysis:													
Net Revenue--Water Ops	4.3%	1.8%	5.0%	3.8%	-7.3%	11.9%	2.3%	9.9%	12.8%	14.3%	5.9%	10.9%	4.8%
G & A	-0.7%	16.2%	0.5%	-12.3%	-22.4%	-16.4%	-12.9%	1.5%	4.0%	-11.9%	19.6%	3.2%	1.5%
Operating Income	10.6%	-13.1%	-16.4%	12.4%	-6.7%	42.6%	7.1%	82.1%	45.2%	41.2%	-16.6%	29.4%	7.5%
EPS	20.2%	-20.7%	-150.6%	16.7%	-1.1%	77.7%	2.9%	nm	62.8%	34.7%	-26.1%	44.0%	7.2%
EBITDA	12.2%	-7.5%	-8.7%	11.6%	-5.8%	26.4%	4.8%	43.8%	29.2%	34.0%	4.6%	26.4%	7.9%
Margin Analysis:													
G & A / Net Rev	26.1%	29.7%	34.5%	24.6%	20.9%	23.5%	25.3%	31.9%	22.7%	16.1%	26.5%	23.5%	22.8%
Maintenance / Net Rev	5.3%	5.6%	7.5%	6.3%	4.9%	5.5%	5.9%	6.3%	5.2%	4.0%	4.8%	5.0%	4.5%
Net Income / Net Rev	15.2%	11.8%	-1.0%	12.1%	20.0%	15.1%	12.5%	3.9%	17.5%	25.8%	10.6%	15.5%	15.9%
Tax rate	33.0%	36.0%	48.2%	38.7%	37.3%	30.8%	35.5%	36.9%	33.4%	37.2%	44.6%	37.6%	38.0%
					*Adjusting out \$3.2MM capital charge	*Assume +\$0.04 frm 2014-2015 drgt mem.		*cost of capital would be filed by march			*+\$0.05 frm 2016 drgt mem (+\$0.01 y/y)		

Source: Company reports and Hilliard Lyons estimates

California Water Service Group

California Water Service Group													
Summary Balance Sheet	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17E	Q2'17E	Q3'17E	Q4'17E	FY'17E	FY'18E
Cash	\$19,587	\$8,837	\$30,878	\$30,826	\$21,351	\$25,492	\$25,492	\$6,790	\$2,620	\$27,420	\$27,860	\$27,860	\$17,260
A/R--Customers	25,803	31,512	31,397	36,635	45,376	30,305	30,305	34,490	41,320	51,880	32,100	32,100	33,550
Regulatory Balance Acct	53,199	35,052	31,554	26,453	19,811	30,332	30,332	30,330	30,330	30,330	30,330	30,330	30,330
Other	55,535	52,177	54,692	65,086	64,589	55,940	55,940	57,430	68,340	67,820	58,740	58,740	61,680
Total CA	154,124	127,578	148,521	159,000	151,127	142,069	142,069	129,040	142,610	177,450	149,030	149,030	142,820
Net Utility Plant	1,590,431	1,701,768	1,739,679	1,785,077	1,817,751	1,859,277	1,859,277	1,886,750	1,924,570	1,967,440	1,999,270	1,999,270	2,139,110
Regulatory assets	390,331	361,893	361,249	363,321	363,597	355,930	355,930	356,030	356,030	356,030	356,030	356,030	356,130
Goodwill	2,615	2,615	2,615	2,615	2,615	2,615	2,615	2,615	2,615	2,615	2,615	2,615	2,615
Other	49,850	52,241	47,741	48,110	50,953	51,854	51,854	50,130	50,520	53,500	54,450	54,450	57,170
Total Assets	\$2,187,351	\$2,246,095	\$2,299,805	\$2,358,123	\$2,386,043	\$2,411,745	\$2,411,745	\$2,424,565	\$2,476,345	\$2,557,035	\$2,561,395	\$2,561,395	\$2,697,845
A/P	59,395	66,380	65,354	77,604	84,052	77,813	77,813	71,800	87,530	96,100	82,410	82,410	86,120
CP of LTD	6,607	6,600	6,113	6,133	6,130	26,208	26,208	20,000	20,000	12,730	12,730	12,730	100,000
ST Borrowings	79,115	33,615	34,500	75,100	57,100	97,100	97,100	122,100	62,100	72,100	82,100	82,100	148,100
Other	72,589	41,860	52,176	43,176	56,699	49,109	49,109	54,780	45,330	59,530	51,560	51,560	54,140
Total CL	217,706	148,455	158,143	202,013	203,981	250,230	250,230	268,680	214,960	240,460	228,800	228,800	388,360
LTD	419,233	512,287	557,849	555,787	555,536	531,745	531,745	537,950	637,950	645,230	645,230	645,230	557,950
Other LT liab	923,786	943,198	950,846	963,563	974,514	970,299	970,299	969,860	982,830	994,000	989,700	989,700	1,009,490
Shareholders' Equity	626,626	642,155	632,967	636,760	652,012	659,471	659,471	648,075	640,605	677,345	697,665	697,665	742,045
Total Liab & SE	\$2,187,351	\$2,246,095	\$2,299,805	\$2,358,123	\$2,386,043	\$2,411,745	\$2,411,745	\$2,424,565	\$2,476,345	\$2,557,035	\$2,561,395	\$2,561,395	\$2,697,845
Summary Cash Flow	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16E	FY'16E	Q1'17E	Q2'17E	Q3'17E	Q4'17E	FY'17E	FY'18E
Net income	\$56,738	\$45,017	(\$798)	\$11,508	\$22,875	\$15,090	\$48,680	\$3,420	\$18,760	\$33,600	\$11,200	\$66,970	\$72,040
D&A	61,217	61,381	16,046	15,842	15,884	15,827	63,599	17,530	17,180	17,130	18,170	70,010	75,160
Deferred Tax	34,125	24,393	5,000	7,000	9,500	8,000	29,500	(5,000)	(5,000)	20,000	15,000	25,000	25,000
(Inc) / Dec in Wrk Cap	(2,430)	(7,948)	10,388	(7,281)	18,369	(630)	20,846	(6,015)	(11,460)	12,730	4,730	(15)	1,900
Operating CF	149,650	122,843	30,636	27,069	66,628	38,287	162,625	9,935	19,480	83,460	49,100	161,965	174,100
Cap Ex	(132,015)	(176,833)	(56,463)	(59,692)	(50,251)	(62,594)	(229,000)	(45,000)	(55,000)	(60,000)	(50,000)	(210,000)	(215,000)
Acquisitions	-	-	-	-	-	-	-	-	-	-	-	-	-
Dividends	(31,063)	(32,066)	(8,258)	(8,274)	(8,275)	(8,270)	(33,077)	(8,640)	(8,650)	(8,660)	(8,660)	(34,610)	(35,690)
Free Cash Flow	(13,428)	(86,056)	(34,085)	(40,897)	8,102	(32,577)	(99,452)	(43,705)	(44,170)	14,800	(9,560)	(82,645)	(76,590)
Issuance LTD	497	99,343	50,039	(216)	-	-	49,823	-	100,000	20,000	-	120,000	12,700
(Retirement) LTD	(8,705)	(7,003)	(254)	(2,209)	(402)	(3,500)	(6,365)	-	-	(20,000)	-	(20,000)	(12,700)
ST Debt Borrowings	117,300	94,303	54,500	48,600	2,000	45,000	150,100	-	40,000	10,000	10,000	60,000	76,000
ST Debt (Repayments)	(85,000)	(141,000)	(53,615)	(8,000)	(20,000)	(5,000)	(86,615)	25,000	(100,000)	-	-	(75,000)	(10,000)
Stock Issued	-	-	-	-	-	-	-	-	-	-	-	-	-
Contrib / (Refund) for Const	5,688	9,300	5,996	1,995	5,001	-	12,992	-	-	-	-	-	-
Net Cash Flow	16,352	(31,113)	22,581	(727)	(5,299)	3,923	20,483	(18,705)	(4,170)	24,800	440	2,355	(10,590)
EBITDA	169,791	157,062	21,391	41,246	59,186	42,774	164,597	30,750	53,290	79,280	44,760	208,070	224,450
EV / TTM EBITDA	9.3x	10.3x	11.7x	13.9x	13.4x	13.1x	13.1x	13.0x	12.7x	11.3x	11.2x	11.2x	10.5x
Selected Financial Statistics	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17E	Q2'17E	Q3'17E	Q4'17E	FY'17E	FY'17E
Book Value	\$13.10	\$13.41	\$13.21	\$13.27	\$13.59	\$13.75	\$13.75	\$13.50	\$13.33	\$14.09	\$14.50	\$14.50	\$15.37
Price / Book	1.9x	1.7x	2.0x	2.6x	2.4x	2.5x	2.5x	2.6x	2.7x	2.5x	2.4x	2.4x	2.3x
Net Indebtedness / Total Capital	43.6%	45.8%	47.3%	48.8%	47.8%	48.8%	48.8%	51.0%	52.8%	50.9%	50.5%	50.5%	51.5%
LTD / Total Capital	40.1%	44.4%	46.8%	46.6%	46.0%	44.6%	44.6%	45.4%	49.9%	48.8%	48.0%	48.0%	42.9%
ROE (TTM)	9.4%	7.1%	6.7%	7.0%	6.6%	7.6%	7.6%	8.2%	9.3%	10.8%	10.1%	10.1%	10.2%

Source: Company reports and Hilliard Lyons estimates

Analyst Certification

I, Spencer E. Joyce, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Suitability Ratings

- 1** - A large cap, core holding with a solid history
- 2** - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
- 3** - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
- 4** - Speculative, due to small size, inconsistent profitability, erratic revenues, volatility, low trading volume or a narrow customer or product base

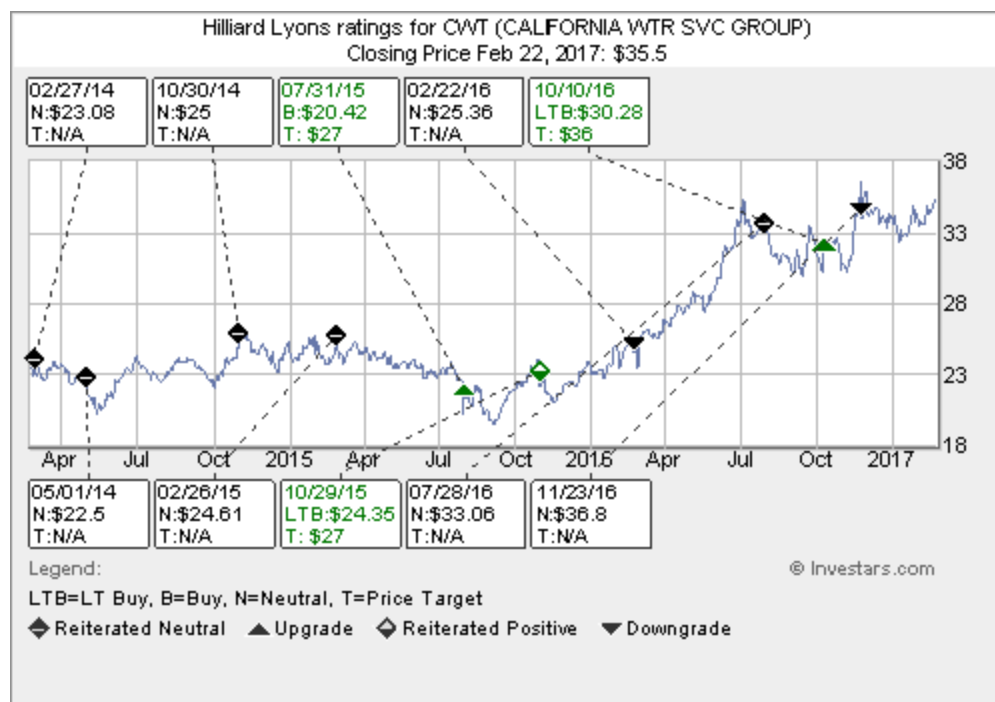
Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.

Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

Underperform - We believe the stock is vulnerable to a price setback in the next 12 months.



Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.		
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	36	30%	17%	83%
Hold/Neutral	76	62%	7%	93%
Sell	10	8%	0%	100%

As of 6 February 2017

Other Disclosures

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