



COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics

CWT - NYSE - as of	7/26/17	\$38.50
Price Target		--
52-Week Range	\$29.25 -	\$39.65
Shares Outstanding (mm)		48.0
Market Cap. (\$mm)		\$1,848.8
1-Mo. Average Daily Volume		150,943
Institutional Ownership		73.8%
LTD / Total Capital	Q2'17	44.0%
ROE--unadjusted	TTM	8.8%
Book Value / Share	Q2'17	\$13.78
Price / Book Value		2.8x
Dividend Yield		1.9%
EBITDA Margin		27.8%

EPS FY 12/31

	2016A	Prior 2017E	Current 2017E	Prior 2018E	Current 2018E
1Q	(\$0.02)	--	\$0.02	A --	--
2Q	\$0.24	--	\$0.39	A --	--
3Q	*\$0.52	\$0.70	\$0.71	--	--
4Q	*\$0.23	\$0.26	\$0.28	--	--
Year	*\$0.97	\$1.37	\$1.39	\$1.49	\$1.47
P/E	39.7x		27.7x		26.2x

*excludes benefit from non-recurring tax gain

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

	2016A	Prior 2017E	Current 2017E	Prior 2018E	Current 2018E
1Q	\$80.7	--	\$80.0	A --	--
2Q	\$94.9	--	\$107.0	A --	--
3Q	\$114.1	\$130.7	\$129.5	--	--
4Q	\$99.8	\$105.9	\$106.5	--	--
Year	\$389.4	\$423.8	\$422.9	\$447	\$446

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

Analyst: Spencer E. Joyce, CFA
502.588.8402 // sjoyce@hilliard.com
Institutional Sales Desk: George Moorin
502.588.9141 // gmoorin@hilliard.com
J.J.B. Hilliard, W.L. Lyons, LLC
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California Water Service Group

CWT – NYSE – Neutral-2

Profit Gates Open in Q2'17 for CWT; Reiterating Neutral Rating.

Investment Highlights

- CWT reported Q2'17 EPS of \$0.39, in line with our estimate but well above Street consensus for \$0.32; CWT earned \$0.24/share in Q2'16. New base rates in California (effective Jan 1) were the primary driver.
- Net revenue (rev – production costs) grew 12.8%, just below our +13.0% estimate, due in part to roughly +\$12.3MM of (net) rate activity; unbilled revenues represented a \$2.5MM yr/yr tailwind.
- Drought memoranda spending was down about \$1MM yr/yr, and should be negligible on an absolute basis moving forward. More comprehensive, total Op Ex (G&A, Maintenance, Other) fell 2.8% yr/yr in Q2.
- CWT's WRAM balance (revenue to be recovered in the future) was \$54.8MM on 6/30, up from \$48MM and \$37MM at 3/31 and 12/31/16, respectively. YTD usage was higher in 1H'17, but below-adopted volumes continue to push the WRAM balance higher.
- Cal Water's CA Cost of Capital filing from early-April remains in progress without much interim clarity. Risk here is to allowed returns/cap structure for 2018; proceedings still suggest completion before year-end.
- Despite the in line Q2, our FY 2017E EPS rises \$0.02 to \$1.39 as we tweak our maintenance, AFUDC (offset to interest) and depreciation assumptions. Our 2018E EPS slides \$0.02 to \$1.47, on slightly lower revenue.
- We are reiterating our Neutral rating. A quarter with fresh rates and little noise from the drought has been (literally) years in the making; however, while the story is still really constructive, in our view, we see shares as fairly valued.

Note Important Disclosures on Pages 5-6
Note Analyst Certifications on Page 5

ADDITIONAL DISCUSSION—MULTIPLE ITEMS

Although Q2 was in line with our expectations from a net revenue and EPS standpoint, it is never easy to call for profit growth of 60%+ and we are both relieved and pleased with second quarter results. We believe the period supports our view that many of the conversation points surrounding CWT would prove fleeting in nature (i.e. accrued unbilled revenue adjustments, drought impact), and that the most recently completed general rate case was settled in a constructive fashion. Having said that, with some uncertainty removed from the story (at least in our view) and consensus for 2017/2018 likely to move higher in coming days, we believe investors need to be incrementally more cautious with respect to entry points into the stock. Thus, we are comfortable reasserting our Neutral rating.

As noted in our opening bullet points, the Cost of Capital (CoC) filing in California continues to move forward, although by our estimation, not much has changed over the past ~3 months. Ratepayer Advocate testimony is due next month and hearings are set for September, which keeps the filing on track to be concluded this year; no changes will take effect before 2018. We view the currently allowed ~9.5% ROE as fair, particularly with the narrative in interest rates having shifted to a hiking cycle, and do not see the pending CoC filing as a reason to avoid CWT shares.

SUITABILITY

We assign CWT a suitability rating of ‘2.’ A complete description of our suitability scale is on page 5. 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	Q1'17	Q2'17	Q3'17E	Q4'17E	FY'17E	FY'18E
Operating Revenue	\$597,499	\$588,368	\$121,727	\$152,445	\$184,268	\$150,930	\$609,370	\$122,036	\$171,132				
Water Production Costs	223,941	207,926	41,069	57,589	70,175	51,160	219,993	42,068	64,131				
Net Revenue--Water Ops	373,558	380,442	80,658	94,856	114,093	99,770	389,377	79,968	107,001	129,470	106,500	422,940	446,140
G & A	97,373	113,110	27,827	23,366	23,844	23,437	98,474	25,249	23,796	21,002	28,041	98,090	100,160
Other Op Exp	65,807	62,848	17,302	17,728	18,301	22,316	75,647	15,924	18,228	18,670	21,669	74,490	79,690
Drought Memorandum Acct	4,400	4,400	2,000	1,175	1,260	0	4,435	200	100	0	0	300	0
Maintenance	19,854	21,463	6,063	5,934	5,545	5,451	22,993	6,112	4,708	4,710	4,910	20,440	20,040
D & A	61,217	61,381	16,046	15,842	15,884	15,827	63,599	19,201	19,218	19,670	20,060	78,150	83,630
Income Tax	26,727	24,528	(925)	6,870	13,247	5,612	24,804	(884)	9,635	18,700	6,750	34,200	38,500
Property and Other Taxes	20,733	21,559	6,075	5,407	5,957	5,792	23,231	6,116	6,057	6,020	5,850	24,040	24,290
Other Op Exp	291,711	309,289	74,388	76,322	84,038	78,435	313,183	71,918	81,742	88,770	87,280	329,710	346,310
Net Operating Income	81,847	71,153	6,270	18,534	30,055	21,335	76,194	8,050	25,259	40,700	19,220	93,230	99,830
% of Net Rev	21.9%	18.7%	7.8%	19.5%	26.3%	21.4%	19.6%	10.1%	23.6%	31.4%	18.0%	22.0%	22.4%
Other Income and Exp:													
Total Other Inc / (Exp)	1,839	1,134	267	571	531	1,613	2,982	1,298	1,787	1,787	2,601	7,470	7,170
Income Before Interest	83,686	72,287	6,537	19,105	30,586	22,948	79,176	9,348	27,046	42,487	21,821	100,700	107,000
Interest Expense	28,483	29,185	8,065	8,434	8,485	8,482	33,466	8,710	9,079	9,190	9,320	36,300	39,350
Less: Capitalized Interest // AFUDC	1,535	1,915	730	837	774	624	2,965	494	564	750	750	2,558	3,000
Total Interest Expense	26,948	27,270	7,335	7,597	7,711	7,858	30,501	8,216	8,515	8,440	8,570	33,742	36,350
Net Income	\$56,738	\$45,017	(\$798)	\$11,508	\$22,875	\$15,090	\$48,675	\$1,132	\$18,531	\$34,047	\$13,251	\$66,958	\$70,650
EPS (FD)	\$1.19	\$0.94	(\$0.02)	\$0.24	\$0.48	\$0.31	\$1.01	\$0.02	\$0.39	\$0.71	\$0.28	\$1.39	\$1.47
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	47,984	48,020	48,060	48,100	48,041	48,200
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%	-0.9%	12.8%	13.5%	6.7%	8.6%	5.5%
G & A	-0.7%	16.2%	0.5%	-12.3%	-22.4%	-16.4%	-12.9%	-9.3%	1.8%	-11.9%	19.6%	-0.4%	2.1%
Operating Income	10.6%	-13.1%	-16.4%	12.4%	-6.7%	42.6%	7.1%	28.4%	36.3%	35.4%	-9.9%	22.4%	7.1%
EPS	20.2%	-20.7%	-150.6%	16.7%	-1.1%	77.7%	2.9%	nm	60.9%	36.6%	-12.4%	44.0%	5.2%
EBITDA	12.2%	-7.5%	-8.7%	11.6%	-5.8%	26.4%	4.8%	23.3%	31.2%	33.6%	7.6%	24.9%	8.0%
Margin Analysis:													
G & A / Net Rev	26.1%	29.7%	34.5%	24.6%	20.9%	23.5%	25.3%	31.6%	22.2%	16.2%	26.3%	23.2%	22.5%
Maintenance / Net Rev	5.3%	5.6%	7.5%	6.3%	4.9%	5.5%	5.9%	7.6%	4.4%	3.6%	4.6%	4.8%	4.5%
Net Income / Net Rev	15.2%	11.8%	-1.0%	12.1%	20.0%	15.1%	12.5%	1.4%	17.3%	26.3%	12.4%	15.8%	15.8%
Tax rate	33.0%	36.0%	48.2%	38.7%	37.3%	30.8%	35.5%	0.4%	36.9%	36.9%	36.6%	36.5%	37.7%
					*Adjusting out \$3.2MM capital charge				*Assume +\$0.04 frm 2014-2015 drgt mem.				
									*April cost of capital filing				
										*+\$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	Q1'17	Q2'17	Q3'17E	Q4'17E	FY'17E	FY'18E
Cash	\$19,587	\$8,837	\$30,878	\$30,826	\$21,351	\$25,492	\$25,492	\$11,990	\$29,103	\$58,420	\$85,980	\$85,980	\$82,560
A/R--Customers	25,803	31,512	31,397	36,635	45,376	30,305	30,305	24,685	39,027	51,490	32,350	32,350	33,840
Regulatory Balance Acct	53,199	35,052	31,554	26,453	19,811	30,332	30,332	30,661	29,071	29,070	29,070	29,070	29,070
Other	55,535	52,177	54,692	65,086	64,589	55,940	55,940	60,869	73,379	67,820	58,740	58,740	61,680
Total CA	154,124	127,578	148,521	159,000	151,127	142,069	142,069	128,205	170,580	206,800	206,140	206,140	207,150
Net Utility Plant	1,590,431	1,701,768	1,739,679	1,785,077	1,817,751	1,859,277	1,859,277	1,888,005	1,928,612	1,966,940	1,996,880	1,996,880	2,128,250
Regulatory assets	390,331	361,893	361,249	363,321	363,597	355,930	355,930	367,476	375,868	375,868	375,868	375,868	375,968
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	53,997	55,351	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	\$2,440,298	\$2,533,026	\$2,605,723	\$2,635,953	\$2,635,953	\$2,771,153
A/P	59,395	66,380	65,354	77,604	84,052	77,813	77,813	69,276	84,222	95,380	83,060	83,060	86,880
CP of LTD	6,607	6,600	6,113	6,133	6,130	26,208	26,208	36,139	36,110	10,910	10,910	10,910	100,000
ST Borrowings	79,115	33,615	34,500	75,100	57,100	97,100	97,100	130,100	190,100	220,100	155,100	155,100	221,100
Other	72,589	41,860	52,176	43,176	56,699	49,109	49,109	57,858	50,595	59,530	51,560	51,560	54,140
Total CL	217,706	148,455	158,143	202,013	203,981	250,230	250,230	293,373	361,027	385,920	300,630	300,630	462,120
LTD	419,233	512,287	557,849	555,787	555,536	531,745	531,745	521,715	519,875	524,170	619,170	619,170	531,890
Other LT liab	923,786	943,198	950,846	963,563	974,514	970,299	970,299	973,877	990,290	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	651,333	661,834	701,633	726,453	726,453	767,653
Total Liab & SE	\$2,187,351	\$2,246,095	\$2,299,805	\$2,358,123	\$2,386,043	\$2,411,745	\$2,411,745	\$2,440,298	\$2,533,026	\$2,605,723	\$2,635,953	\$2,635,953	\$2,771,153
Summary Cash Flow	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17p	Q3'17E	Q4'17E	FY'17E	FY'18E
Net income	\$56,738	\$45,017	(\$798)	\$11,508	\$22,875	\$15,090	\$48,675	\$1,132	\$18,531	\$34,050	\$13,250	\$66,960	\$70,650
D&A	61,217	61,381	16,046	15,842	15,884	15,827	63,599	19,658	19,218	19,670	20,060	78,150	83,630
Deferred Tax	34,125	24,393	5,000	7,000	9,500	5,318	26,818	(5,000)	1,000	20,000	15,000	31,000	25,000
(Inc) / Dec in Wrk Cap	(2,430)	(7,948)	10,388	(7,281)	18,369	(630)	20,846	574	(17,579)	13,160	7,910	4,065	1,970
Operating CF	149,650	122,843	30,636	27,069	66,628	35,605	159,938	16,364	21,170	86,880	56,220	180,175	181,250
Cap Ex	(132,015)	(176,833)	(56,463)	(59,692)	(50,251)	(62,532)	(228,938)	(51,853)	(56,847)	(58,000)	(50,000)	(216,700)	(215,000)
Acquisitions	-	-	-	-	-	-	-	-	-	-	-	-	-
Dividends	(31,063)	(32,066)	(8,258)	(8,274)	(8,275)	(8,274)	(33,081)	(8,634)	(8,640)	(8,650)	(8,660)	(34,584)	(35,670)
Free Cash Flow	(13,428)	(86,056)	(34,085)	(40,897)	8,102	(35,201)	(102,081)	(44,123)	(44,317)	20,230	(2,440)	(71,109)	(69,420)
Issuance LTD	497	99,343	50,039	(216)	-	-	49,823	-	-	-	95,000	95,000	12,700
(Retirement) LTD	(8,705)	(7,003)	(254)	(2,209)	(402)	(4,131)	(6,996)	(286)	-	(20,909)	-	(21,195)	(12,700)
ST Debt Borrowings	117,300	94,303	54,500	48,600	2,000	40,000	145,100	35,000	60,000	10,000	10,000	115,000	76,000
ST Debt (Repayments)	(85,000)	(141,000)	(53,615)	(8,000)	(20,000)	-	(81,615)	(2,000)	(100)	20,000	(75,000)	(57,100)	(10,000)
Stock Issued	-	-	-	-	-	-	-	-	-	-	-	-	-
Contrib / (Refund) for Const	5,688	9,300	5,996	1,995	5,001	1,571	14,563	1,739	2,000	-	-	3,739	-
Net Cash Flow	16,352	(31,113)	22,581	(727)	(5,299)	2,239	18,794	(9,670)	17,583	29,321	27,560	64,335	(3,420)
EBITDA	169,791	157,062	21,391	41,246	59,186	42,774	164,597	26,367	54,112	79,070	46,030	205,580	221,960
EV / TTM EBITDA	9.3x	10.3x	11.7x	13.9x	13.4x	13.1x	13.1x	13.4x	12.6x	11.5x	11.7x	11.7x	10.8x
Selected Financial Statistics	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17E	Q4'17E	FY'17E	FY'17E
Book Value	\$13.10	\$13.41	\$13.21	\$13.27	\$13.59	\$13.75	\$13.75	\$13.57	\$13.78	\$14.60	\$15.10	\$15.10	\$15.91
Price / Book	1.9x	1.7x	2.0x	2.6x	2.4x	2.5x	2.5x	2.6x	2.7x	2.6x	2.5x	2.5x	2.4x
Net Indebtedness / Total Capital	43.6%	45.8%	47.3%	48.8%	47.8%	48.8%	48.8%	50.9%	52.0%	49.8%	49.0%	49.0%	50.1%
LTD / Total Capital	40.1%	44.4%	46.8%	46.6%	46.0%	44.6%	44.6%	44.5%	44.0%	42.8%	46.0%	46.0%	40.9%
ROE (TTM)	9.4%	7.1%	6.7%	7.0%	6.6%	7.6%	7.6%	7.8%	8.8%	10.3%	9.8%	9.8%	9.7%

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

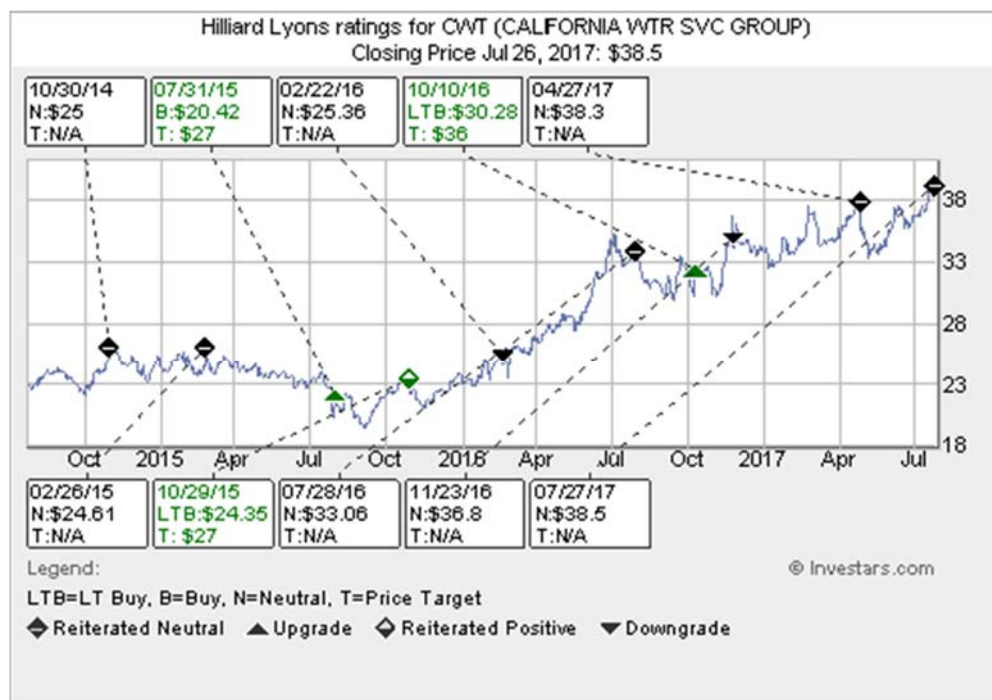
Investment Ratings

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.



Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	36	29%	14%	86%
Hold/Neutral	79	63%	5%	95%
Sell	10	8%	0%	100%

As of 7 July 2017

Other Disclosures

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