



COMPANY UPDATE / RATING CHANGE ESTIMATE CHANGE / TARGET CHANGE

Key Metrics

CWT - NYSE - as of	1/16/18	\$43.35
Price Target		\$37.00
52-Week Range	\$32.68 -	\$46.15
Shares Outstanding (mm)		48.0
Market Cap. (\$mm)		\$2,081.5
1-Mo. Average Daily Volume		211,118
Institutional Ownership		74.5%
LTD / Total Capital	Q3'17	43.0%
ROE--unadjusted	TTM	10.4%
Book Value / Share	Q3'17	\$14.32
Price / Book Value		3.0x
Dividend Yield		1.7%
EBITDA Margin		31.0%

EPS FY 12/31

		Prior	Current	Prior	Current
	2016A	2017E	2017E	2018E	2018E
1Q	(\$0.02)	--	\$0.02	A --	--
2Q	\$0.24	--	\$0.39	A --	--
3Q	*\$0.52	--	\$0.70	A --	--
4Q	*\$0.23	\$0.20	\$0.20	--	--
Year	*\$0.97	\$1.31	\$1.31	\$1.45	\$1.43
P/E	44.7x		33.1x		30.3x

*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	--	\$80.0	A --	--
2Q	\$94.9	--	\$107.0	A --	--
3Q	\$114.1	--	\$136.5	A --	--
4Q	\$99.8	\$107.5	\$107.5	--	--
Year	\$389.4	\$431.0	\$431.0	\$453	\$453

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 – Underperform-2

Downgrading CWT to Underperform.

Investment Highlights

- We are downgrading our rating on CWT from Neutral to Underperform; we assign shares a 1-year \$37 price target. Our suitability rating remains ‘2.’
- Our downgrade reflects a mix of bottom-up and top down concerns, coupled with our view that valuation is too high for this point in a rate case cycle. By our model, CWT’s TTM EPS growth rate (and TTM ROE) for this 3-yr cycle peaked with its Q3’17 release.
- Our rating change is in agreement with a reduced affinity for the Utility sector in early 2018. Risk to utility multiples remains negative, in our view, with most sectors better-impacted by tax changes and with growth accelerating across the broader market.
- We believe CWT’s Cost of Capital filing represents (net) negative risk to the stock at this point, and we are comfortable reducing our opinion ahead of clarity we expect to come in early-2018. While ‘fully litigated’ does not mean ‘negative,’ we would be surprised by an outcome that drives material upward revisions.
- We expect CWT to report Q4’17 EPS of \$0.20 later this month, lower yr/yr and below consensus for \$0.22. We are comfortable trimming positions ahead of the event; our FY 2017E EPS is unchanged at \$1.31.
- Our base case for 2018 is for CWT to raise \$80MM of secondary equity, although we submit that ripple effect from tax changes could impact here.
- Our 2018/2019 EPS estimates each slip \$0.02 to \$1.43/\$1.47. We view consensus versus our targets here as fair, but nonetheless reiterate a view that growth is likely to flatten out a bit.
- At our target, shares would trade approximately in line with 5-yr average trailing P/E and EV/EBITDA multiples, based on our 2018 expectations. With growth having likely crested this rate case cycle, we believe valuations could reasonably revert.

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

ADDITIONAL DISCUSSION—FINAL THOUGHTS

Our downgrade should be viewed as a tactical call on the stock. We do not suggest any material weakening of the longer-term secular growth outlook for CWT and we do not suggest any negative strategic items have surfaced for us in the most recent couple of months. At this time, we merely see more compelling opportunities across the water space and broader Utility sector, and suggest investors trim exposure, as appropriate based on their individual circumstances. Our price target calls for CWT to revert to 5-year average P/E (~26x) and EV/EBITDA (~11x) metrics over the next year, netting sufficient downside, in our view, to warrant an Underperform rating.

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	Q3'17	Q4'17E	FY'17E	FY'18E	FY'19E
Operating Revenue	\$597,499	\$588,368	\$121,727	\$152,445	\$184,268	\$150,930	\$609,370	\$122,036	\$171,132	\$211,731				
Water Production Costs	223,941	207,926	41,069	57,589	70,175	51,160	219,993	42,068	64,131	75,261				
Net Revenue--Water Ops	373,558	380,442	80,658	94,856	114,093	99,770	389,377	79,968	107,001	136,470	107,520	430,960	452,650	472,630
G & A	97,373	113,110	27,827	23,366	23,844	23,437	98,474	25,249	23,796	24,886	30,661	104,590	103,020	108,280
Other Op Exp	65,807	62,848	17,302	17,728	18,301	22,316	75,647	15,924	18,228	21,208	22,320	77,680	78,130	79,960
Drought Memorandum Acct		4,400	2,000	1,175	1,260	0	4,435	200	100	0	0	300	0	0
Maintenance	19,854	21,463	6,063	5,934	5,545	5,451	22,993	6,112	4,708	6,057	4,910	21,790	21,770	21,770
D & A	61,217	61,381	16,046	15,842	15,884	15,827	63,599	19,201	19,218	19,231	19,820	77,470	83,360	88,830
Income Tax	26,727	24,528	(925)	6,870	13,247	5,612	24,804	(884)	9,635	17,348	7,100	33,200	38,100	40,000
Property and Other Taxes	20,733	21,559	6,075	5,407	5,957	5,792	23,231	6,116	6,057	6,544	5,850	24,570	24,820	25,070
Other Op Exp	291,711	309,289	74,388	76,322	84,038	78,435	313,183	71,918	81,742	95,274	90,660	339,600	349,200	363,910
Net Operating Income	81,847	71,153	6,270	18,534	30,055	21,335	76,194	8,050	25,259	41,196	16,860	91,360	103,450	108,720
% of Net Rev	21.9%	18.7%	7.8%	19.5%	26.3%	21.4%	19.6%	10.1%	23.6%	30.2%	15.7%	21.2%	22.9%	23.0%
Other Income and Exp:														
Total Other Inc / (Exp)	1,839	1,134	267	571	531	1,613	2,982	1,298	1,787	1,230	1,601	5,920	5,670	5,430
Income Before Interest	83,686	72,287	6,537	19,105	30,586	22,948	79,176	9,348	27,046	42,426	18,461	97,280	109,120	114,150
Interest Expense	28,483	29,185	8,065	8,434	8,485	8,482	33,466	8,710	9,079	9,284	9,720	36,790	41,350	43,350
Less: Capitalized Interest // AFUDC	1,535	1,915	730	837	774	624	2,965	494	564	707	750	2,515	3,000	3,000
Total Interest Expense	26,948	27,270	7,335	7,597	7,711	7,858	30,501	8,216	8,515	8,577	8,970	34,275	38,350	40,350
Net Income	\$56,738	\$45,017	(\$798)	\$11,508	\$22,875	\$15,090	\$48,675	\$1,132	\$18,531	\$33,849	\$9,491	\$63,005	\$70,770	\$73,800
EPS (FD)	\$1.19	\$0.94	(\$0.02)	\$0.24	\$0.48	\$0.31	\$1.01	\$0.02	\$0.39	\$0.70	\$0.20	\$1.31	\$1.43	\$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	48,017	48,057	48,020	49,080	50,162
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	\$0.760
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%	19.6%	7.8%	10.7%	5.0%	4.4%
G & A	-0.7%	16.2%	0.5%	-12.3%	-22.4%	-16.4%	-12.9%	-9.3%	1.8%	4.4%	30.8%	6.2%	-1.5%	5.1%
Operating Income	10.6%	-13.1%	-16.4%	12.4%	-6.7%	42.6%	7.1%	28.4%	36.3%	37.1%	-21.0%	19.9%	13.2%	5.1%
EPS--adj if necessary	20.2%	-20.7%	-150.6%	16.7%	-1.1%	77.7%	2.9%	nm	60.9%	35.9%	-12.4%	35.6%	9.2%	2.6%
EBITDA	12.2%	-7.5%	-8.7%	11.6%	-5.8%	26.4%	4.8%	23.3%	31.2%	31.4%	2.4%	22.7%	11.3%	5.6%
Margin Analysis:														
G & A / Net Rev	26.1%	29.7%	34.5%	24.6%	20.9%	23.5%	25.3%	31.6%	22.2%	18.2%	28.5%	24.3%	22.8%	22.9%
Maintenance / Net Rev	5.3%	5.6%	7.5%	6.3%	4.9%	5.5%	5.9%	7.6%	4.4%	4.4%	4.6%	5.1%	4.8%	4.6%
Net Income / Net Rev	15.2%	11.8%	-1.0%	12.1%	20.0%	15.1%	12.5%	1.4%	17.3%	24.8%	8.8%	14.6%	15.6%	15.6%
Tax rate	33.0%	36.0%	48.2%	38.7%	37.3%	30.8%	35.5%	0.4%	36.9%	35.0%	45.7%	37.0%	37.2%	37.3%
				*Adjusting	*Assume				*April cost		*+\$0.00 frm			
				out \$3.2MM	+\$0.04 frm				of capital		2016-17 drgt			
				capital	2014-2015				filing		mem. (-\$0.04			
				charge	drgt mem.						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	Q3'17	Q4'17E	FY'17E	FY'18E	FY'19E
Cash	\$19,587	\$8,837	\$30,878	\$30,826	\$21,351	\$25,492	\$25,492	\$11,990	\$29,103	\$28,341	\$24,560	\$24,560	\$25,980	\$12,260
A/R--Customers	25,803	31,512	31,397	36,635	45,376	30,305	30,305	24,685	39,027	46,963	32,660	32,660	34,160	35,720
Regulatory Balance Acct	53,199	35,052	31,554	26,453	19,811	30,332	30,332	30,661	29,071	31,364	31,360	31,360	31,360	31,360
Other	55,535	52,177	54,692	65,086	64,589	55,940	55,940	60,869	73,379	73,817	58,740	58,740	61,680	64,760
Total CA	154,124	127,578	148,521	159,000	151,127	142,069	142,069	128,205	170,580	180,485	147,320	147,320	153,180	144,100
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	1,981,924	2,012,100	2,012,100	2,143,740	2,284,910
Regulatory assets	390,331	361,893	361,249	363,321	363,597	355,930	355,930	367,476	375,868	379,884	379,884	379,884	379,984	379,984
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	2,615
Other	49,850	52,241	47,741	48,110	50,953	51,854	51,854	53,997	55,351	58,196	54,450	54,450	57,170	60,030
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	\$2,603,104	\$2,596,369	\$2,596,369	\$2,736,689	\$2,871,639
A/P	59,395	66,380	65,354	77,604	84,052	77,813	77,813	69,276	84,222	89,394	83,860	83,860	87,710	91,730
CP of LTD	6,607	6,600	6,113	6,133	6,130	26,208	26,208	36,139	36,110	36,015	10,910	10,910	100,000	17,200
ST Borrowings	79,115	33,615	34,500	75,100	57,100	97,100	97,100	130,100	190,100	195,100	210,100	210,100	1,100	66,100
Other	72,589	41,860	52,176	43,176	56,699	49,109	49,109	57,858	50,595	59,852	51,560	51,560	54,140	56,850
Total CL	217,706	148,455	158,143	202,013	203,981	250,230	250,230	293,373	361,027	380,361	356,430	356,430	242,950	231,880
LTD	419,233	512,287	557,849	555,787	555,536	531,745	531,745	521,715	519,875	519,700	524,810	524,810	637,530	740,330
Other LT liab	923,786	943,198	950,846	963,563	974,514	970,299	970,299	973,877	990,290	1,015,320	989,700	989,700	1,009,490	1,029,680
Shareholders' Equity	626,626	642,155	632,967	636,760	652,012	659,471	659,471	651,333	661,834	687,723	725,429	725,429	846,719	869,749
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	\$2,603,104	\$2,596,369	\$2,596,369	\$2,736,689	\$2,871,639
Summary Cash Flow	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17	Q4'17E	FY'17E	FY'18E	FY'19E
Net income	\$56,738	\$45,017	(\$798)	\$11,508	\$22,875	\$15,090	\$48,675	\$1,132	\$18,531	\$33,849	\$9,490	\$63,010	\$70,770	\$73,800
D&A	61,217	61,381	16,046	15,842	15,884	15,827	63,599	19,658	19,670	19,688	19,820	77,470	83,360	88,830
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	25,000
(Inc) / Dec in Wrk Cap	(2,430)	(7,948)	10,388	(7,281)	18,369	(630)	20,846	574	(17,579)	3,762	15,558	2,315	2,600	1,760
Operating CF	149,650	122,843	30,636	27,069	66,628	35,605	159,938	16,364	21,622	77,299	59,868	173,795	181,730	189,390
Cap Ex	(132,015)	(176,833)	(56,463)	(59,692)	(50,251)	(62,532)	(228,938)	(51,853)	(56,859)	(71,730)	(50,000)	(230,442)	(215,000)	(230,000)
Acquisitions	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Dividends	(31,063)	(32,066)	(8,258)	(8,274)	(8,275)	(8,274)	(33,081)	(8,634)	(8,644)	(8,642)	(8,650)	(34,570)	(36,320)	(38,120)
Free Cash Flow	(13,428)	(86,056)	(34,085)	(40,897)	8,102	(35,201)	(102,081)	(44,123)	(43,881)	(3,073)	1,218	(91,217)	(69,590)	(78,730)
Issuance LTD	497	99,343	50,039	(216)	-	-	49,823	-	-	-	-	-	212,700	100,000
(Retirement) LTD	(8,705)	(7,003)	(254)	(2,209)	(402)	(4,131)	(6,996)	(286)	(2,121)	(390)	(20,000)	(22,797)	(12,700)	(100,000)
ST Debt Borrowings	117,300	94,303	54,500	48,600	2,000	40,000	145,100	35,000	105,000	45,000	75,000	260,000	91,000	80,000
ST Debt (Repayments)	(85,000)	(141,000)	(53,615)	(8,000)	(20,000)	-	(81,615)	(2,000)	(45,000)	(40,000)	(60,000)	(147,000)	(300,000)	(15,000)
Stock Issued	-	-	-	-	-	-	-	(1,119)	(117)	(123)	-	(1,359)	80,000	-
Contrib / (Refund) for Const	5,688	9,300	5,996	1,995	5,001	1,571	14,563	1,739	4,143	9,082	-	14,964	-	-
Net Cash Flow	16,352	(31,113)	22,581	(727)	(5,299)	2,239	18,794	(10,789)	18,024	10,496	(3,782)	12,591	1,410	(13,730)
EBITDA	169,791	157,062	21,391	41,246	59,186	42,774	164,597	26,367	54,112	77,775	43,780	202,030	224,910	237,550
EV / TTM EBITDA	9.3x	10.3x	11.7x	13.9x	13.4x	13.1x	13.1x	13.4x	12.6x	11.7x	12.8x	12.8x	12.8x	12.3x
Selected Financial Statistics	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17	Q2'17	Q3'17	Q4'17E	FY'17E	FY'18E	FY'19E
Book Value	\$13.10	\$13.41	\$13.21	\$13.27	\$13.59	\$13.75	\$13.75	\$13.57	\$13.78	\$14.32	\$15.10	\$15.10	\$16.91	\$17.32
Price / Book	1.9x	1.7x	2.0x	2.6x	2.4x	2.5x	2.5x	2.6x	2.7x	2.7x	2.9x	2.9x	2.6x	2.5x
Net Indebtedness / Total Capital	43.6%	45.8%	47.3%	48.8%	47.8%	48.8%	48.8%	50.9%	52.0%	51.2%	49.9%	49.9%	45.7%	48.3%
LTD / Total Capital	40.1%	44.4%	46.8%	46.6%	46.0%	44.6%	44.6%	44.5%	44.0%	43.0%	42.0%	42.0%	43.0%	46.0%
ROE (TTM)	9.4%	7.1%	6.7%	7.0%	6.6%	7.6%	7.6%	7.8%	8.8%	10.4%	9.3%	9.3%	9.3%	8.9%

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

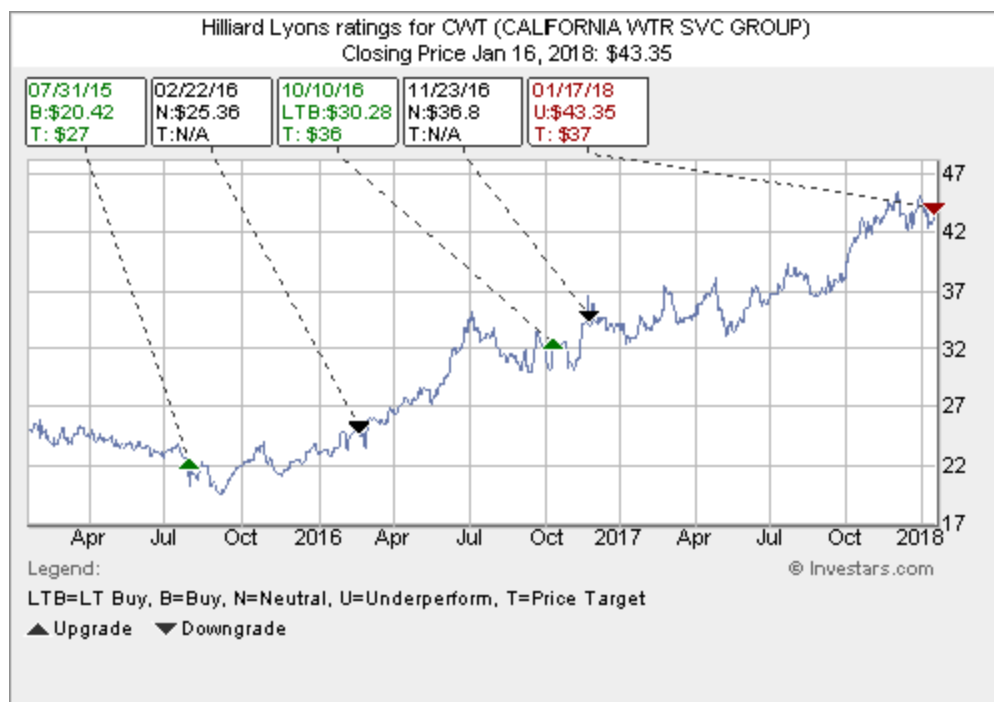
Investment Ratings

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	31	28%	10%	90%
Hold/Neutral	75	67%	9%	91%
Sell	6	5%	0%	100%

As of 8 January 2018

Other Disclosures

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