California Water Service Group

A refreshingly clear choice

2002 ANNUAL REPORT

CALIFORNIA WATER SERVICE GROUP (COMPANY) PROVIDES HIGH-QUALITY WATER UTILITY SERVICES TO 2 MILLION PEOPLE BY MEANS OF FOUR SUBSIDIARIES: CALIFORNIA WATER SERVICE COMPANY (CAL WATER), WASHINGTON WATER SERVICE COMPANY (WASHINGTON WATER), NEW MEXICO WATER SERVICE COMPANY (NEW MEXICO WATER), AND CWS UTILITY SERVICES. REGULATED BY STATE UTILITY COMMISSIONS, CAL WATER, WASHINGTON WATER, AND NEW MEXICO WATER PROVIDE WATER UTILITY SERVICES TO CUSTOMERS IN 98 COMMUNITIES THROUGHOUT CALIFORNIA, WASHINGTON, AND NEW MEXICO. THE COMPANY EXPECTS TO BEGIN PROVIDING REGULATED WATER SERVICES IN HAWAII BY MID-2003 UPON COMPLETION OF ITS ACQUISITION OF THE KAANAPALI WATER CORPORATION. CWS UTILITY SERVICES CONDUCTS THE COMPANY'S NON-REGULATED BUSINESS, WHICH INCLUDES PERFORMING BILLING AND METER READING SERVICES AND FULL-SYSTEM WATER OPERATIONS FOR CITIES AND COMPANIES IN CALIFORNIA, WASHINGTON, AND NEW MEXICO.

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Financial Highlights

In thousands, except per share amounts

Year ended December 31	*2002*	*2001*	*2000*	*1999*	*1998*
Book value	$ 13.12	$ 12.95	$ 13.13	$ 12.89	$ 12.49
Market price at year-end	23.65	25.75	27.00	30.31	31.31
Earnings per share	1.25	0.97	1.31	1.44	1.31
Dividends per share	1.12	1.115	1.10	1.085	1.07
Revenue	263,151	246,820	244,806	234,937	214,926
Net income	19,073	14,965	19,963	21,971	19,860

To Our Stockholders

What does it mean to be the refreshingly clear choice? To us, it means being the company that stockholders choose because we offer value. It means being the company that customers trust because we provide the highest quality service and the highest quality product. And it means being the company that attracts the best water professionals in the industry because we expect and reward excellent performance.

INDUSTRY OVERVIEW

California Water Service Group is the largest investor-owned water utility west of the Mississippi, and the second largest in the United States. After a period of considerable consolidation, only 12 investor-owned water utilities remain in our country. Investors continue to like the industry because it is regulated and subject to lower business cycle risk than non-regulated industries, its earnings drivers are straightforward, it has a long record of paying dividends, and it provides a life-sustaining, essential product, the demand for which continues to grow. So what sets an industry leader apart from the rest of the pack? What makes California Water Service Group the refreshingly clear choice?

2002 FINANCIAL RESULTS

In our estimation, leaders emerge in the most challenging of times. Last year, we reported on the significant challenges facing the industry—most notably, the tough regulatory climate in California and cool, wet weather. We laid out our strategy for tackling these challenges, which included pursuing growth in new and existing service areas, initiating a comprehensive plan to counteract unfair delays in regulatory decisions, and continuing to be diligent in our efforts to reduce expenses and increase our efficiency.

We are pleased to report that our strategy has yielded success, as reflected in our improved financial results for 2002. We posted earnings per share of $1.25, a 29% increase over 2001 earnings per share of $0.97. Net income increased to $19,073,000 in 2002, compared to net income of $14,965,000 in 2001. And revenue rose to $263,151,000, a 7% increase over last year. While our results are significantly better than they were in 2001, we recognize that we must continue executing our strategy to deliver even better results in the coming years.

INCREASE IN EARNINGS PER SHARE

29%

NUMBER OF NEW CONNECTIONS

8,600

CONSECUTIVE YEARS A DIVIDEND HAS BEEN PAID

58 years

Weather is a key earnings driver in the water industry, and there is no question that the climate played a role in our improved results; in fact, increased water sales to existing customers added $6,887,000 to 2002 revenue. But our efforts to grow and to win fair regulatory treatment paid off too, as sales to new customers added $2,813,000 in revenue and rate increases added another $6,631,000.

GROWTH IN REGULATED BUSINESS

In 2002, we continued to execute our disciplined and strategic growth plan. On the regulated side of the business, we added 8,600 customer connections. Nearly half of these new customers are served by our New Mexico subsidiary, which completed its acquisition of the Rio Grande Utility Corporation in 2002 and signed an agreement to purchase National Utilities Corporation, an acquisition we expect to complete in the third quarter of 2003. Washington Water added 600 customers with its purchase of the Agotaras and Cascade Highlands North water systems. In California, we expanded existing service areas, adding 3,900 connections in 2002.

We also took steps last year to establish our presence in yet another state. In August, we signed an agreement to purchase for book value the Kaanapali Water Corporation, a premium system serving several large, high-end water users on the island of Maui in Hawaii. We expect to complete this first transaction in the Aloha State by mid-2003.

NON-REGULATED BUSINESS

On the non-regulated side of the business, we focused on improving the profitability of our contract operations, renegotiating agreements and improving efficiency to enhance results. Our water rights brokering business improved, and we leased additional antenna sites and sold several surplus properties. We also began providing billing services to the City of Stockton.

RATE RELIEF IN 2002

Our progress for the year was quite remarkable, considering the fact that we did not have any new General Rate Cases approved in California in 2002. However, we relentlessly pursued rate relief throughout the year, and secured authorization to recover $1.9 million in previously-incurred higher power costs, $2 million in step rate increases, and $2.7 million from General Rate Case decisions approved in 2001. Also, in Washington, our General Rate Case was approved, adding $800,000 to 2002 revenues.

Although we did not receive the magnitude of rate relief we feel we were entitled to in 2002, we did help bring about two significant developments in the regulatory arena. First, we joined our colleagues in the water utility industry to promote the passage of California Assembly Bill 2838,

a law intended to protect water utilities from losses resulting from regulatory delays. Second, we were successful in urging the California Public Utilities Commission (Commission) to allow water utilities to recover higher purchased water and electricity costs incurred prior to November 29, 2001, but not yet billed to customers. In the first quarter of 2003, we filed a request with the Commission to recover $6.4 million as a result of this decision; we expect the Commission to respond to our request by mid-year 2003.

OTHER PENDING RATE CASES AND REGULATORY ISSUES

In January 2003, the Commission authorized additional step rate increases in several California districts totaling $1.6 million in annual revenue. More significantly, the Commission finally issued a draft of a proposed decision on the 15 General Rate Case applications that we filed in mid-2001. We expect final decisions in the first or second quarter of 2003, which could add nearly $13 million to annual revenue. Decisions on the General Rate Case applications submitted in 2002 are expected in the third quarter of 2003.

Another significant development at the Commission was Governor Gray Davis' January 1, 2003, appointment of a new Commission president and a new commissioner. The Company is encouraged by these appointments and hopeful that with the new leadership, the Commission will return to processing rate applications in a timely fashion and granting fair and reasonable rate relief.

PRUDENT FISCAL MANAGEMENT

Rounding out our efforts to grow the business and seek better regulatory treatment was our continued focus on prudent fiscal management. We launched a program late in 2002 to refinance several series of first mortgage bonds with lower interest rate senior notes. As a result of the refinancing program, which will be completed in May 2003, we expect to realize a $1.5 million annual reduction in interest costs, which will benefit both stockholders and customers.

In 2002, we faced a 6% increase in purchased water and purchased power costs and pump taxes, as well as higher wage and benefit expenses and increases in income taxes resulting from higher income. We responded to increased costs by improving efficiency and applying strict budgetary controls in every area of our operation. It is a reflection of our employees' commitment that we made such strides in reducing costs without adversely impacting customer service or water quality, and we commend each and every employee for helping us achieve improved results.

DIVIDEND INCREASE

After carefully considering 2002 operating results and the outlook for the future, on January 29, 2003, our Board of Directors increased the dividend for the 36th consecutive year to $1.125 per share. Our stockholders place great value on dividends, and 2002 marked the 58th consecutive year that we have paid a dividend.

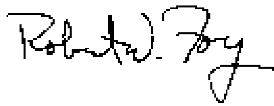
OUR VISION

In the coming year, we will continue to execute the strategy that resulted in improved performance in 2002. We will pursue strategic growth opportunities in the western United States; we will proactively seek fair and timely rate relief; and we will maintain discipline in our fiscal management. Most importantly, we will continue to transact all of our business prudently, forthrightly, and with integrity.

We invite you to read on to see how our Vision, Value, Quality, and Commitment make us the refreshingly clear choice–not just for investors, but for customers and employees as well. In our view, financial performance is but one of the measures of our success in 2002.

We look forward to achieving even better results in the coming years, and we thank you for your continued investment in the California Water Service Group.

Sincerely,



Robert W. Foy
Chairman of the Board

Peter C. Nelson
President and CEO

We are the refreshingly clear choice...

...for stockholders, who have come to know us for our reliable dividends and our solid financial performance; for customers, who rely on us to provide a high-quality product and excellent service; and for employees, who have come to work where they are appreciated and their contributions are valued.

vision

1

Being successful means meeting the diverse but interdependent needs of stockholders, customers, and employees.

When employees are engaged, customers are well served. When customers are well served, stockholders see good results. But does meeting the needs of one constituent preclude the Company from meeting the needs of another? We think not, because we see a common denominator in our ability to meet the needs of all three, and that common denominator is resources. To achieve our vision, we are executing a strategic plan that will enable us to secure and deploy resources to meet the needs of stockholders, customers, and employees.

First, we are continuing to seek growth in the western United States, because disciplined expansion results in a more valuable company, higher sales, and economies of scale. Second, we are pursuing fair and reasonable rates, because no one wins when we are not allowed to recover the true costs of providing water service. Third, we are augmenting our regulated business by maximizing non-regulated business performance, because doing so enables us to serve more people while adding to the bottom line. And fourth, we are staying focused on excellent service and efficiency, because our stockholders, customers, and employees expect no less.

value

2

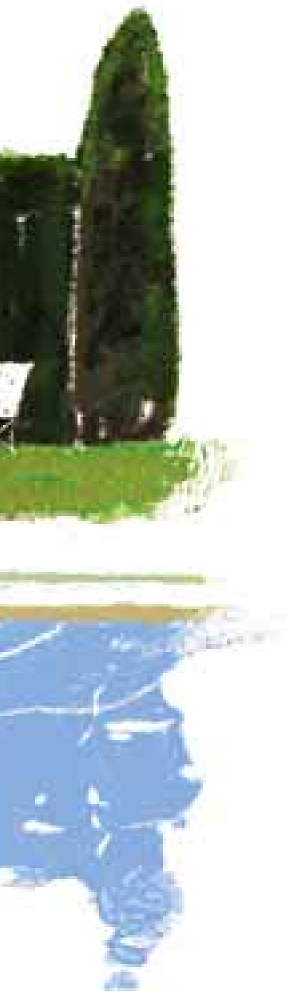
Some investors take chances on businesses that promise sky-rocketing results, but our stockholders choose us because we provide value.

Our business is straightforward—we are providing a critical, essential product to a growing population. And as the demand for an increasingly high-quality water supply grows, we will continue to increase our investment in infrastructure. We will need more projects like our Bakersfield Treatment Plant, which will add 20 million gallons of treated surface water per day to our supply. We will need wellhead treatment to meet new water quality standards, like the one for arsenic, which will cost roughly $61 million by the time it takes effect in 2006. We will need reverse osmosis plants, like the one in our Kern River Valley District that helps ensure we have plenty of water to meet summertime demands. That is where our stockholders come in—they earn a return on these investments.

California Water Service Group is not a risky new venture. We are a solid, disciplined, 77-year-old company that provides a life-sustaining, basic necessity. To our stockholders we have delivered steady, reliable results through the decades, paying dividends every year for 58 years and increasing them for 36 consecutive years.

quality

3



Customers expect quality, both in our service and in our product.

We are committed to meeting the needs of our customers, both for friendly, responsive service and for clean, good-tasting water. To evaluate our efforts to continuously improve our service, we conduct regular surveys. In 2002, we again tracked our performance in meeting customers' needs the first time they called us and asked customers how they would rate our knowledge, professionalism, and courtesy. Satisfaction levels continue to climb, with 92% of the respondents ranking our service "excellent" or "very good." In addition to our ongoing program of service enhancement and satisfaction measurement, we seek new and innovative ways to serve our customers. For example, last year, we embarked on a quest to determine the best ways of communicating with customers in emergencies, and we expect to implement an automated telephone notification system by the end of 2003.

The only thing more important to us than providing excellent service is providing a safe, high-quality product that meets increasingly stringent water quality standards. Doing so requires a dedicated, knowledgeable team of scientists and water professionals, diligent monitoring, and state-of-the-art equipment and facilities. In addition to its efforts to ensure that we deliver a high-quality product every minute of every day, our best-in-class water quality team is working in concert with state and federal agencies to enhance the security of our water supplies.

4

Every job is important in this Company, and every employee is key in enabling us to meet the needs of our stockholders and customers.

Every success we have can be traced back to the efforts of committed employees, whether it is on-time, on-budget completion of a water facility, identification of a new way to increase efficiency, implementation of a process that saves a busy customer from having to call us twice, or development of a system that allows for better tracking of water quality trends.

Every employee contributes to the overall success of the Company, and that is why every employee works on Continuous Improvement Process teams to increase our efficiency and enhance our customer service. That is why every employee is encouraged to continue his or her education through professional development and certification programs and tuition reimbursement. That is why every employee is compensated fairly and treated as a vital part of the team. Because every employee makes a difference, and it takes the commitment of every employee to make the Company *the* leader in providing traditional and innovative utility services to our customers and communities.

CALIFORNIA WATER SERVICE COMPANY
WASHINGTON WATER SERVICE COMPANY
NEW MEXICO WATER SERVICE COMPANY
HAWAII WATER SERVICE COMPANY

WASHINGTON
Harbor
South Sound

CALIFORNIA
Chico
Willows
Oroville
Marysville
Redwood Valley
Dixon
Stockton
South San Francisco
Mid-Peninsula
Livermore
Bear Gulch
Los Altos
General Office
Selma
Salinas
King City
Visalia
Kern River Valley
Bakersfield
Antelope Valley
Hawthorne
Westlake
Hermosa-Redondo
Palos Verdes
East Los Angeles
Dominguez

NEW MEXICO
Los Alamos
Belen

HAWAIIAN ISLANDS
Kauai
Oahu
Molokai
Maui
Kaanapali
Hawaii
(Pending regulatory approval, expected by mid-2003)

Customers

District Name	Including	Regulated	Non-regulated
CALIFORNIA			
Antelope Valley	Fremont Valley, Lake Hughes, Lancaster & Leona Valley; Painted Turtle, Prayer Mountain and other operating agreements	1,300	500
Bakersfield	O&M contracts for the City of Bakersfield, Spicer City & Lost Hills	59,300	29,000
Bear Gulch	Atherton, Woodside, Portola Valley, portions of Menlo Park & City of Menlo Park service contract	17,600	4,200
Chico	Hamilton City	24,400	–
Dixon	Rural North Vacaville Water District	2,800	300
Dominguez	Carson and portions of Compton, Harbor City, Long Beach, Los Angeles & Torrance	33,100	–
East Los Angeles	O&M contracts for cities of Commerce & Montebello	26,500	2,700
Hawthorne	15-year lease — full-service water operations	–	6,100
Hermosa-Redondo	A portion of Torrance; meter reading for Manhattan Beach	25,800	13,400
Kern River Valley	Bodfish, Kernville, Lakeland, Mtn. Shadows, Onyx, Squirrel Valley, South Lake & Wofford Heights; numerous operating contracts	4,100	500
King City		2,200	–
Livermore	O&M contracts for Castlewood Country Club & Crane Ridge MWC	17,400	200
Los Altos	Portions of Cupertino, Los Altos Hills, Mtn. View & Sunnyvale	18,400	–
Marysville		3,800	–
Mid-Peninsula	San Mateo & San Carlos	35,900	–
Oroville		3,500	–
Palos Verdes	Palos Verdes Estates, Rancho Palos Verdes, Rolling Hills Estates & Rolling Hills	23,800	–
Redwood Valley	Lucerne, Duncans Mills, Guerneville, Dillon Beach and a portion of Santa Rosa	1,900	–
Salinas	O&M contracts for Foothill Estates & Spreckels Water Co.	27,300	300
Selma		5,400	–
South San Francisco	Colma & Broadmoor	16,500	–
Stockton		41,900	–
Visalia		32,200	–
Westlake	A portion of Thousand Oaks	7,000	–
Willows		2,300	–
	SUBTOTAL	434,400	57,200
NEW MEXICO	Meter-reading contract	4,100	23,000
WASHINGTON	Numerous O&M contracts	14,400	3,900
	TOTAL	452,900	84,100

MWC = Mutual Water Company
O&M = Operations and Maintenance

Ten-Year Financial Review

Dollars in thousands, except per share amounts	2002	2001	2000
Summary of Operations			
Operating revenue			
Residential	$184,894	$173,823	$171,234
Business	46,404	44,944	44,211
Industrial	11,043	9,907	11,014
Public authorities	12,706	11,860	11,609
Other	8,104	6,286	6,738
Total operating revenue	263,151	246,820	244,806
Operating expenses	232,854	221,669	211,610
Interest expense, other income and expenses, net	11,224	10,186	13,233
Net income	$ 19,073	$ 14,965	$ 19,963
Common Share Data			
Earnings per share – diluted	$ 1.25	$ 0.97	$ 1.31
Dividend declared	1.12	1.115	1.100
Dividend payout ratio	90%	115%	84%
Book value	$ 13.12	$ 12.95	$ 13.13
Market price at year-end	23.65	25.75	27.00
Common shares outstanding at year-end (in thousands)	15,182	15,182	15,146
Return on average common stockholders' equity	9.7%	7.6%	10.1%
Long-term debt interest coverage	2.73	2.64	3.31
Balance Sheet Data			
Net utility plant	$696,988	$624,342	$582,782
Utility plant expenditures	88,800	62,049	37,161
Total assets	800,582	710,214	666,605
Long-term debt including current portion	251,365	207,981	189,979
Capitalization ratios:			
Common stockholders' equity	44.0%	48.8%	51.1%
Preferred stock	0.7%	0.9%	0.9%
Long-term debt	55.3%	50.3%	48.0%
Other Data			
Water production (million gallons)			
Wells and surface supply	67,488	65,283	65,408
Purchased	64,735	61,343	62,237
Total water production	132,223	126,626	127,645
Metered customers	380,087	371,281	366,242
Flat-rate customers	78,901	79,146	78,104
Customers at year-end, including Hawthorne	458,988	450,427	444,346
New customers added	8,561	6,081	5,219
Revenue per customer	$ 579	$ 552	$ 554
Utility plant per customer	2,182	2,020	1,916
Employees at year-end	802	783	797

1999	1998	1997	1996	1995	1994	1993
$163,681	$150,491	$158,210	$148,313	$132,859	$127,228	$122,585
41,246	38,854	40,520	37,605	35,873	33,712	31,360
12,695	10,150	10,376	9,748	9,952	9,080	8,415
10,898	9,654	11,173	10,509	9,585	9,397	8,535
6,417	5,777	4,886	4,083	4,833	3,767	4,985
234,937	214,926	225,165	210,258	193,102	183,184	175,880
201,890	183,245	188,020	177,356	164,958	155,012	145,517
11,076	11,821	11,388	11,502	11,176	11,537	12,785
$ 21,971	$ 19,860	$ 25,757	$ 21,400	$ 16,968	$ 16,635	$ 17,578
$ 1.44	$ 1.31	$ 1.71	$ 1.42	$ 1.13	$ 1.17	$ 1.26
1.085	1.070	1.055	1.040	1.020	0.990	0.960
75%	82%	62%	73%	90%	85%	76%
$ 12.89	$ 12.49	$ 12.15	$ 11.47	$ 10.97	$ 10.72	$ 10.03
30.31	31.31	29.53	21.00	16.38	16.00	20.00
15,094	15,015	15,015	15,015	14,934	14,890	13,773
11.5%	10.8%	14.5%	12.8%	10.6%	11.1%	12.6%
3.79	3.64	4.37	3.81	3.41	3.49	3.34
$564,390	$538,741	$515,917	$495,985	$471,994	$455,769	$437,065
48,599	41,061	37,511	40,310	31,031	32,435	31,097
645,507	613,143	594,444	569,745	553,027	516,507	497,717
171,613	152,674	153,271	151,725	154,416	138,628	138,863
53.0%	54.6%	53.8%	52.7%	50.9%	52.9%	49.3%
0.9%	1.0%	1.0%	1.1%	1.1%	1.2%	1.2%
46.1%	44.4%	45.2%	46.2%	48.0%	45.9%	49.5%
65,144	57,482	63,736	60,964	54,818	53,274	48,598
58,618	54,661	59,646	56,769	57,560	59,850	59,103
123,762	112,143	123,382	117,733	112,378	113,124	107,701
361,235	354,832	350,139	345,307	335,238	332,146	326,564
77,892	77,568	77,878	77,991	78,330	79,159	81,416
439,127	432,400	428,017	423,298	413,568	411,305	407,980
6,727	4,383	4,719	9,730	2,263	3,325	2,906
$ 539	$ 500	$ 529	$ 502	$ 468	$ 447	$ 433
1,851	1,768	1,694	1,632	1,580	1,520	1,459
790	759	752	740	738	729	717

Management's Discussion and Analysis of Results of Operations and Financial Condition

California Water Service Group (Company) is a holding company, incorporated in Delaware, with four operating subsidiaries: California Water Service Company (Cal Water), CWS Utility Services (Utility Services), New Mexico Water Service Company (New Mexico Water) and Washington Water Service Company (Washington Water). Cal Water, New Mexico Water and Washington Water are regulated public utilities. Their assets and operating revenues currently comprise the majority of the Company's assets and revenues. The regulated utilities also provide some non-regulated water-related services. Utility Services provides non-regulated water operations and related services to private companies and municipalities. The following discussion and analysis provides information regarding the Company, its assets, operations and financial condition.

FORWARD-LOOKING STATEMENTS

This annual report, including the Letter to Stockholders and Management's Discussion and Analysis, contains forward-looking statements within the meaning established by the Private Securities Litigation Reform Act of 1995 (Act). The forward-looking statements are intended to qualify under provisions of the federal securities laws for "safe harbor" treatment established by the Act. Forward-looking statements are based on currently available information, expectations, estimates, assumptions and projections, and management's judgment about the Company, the water utility industry and general economic conditions. Such words as expects, intends, plans, forecasts, predicts, believes, estimates, anticipates, projects or variations of such words or similar expressions are intended to identify forward-looking statements. The forward-looking statements are not guarantees of future performance. They are subject to uncertainty and changes in circumstances. Actual results may vary materially from what is contained in a forward-looking statement. Factors that may cause a result different than expected or anticipated include: future economic conditions, governmental and regulatory commissions' decisions, changes in regulatory commissions' policies or procedures, the timeliness of regulatory commissions' actions concerning rate relief, new legislation, electric power interruptions, access to capital, increases in suppliers' prices and the availability of supplies including water and power, changes in environmental compliance requirements, acquisitions, the ability to successfully implement business plans, changes in customer water use patterns and the impact of weather on operating results, especially as it impacts water sales. When considering forward-looking statements, the reader should keep in mind the cautionary statements included in this paragraph. The Company assumes no obligation to provide public updates of forward-looking statements.

BUSINESS

Cal Water, which began operation in 1926, is a public utility supplying water service to 440,500 customers in 75 California communities through 25 separate water systems or districts. Cal Water's 24 regulated systems, which are subject to regulation by the California Public Utilities Commission (CPUC), serve 434,400 customers. An additional 6,100 customers receive service through a long-term lease of the City of Hawthorne's water system, which is not subject to CPUC regulation. Cal Water accounts for 96% of the Company's total customers and 98% of the Company's operating revenue.

Washington Water's utility operations are regulated by the Washington Utilities and Transportation Commission (WUTC). Washington Water, which started operations in 1999, provides domestic water service to 14,400 customers in the Tacoma and Olympia areas, and accounts for 2% of the Company's operating revenue. An additional 3,900 customers are served under operating agreements with private owners.

New Mexico Water acquired the assets of Rio Grande Utility Corporation in July 2002. New Mexico Water provides service to 2,400 water and 1,700 wastewater customers south of Albuquerque. Its regulated operations, which account for less than 1% of the Company's operating revenue, are subject to the jurisdiction of the New Mexico Public Regulation Commission. It also provides non-regulated meter reading service under contract with a county.

Rates and operations for regulated customers are subject to the jurisdiction of the respective state's regulatory commissions. The commissions require that water rates for each regulated district be independently determined. The commissions are expected to authorize water rates sufficient to recover normal

operating expenses and allow the utility to earn a fair and reasonable return on invested capital. Rates for the City of Hawthorne water system are established in accordance with an operating agreement and are subject to ratification by the Hawthorne City Council. Fees for other operating agreements are based on contracts negotiated between the parties.

Utility Services derives non-regulated income from contracts with other private companies and municipalities to operate water systems and provide meter reading and billing services. It also leases communication antenna sites, operates recycled water systems and conducts real estate sales of surplus properties.

CRITICAL ACCOUNTING POLICIES

The Company maintains its accounting records in accordance with accounting principles generally accepted in the United States of America and as directed by the regulatory commissions to which the Company's operations are subject. The process of preparing financial statements 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 judgement and can have a material impact on the Company's results of operations and financial condition.

Revenue Recognition. Revenue from metered customers includes billings to customers based on monthly meter readings plus an estimate for unbilled revenue which represents water used between the last reading of the customer's meter and the end of the accounting period. The unbilled revenue amount is recorded as a current asset on the balance sheet under the caption "Unbilled Revenue." At December 31, 2002, the unbilled revenue amount was $8.0 million and at December 31, 2001, was $7.3 million. The unbilled revenue amount is generally higher during the summer months when water sales are higher. The amount recorded as unbilled revenue varies depending on water usage in the preceding period, the number of days between meter reads for each billing cycle, and the number of days between each cycle's meter reading and the end of the accounting cycle.

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 accounting period is included in that period's revenue. The portion related to a subsequent accounting period is recorded as unearned revenue on the balance sheet and recognized as revenue when earned in the subsequent accounting period. The unearned revenue liability was $1.7 million at December 31, 2002 and 2001. It is included in "Other accrued liabilities" on the balance sheet.

Expense-balancing and Memorandum Accounts. Expense-balancing accounts and memorandum accounts represent costs incurred, but not billed to Cal Water customers. The amounts included in these accounts relate to rate increases charged to the Company by suppliers of purchased water and purchased power, and increases in pump taxes. The Company does not record expense-balancing or memorandum accounts in its financial statements as revenue, nor record a receivable until the CPUC has authorized recovery of the higher costs and customers have been billed. The accounts are only used to track the higher costs. The cost increases, which are beyond the Company's control, are referred to as "offsetable expenses" because under certain circumstances they are recoverable from customers in future offset rate increases.

In October 2001, the CPUC adopted a resolution implementing its staff's interim recommendation concerning practices and policies that enable water utilities to recover cost increases in purchased water, purchased power and pump taxes. The interim recommendation directed that future Company requests to recover offsetable expenses will be processed only if an operating district has filed a General Rate Case (GRC) application within a three-year period and the district is not earning more than its authorized rate of return on a forward-looking, pro forma basis. Neither of these requirements applied to offset rate increase recovery prior to adoption of the resolution. The CPUC also directed its staff to open a proceeding to evaluate offsetable expense recovery practices and policies and to recommend permanent revisions.

Historically, offset rate increases enabled water utilities to recover as a pass-through cost increases for offsetable expenses that were not known or anticipated when customer rates were established and were beyond the utility's control. Offsetable expenses incurred prior to the CPUC's adoption of the staff's interim recommendation were frozen as of November 29, 2001 in the balancing accounts. The Company was authorized to track offsetable expenses incurred after the CPUC changed its policy with regard to regulatory memorandum accounts for potential recovery subject to the CPUC's future determination of appropriate practices and policies. Because of the uncertainty of collection, the Company's accounting policy is to not record the expense-balancing and memorandum account amounts in its financial statements until such amounts are billed to customers.

In September 2002, the assigned administrative law judge recommended that the CPUC adopt as permanent the interim recommendation regarding recovery of expense-balancing and memorandum accounts as described above, but modify the limit on the amount subject to recovery. Under the interim rules, a utility is not allowed to recover any of the balancing or memorandum account balance if it is earning more than its authorized return on equity. However, the proposed modification by the administrative law judge would allow recovery of a portion of the balancing or memorandum account up to the amount by which the Company's over earning of its authorized rate of return did not exceed the amount in the balancing account. While this recommendation was an improvement over the interim rules currently in place, the Company believes there should be no limit on allowed recovery of the balancing and memorandum accounts. The Company is continuing to present its arguments to the CPUC staff.

In December 2002, the CPUC issued a decision that will allow the Company to recover offsetable expenses tracked in the frozen balancing accounts. The decision provided that recovery of these expenses will not be subject to the interim rules adopted in October 2001. The CPUC is now expected to adopt permanent rules regarding recovery of memorandum accounts during the first half of 2003. The Company is unable to predict what the final rules will comprise or their financial impact.

At December 31, 2001, the amount included in the balancing and memorandum accounts was $6.5 million. At December 31, 2002, the amount had increased to $12.5 million after reflecting collection of $1.9 million of balancing account power costs during 2002. The increase in balancing and memorandum accounts was attributable primarily to higher electric costs incurred by the Company since 2001 when power rates charged to the Company by electric suppliers, as authorized by the CPUC, increased an average of 48%. Increases in the memorandum accounts are expected to be smaller once current power rates are reflected in customer rates through future GRC decisions and assuming there are no large increases in purchased water or power costs.

Regulated Utility Accounting. Because the Company operates extensively in a regulated business, it is subject to the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation." Regulators establish rates that are expected to permit the recovery of the cost of service and a return on investment. In the event a portion of the Company's operations were no longer subject to the provisions of SFAS No. 71, the Company would be required to write off related regulatory assets and liabilities that are not specifically recoverable and determine if other assets might be impaired. If a regulatory commission determined that a portion of the Company's assets were not recoverable in customer rates, the Company would be required to determine if it had suffered an asset impairment that would require a write-down in the assets' valuation. There had been no such asset impairment as of December 31, 2002.

Income Taxes. Significant judgment by management is required in determining the provision for income taxes. The preparation of consolidated financial statements requires the estimation of income tax expense. The process involves the estimating of current tax exposure together with assessing temporary differences resulting from different treatment of certain items, such as depreciation, for tax and financial statement reporting. These differences result in deferred tax assets and liabilities, which are reported in the consolidated balance sheet. The Company must also assess the likelihood that deferred tax assets will be recovered in future taxable income. To the extent recovery is unlikely, a valuation allowance would be recorded. If a valuation allowance were required, it could significantly increase income tax expense. In management's view, a valuation allowance was not required at December 31, 2002.

Pension Benefits. The Company incurs costs associated with its pension and postretirement health care benefits plans. To measure the expense of these benefits, management must estimate compensation increases, mortality rates, future health cost increases and discount rates used to value related liabilities and to determine appropriate funding. Different estimates used by management could result in significant variances in the cost recognized for pension benefit plans. The estimates used are based on historical experience, current facts, future expectations and recommendations from independent advisors and actuaries. The Company uses an investment advisor to provide expert advice in managing its benefit investments. To diversify investment risk, the plan's goal is to invest 60% of the assets in equity mutual funds and 40% in bond funds. At December 31, 2002, 48% of the assets were invested in equity mutual funds and 52% in bond funds. Based on the market values of the investment funds, for the year ended December 31, 2002, the total return on the pension plan assets was a decline of 3.7%, and for the year ended December 31, 2001, pension plan assets had a positive 2.6% total return. For December 31, 2002, the discount rate used for pension plan obligations or pension plan expense was 6.7%, which was based on high-quality bond rates in December 2002. The long-term rate of return used to determine the Company's pension obligation was 8%. By comparison, a 20-year return of assets invested using the same investment diversification as for the Company's pension plan would have returned 11.8%. The Company anticipates any increase in funding for the pension and postretirement health care benefits plans will be recovered in future customer rates.

RESULTS OF OPERATIONS

Earnings and Dividends. Net income in 2002 was $19,073,000 compared to $14,965,000 in 2001 and $19,963,000 in 2000. Diluted earnings per common share were $1.25 in 2002, $0.97 in 2001 and $1.31 in 2000. The weighted average number of common shares outstanding was 15,185,000 in 2002, 15,186,000 in 2001, and 15,129,000 in 2000. As explained below, the decline in 2001 net income resulted from three primary factors: low water sales to existing customers due to weather conditions, significantly higher purchased power costs and delays in receipt of regulatory rate relief.

At its January 2002 meeting, the Board of Directors increased the common stock dividend for the 35th consecutive year. 2002 also marked the 58th consecutive year that a dividend had been paid on the Company's common stock. The annual dividend paid in 2002 was $1.12, a 0.4% increase over the $1.115 paid in 2001, which was an increase of 1.4% over the $1.100 paid in 2000. The dividend increases were based on projections that the higher dividend could be sustained while still providing the Company with adequate financial resources and flexibility. Earnings not paid as dividends are reinvested in the business for the benefit of stockholders. The dividend payout ratio was 90% in 2002, 115% in 2001, and 84% in 2000, an average of 97% during the three-year period.

Operating Revenue. Operating revenue, including revenue from the City of Hawthorne lease, was $263.2 million, 6.6% more than the $246.8 million recorded in 2001. Revenue in 2000 was $244.8 million. The sources of changes in operating revenue were:

Dollars in millions	2002	2001	2000
Customer water usage	$ 6.9	$ (5.7)	$ 4.8
Rate increases	6.6	5.4	3.0
Usage by new customers	2.8	2.3	2.1
Net change	$ 16.3	$ 2.0	$ 9.9
Average revenue per customer (in dollars)	$ 579	$ 552	$ 554
Average metered customer usage (Ccf)	373	363	371
New customers added	8,600	6,100	5,200

Temperatures and rainfall in the Company's service territories were relatively normal throughout 2002. In 2001, the weather patterns were cooler and more rainy than normal. From a water sales perspective, 2002's weather resulted in a 2% increase in customer's water usage compared to 2001 and a $6.9 million increase in revenue.

Rate increases added $6.6 million to 2002 revenue. Revenue from GRC decisions received in 2001 accounted for $2.7 million of the increase, $2.0 million came from step rate increases and $1.9 million from offset rate increases to recover electric costs included in expense-balancing accounts for four California districts. No new GRC decisions were authorized by the CPUC during 2002. Washington Water did receive a GRC decision in 2002. The "RATES AND REGULATION" section of this report provides a detailed discussion of regulatory activity.

During 2001, revenue from usage by existing customers declined $5.7 million. A cool, wet spring, mild summer and early fall rains throughout the Company's service territories caused water usage by existing customers to decline by 2%. Rainfall was near normal in the northern part of California, but well above normal in the south. The unusually heavy rains in southern California reduced water sales, a trend that continued all year because of the year's weather pattern. Washington Water experienced dry conditions during the winter and spring months; however, summer rains reduced water sales in the normally high usage summer months.

The December 31, 2002, customer count including the Hawthorne customers was 459,000, an increase of 2% from the 450,400 customers at the end of 2001, which was an increase of 1% from the 444,300 customers at the end of 2000. The increase in customers is due to normal growth within existing service areas and acquisitions of water systems. The acquisition in July 2002 of the Rio Grande Utility Corporation's 4,100 customers is included in the customer count increase.

Operating Income and Expenses. Total operating expenses, including those for the Hawthorne operation, were $232.9 million in 2002, $221.7 million in 2001 and $211.6 million in 2000.

Water pumped from Company-owned wells provided 50.4% of water delivered to customers in 2002. Water purchased from wholesale suppliers provided 49.0% and the remaining 0.6% was obtained from surface supplies. For 2001, the corresponding percentages were 50.6%, 48.9% and 0.5%.

As a group, water production costs, which consist of purchased water, purchased power and pump taxes, comprise the largest segment of total operating costs. Water production costs accounted for 45% of total operating costs in 2002, 2001 and 2000. The rates charged for wholesale water supplies, electricity and pump taxes are established by various public agencies. As such, these rates are beyond the Company's control. The table below provides comparative information regarding water production costs during the past three years:

Dollars in millions	*2002*	*2001*	*2000*
Purchased water	$ 76.7	$ 73.2	$73.8
Purchased power	22.9	21.1	15.1
Pump taxes	6.3	5.9	6.3
Total water production costs	$105.9	$100.2	$95.2
Change from prior year	6%	5%	5%
Water production (billions of gallons)	132	127	128
Change from prior year	4%	(1)%	3%

Water production expenses vary with wholesale suppliers' prices, the quantity of water produced to supply customer water usage, and the sources of supply. In 2002, four wholesale water suppliers increased their rates charged to the Company. The increases ranged from 2% to 5%. One wholesale supplier reduced its rate by 9%. In 2001, seven wholesale water suppliers increased rates with increases ranging from 2% to 7%. In December 2001, wholesale suppliers in the Los Angeles area refunded $1.4 million for over-collection of prior period water purchases. The refunds were recorded as a reduction of purchased water costs. There were no comparable refunds in 2002. During 2003, wholesale rate increases are expected in 17 districts ranging from 1% to 47%. The 47% increase will add an estimated $1.0 million to purchased water cost. The increased costs will be tracked in regulatory memorandum accounts that the Company will include in future rate proceedings for recovery.

Purchased power is required to operate wells and pumps. Prior to 2001, the Company had not been subjected to significant electric power cost increases. However, California energy costs rose significantly in 2001. In January 2001, the CPUC approved an energy surcharge that increased the Company's cost of purchased electricity by 10%. A second, more significant 38% increase in electric costs became effective in May 2001, bringing the total increase to 48%. When the CPUC proposed electric cost increases, the Company believed the higher costs were recoverable from consumers on a pass-through basis under established CPUC procedures regarding expense-balancing accounts. However, the CPUC subsequently revised its rules regarding recovery of the higher costs, resulting in delays in recovering the higher costs. While no new power rate increases are proposed or known at this time, the Company continues to purchase electricity from suppliers at rates greater than it is recovering from its water customers in 20 California districts.

Purchased power increased $1.8 million in 2002, $6.0 million in 2001 and $0.7 million in 2000. The 2002 cost increase was caused by higher electric rates paid through May 2002 as compared to 2001's electric rates and a 5% increase in well production. The purchased power cost increase in 2000 was due mainly to a 3% increase in water production.

Employee payroll and benefits charged to operations and maintenance was $50.3 million in 2002, $47.8 million for 2001, and $44.5 million for 2000. The increases in payroll and related benefits are attributable to general wage increases effective at the start of each year and additional hours worked. At year-end 2002, there were 802 employees, including 12 employees added in New Mexico with the acquisition of Rio Grande Utility Corporation. At the end of 2001 and 2000, there were 783 and 797 employees, respectively. Most non-supervisory employees are represented by the Utility Workers Union of America, AFL-CIO, with the exception of certain engineering and laboratory employees who are represented by the International Federation of Professional and Technical Engineers, AFL-CIO. In December 2002, the Company successfully negotiated new three-year agreements with both unions covering 2003 through 2005. Wage increases under the new agreements will be 1% in 2003, 1.5% in 2004 and 2% in 2005. Improvements in employee benefit plans were also negotiated.

During 2000, a curtailment of the Dominguez pension plan was recorded resulting in a non-taxable gain of $1.2 million that was offset against operating expenses. The curtailment occurred because the Dominguez pension plan was frozen at the merger date and its participants became participants in the Company's pension plan. Previous amounts expensed by Dominguez but not funded to the plan comprise the curtailment amount. This amount is included in the $44.5 million reported for payroll and benefits charged to operations and maintenance expense.

Income tax expense was $12.6 million in 2002, $9.7 million in 2001 and $11.6 million in 2000. The changes in taxes are generally due to variations in taxable income.

Long-term debt interest expense increased $1.4 million compared to 2001. Series E, 7.11% $20 million senior notes were issued in May 2002 and Series F, 5.90% $20 million senior notes were issued in August 2002. Proceeds from the issues were used to repay short-term bank borrowings and to fund the Company's construction program.

As part of a program to refinance certain high interest rate first mortgage bonds, Series G and Series H, 5.29% senior notes were issued in November and December 2002, each for $20 million. With the proceeds from these two issues, three series of first mortgage bonds totaling $33 million were redeemed. The remaining proceeds were used to repay short-term bank borrowings.

The issuance of the new senior notes caused long-term interest expense to increase because of the higher principal amount outstanding. In 2001, interest on long-term debt increased $1.3 million over 2000. The issuance of $20 million of Series D senior notes in September 2001 and $20 million of Series C senior notes in October 2000, net of sinking fund payments on first mortgage bonds, resulted in a larger principal amount of long-term debt outstanding and thus increased interest expense. In 2002, 2001 and 2000, interest capitalized on construction projects was $1.5 million, $0.9 million, and $0.7 million, respectively. The increase in the amount capitalized in 2002 is attributable to an increase in the Company's construction expenditures, particularly those associated with construction of a water treatment plant in the Bakersfield district. Interest coverage of long-term debt before income taxes was 2.7 times in 2002, 2.6 times in 2001 and 3.3 times in 2000. The reduction in interest coverage for 2002 and 2001 compared to 2000 resulted from lower earnings and the new senior note issues outstanding. The interest coverage is expected to improve once GRC decisions are authorized by the CPUC and as a result of the lower interest costs realized by refinancing certain first mortgage bond issues.

Other interest expense, which includes short-term bank borrowings needed to meet operating and interim construction funding, decreased $0.6 million in 2002. The amount borrowed in 2002 was larger because of an increase in capital expenditures. In 2001, other interest increased by $0.1 million because higher borrowings were necessary due to reduced cash flow from operations and increased capital expenditures. Lower interest rates on short-term borrowings in both years offset the interest cost that resulted from higher borrowing levels. There was $36.4 million in short-term borrowings outstanding at December 31, 2002 and $22.0 million at December 31, 2001.

Other Income and Expenses. Other income is derived from management contracts under which the Company operates private and municipally-owned water systems and recycled water systems and provides meter reading, water testing and billing services to various cities; leases of communication antenna sites; sales of surplus property; and interest on short-term investments. Other income, net of expenses, was $5.6 million in 2002, $5.8 million in 2001 and $1.4 million in 2000. During 2002, $3.0 million in pre-tax profits were realized from surplus properties sold as part of the Real Estate Program that is described in more detail in the "LIQUIDITY AND CAPITAL RESOURCES" section of this report. There were $3.9 million of gains from surplus property sales in 2001 and no property sales in 2000.

RATES AND REGULATION

2002 Regulatory Activity. Washington Water filed a GRC application in February 2002. The WUTC issued its decision early in April 2002 granting a $1 million increase in annual revenue to cover higher operating costs and capital expenditures.

In June 2002, the CPUC authorized the Company to increase rates in its Bakersfield district by $796,000 on an annual basis. This decision was based on an advice letter filing to cover approximately $6 million of construction cost incurred to date for a new water treatment plant.

The Company filed a Notice of Intent to file GRC applications for three California districts in July 2002. The Commission's staff accepted the applications in November. Four additional district GRC applications, including the General Office operation, were submitted in January 2003. Combined, these districts represent 17% of the California customers. The Commission staff has indicated that a decision on these filings should be expected in late 2003.

2001 Regulatory Activity. After analyzing 17 Cal Water districts that were eligible for general rate filings in 2001, and based on current earnings levels, projected expense increases, including higher electric power costs, and expected capital expenditures, applications were filed in July 2001 for 15 districts covering about 70% of Cal Water's customers. The applications requested an 11.5% return on equity including 75 basis points to reflect the increased risk associated with the CPUC's changes in recovery of water production expense increases and $21 million in new annual revenue. Under the CPUC's rate case processing schedule, a decision on the district GRC applications was expected by the third quarter of 2002. However, despite the filing of briefs by all parties in May 2002, a Proposed Decision has not been issued. At this time, a final decision is expected in April 2003, about 20 months after filing of the applications. Based on the administrative law judge's Draft of a Proposed Decision (DPD) released in January 2003, the Company would be authorized a $12.8 million increase in annual revenue. Additionally, the DPD recommends a return on equity of 9.7% with an equity percentage of capitalization at 51.5%. While that is positive news, it does not recognize that regulatory delays have resulted in the loss of revenues, which the DPD finds just and reasonable.

The DPD also recommends an allocation method for sharing expenses between regulated and non-regulated activities that is inconsistent with a prior Commission decision that was issued following a Commission rulemaking investigation. Furthermore, the DPD proposes changing the rate-setting practice regarding the treatment of gain on the sale for surplus property. The existing rules are based on legislation adopted in 1995 by the California legislature, which requires that gains realized on the sale of surplus property be reinvested in new utility plant and that the Company be allowed to earn a reasonable rate of return on the reinvestment. As proposed in the DPD, the Company would be required to treat the reinvestment of gains on the sale of surplus property as contributed plant and it would not be allowed to earn a return on its reinvestment. The Company, along with other California water utilities, opposes these rate-setting changes and will aggressively defend the legislation administratively and, if necessary, pursue legislative remedies. If these proposals were adopted by the Commission, they would have a detrimental impact on the Company's non-

regulated activities and surplus real estate program. The DPD on treatment of gains on sale of properties could result in a reduction of earnings and the rate base on which the Commission determines the Company's future earnings. However, because this is only a draft that does not recommend specific actions, the Company cannot predict the final outcome of this matter. Since 1997, the Company has recorded $10.4 million in pre-tax gains under its surplus property sale program.

In October 2001, the CPUC adopted a resolution implementing its staff's interim recommendation concerning practices and policies that enable water utilities to recover increases in purchased water, purchased power and pump taxes. These expenses are referred to as "offsetable expenses." The CPUC also directed its staff to open a proceeding to evaluate offsetable expense recovery practices and policies, and recommend permanent revisions. Historically, offset rate increases have enabled water utilities to recover increases in offsetable expenses that were not anticipated when customer rates were established and are beyond the utility's control. Future Company requests to recover offsetable expenses will be processed only if a district has filed a GRC application within its three-year rate case cycle and the district is not earning more than its authorized rate of return on a forward-looking, pro forma basis. Neither of these requirements applied to offset rate increases prior to adoption of the resolution. The Company can continue to track offsetable expenses in regulatory memorandum accounts for potential recovery subject to the CPUC's future determination of appropriate practices and policies.

During 2001, the rates charged to the Company by electric power suppliers were increased 48%. In May 2001, immediately after the CPUC authorized substantial electric rate increases for the state's two largest power companies, the Company requested authorization to recover $5.9 million in higher power costs for 23 of its 24 regulated California districts. The CPUC's authorization allowing the Company to recover a portion of the higher power costs in four districts was not effective until September and November 2001, well after the high usage summer months. The authorization will allow recovery in four districts totaling $2.7 million in additional annual revenue. The CPUC did not authorize any additional recovery of the higher electric costs during 2002. However, in December 2002, the CPUC did authorize the Company to file for recovery of up to $6.4 million of electric cost increases tracked in expense-balancing accounts. In January 2003, the Company applied to the CPUC requesting authorization to recover the $6.4 million of electric increases included in the expense-balancing accounts. A resolution regarding these advice letter filings is expected in the first half of 2003.

Legislative Initiative. Regulatory delays in obtaining GRC decisions have been costly to California regulated water utilities. In recent years, the Company has experienced significant revenue losses due to regulatory delays. The Company normally files its GRC applications in July. The CPUC's stated rate processing plan provides for a decision within ten months of accepting a GRC application. When decisions are not issued in a timely manner, customer rates are not increased. As a result, the Company loses revenue and does not recover costs during the period the decisions are delayed.

California Assembly Bill 2838 became effective January 1, 2003. This bill is intended to preserve the cash flow and financial ratings of regulated water utilities by providing interim rate relief based on inflation and a procedure for applying the final adopted GRC rates on a retroactive basis. In December 2002, the Company filed for protection of its 2002 GRC applications under the new law. The Commission staff rejected the application on the basis that the legislation does not apply to GRC applications submitted prior to January 1, 2003. An appeal of the Commission staff rejection has been filed with the Commission.

WATER SUPPLY

The Company's source of supply varies among its operating districts. Certain districts obtain all of their supply from wells; some districts purchase all of the supply from wholesale suppliers; and other districts obtain the supply from a combination of well and purchased sources. A small portion of the supply is from surface sources processed through three Company-owned water treatment plants. In 2003, the Company expects to complete construction of a new water treatment plant in the Bakersfield district that will increase the amount of surface water delivered to that system and reduce the amount of water pumped from wells. On average, slightly more than half of the water delivered to customers is produced from wells and surface supply, with the remainder purchased from wholesale suppliers.

California's normal weather pattern yields little precipitation between mid-spring and mid-fall. The Washington service areas receive precipitation in all seasons with the heaviest amounts during the winter. New Mexico's rainfall is heaviest in the summer monsoon season. 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 basins and fill reservoirs providing the water supply for subsequent delivery to customers. To date, snow and rainfall accumulation during the 2002-2003 water year has been above average. Precipitation in the prior five years has been near normal levels. Water storage in California's reservoirs at the end of 2002 was at historic average. The Company believes that its supply from underground aquifers and purchased sources should be adequate to meet customer demand during 2003. The Company also develops long-term water supply plans for each of its districts to help assure an adequate water source under various operating and supply conditions.

ENVIRONMENTAL MATTERS

The Company is subject to regulations of the United States Environmental Protection Agency (EPA), state health service departments and various local health departments concerning water quality matters. It is also subject to the jurisdiction of various state and local regulatory agencies relating to environmental matters, including handling and disposal of hazardous materials. The Company strives for complete compliance with all requirements set forth by the various agencies.

The Safe Drinking Water Act (SDWA) was amended in 1996 to provide a new process for the EPA to select and regulate waterborne contaminants. The EPA can now regulate only contaminants that are known or likely to occur at levels expected to pose a risk to public health when regulation would provide a meaningful opportunity to reduce a health risk. New drinking water regulations will be based primarily on risk assessment and measurement of cost/benefit considerations for minimizing overall health risk. The amended SDWA allows the EPA to require monitoring of up to 30 contaminants in any five-year cycle. Also, every five years the EPA must select at least five listed contaminants and determine if they should be regulated.

The Company has an established water supply monitoring program to test for contaminants in accordance with SDWA requirements. Employees are provided training in water operations and water treatment procedures. Water pumped from underground sources is treated as necessary or required by regulations. The Company owns and operates three surface water treatment plants. The cost of existing treatment is being recovered in customer rates as authorized by the regulatory authorities. Water purchased from wholesale suppliers is treated before delivery to the Company's systems.

Enforcement of the EPA standards is the responsibility of individual states. The states can impose more stringent regulations than mandated by EPA. In addition to the EPA's requirements, various regulatory agencies could require increased monitoring and possibly require additional treatment of water supplies.

During 2001, EPA released a new, lower Maximum Contaminant Level (MCL) standard of 10 parts per billion for arsenic, a naturally-occurring element that is sometimes present in groundwater. Compliance with the new standard is required by January 2006. Of the Company's 600 wells, 56 will require treatment to comply with the new MCL. The Company estimates the compliance cost at $61 million in capital expenditures over the next three years and $10 million in additional annual operating costs. The State of California could establish a lower arsenic MCL standard. If the state were to set the standard at five parts per billion, the estimated capital expenditures necessary for compliance would be approximately $125 million. At this time, the Company is unable to predict if the state will adopt the EPA standard or require a lower MCL. The Company is participating in testing alternate arsenic treatment technologies in order to meet the standard in the most cost-efficient manner. The required capital expenditures to meet the new standards and the increased operating costs associated with new treatment are expected to be recovered in customers' future water rates.

The Company anticipates that the EPA will issue other regulations that will require further monitoring and possible treatment for specific contaminants. Depending on the MCLs contained in the regulations, the cost of compliance with the new regulations could be significant in certain Company districts. The Company intends to request recovery for capital investments and additional treatment costs needed to remain in compliance with established health standards through the ratemaking process.

The Company is also working with regional water quality control boards and air quality districts to meet current and upcoming regulations. The focus of this work is to meet more stringent National Pollutant Discharge Elimination System requirements for water discharged from wells and for diesel exhaust emissions from operation of emergency generators.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity. The Company's short-term liquidity is provided by bank lines of credit and internally generated funds. On a long-term basis, the Company obtains financing through its access to debt and equity markets.

Short-term Financing. Negotiations to renew separate bank credit agreements for the Company and Cal Water that were scheduled to expire on April 30, 2003, have been completed. The new agreements, which replace a combined $60 million credit line, became effective on February 28, 2003, and expire on April 30, 2005. Under the new agreements the Company will have available a total of $65 million. Of the total, $55 million is designated for Cal Water and $10 million for the Company, including funding of its subsidiaries' operations. Cal Water's $55 million portion can be used solely for purposes of the regulated California utility. As of July 1, 2003, the credit facility available to Cal Water will be reduced to $45 million. The reduction will lower the commitment fee paid by Cal Water on the unused portion of the credit line. The prior agreements required a 30-day out-of-debt period for borrowings under the agreements in calendar year 2002. However, on September 23, 2002, the agreements were amended to extend the out-of-debt compliance period to between January 1, 2002 and April 30, 2003. The new agreements will also have a 30-day out-of-debt requirement that must be met by December 31, 2003.

During 2002 and 2001, the Company had committed $7.6 million of the $10 million credit line to a contractor for construction of a customer and operation center. The Company has occupied the new facility where four of its southern California district operations were consolidated. The combined operations will provide for more efficient service to customers in the South Bay area of Los Angeles County. The tax-free exchange of seven surplus Company properties to the contractor for the new customer and operations center was completed on September 30, 2002. Because the transaction was structured as a property exchange, acquiring the new facility did not require a significant expenditure of cash. Under terms of the exchange agreement, during the construction period the Company had guaranteed the contractor's bank loan. The new facility, which is valued at over $7 million, served as security to the Company for the guarantee. When the property exchange was completed, the contractor paid off the bank loan, and the Company was released from its guarantee.

Washington Water has loan commitments from two banks to meet its operating and capital equipment purchase requirements at interest rates negotiated with the banks. At December 31, 2002, nothing was outstanding under the short-term commitments. Generally, short-term borrowings under the commitments are converted annually to long-term borrowings with repayment terms tied to system and equipment acquisitions.

New Mexico Water Company has a credit arrangement with a New Mexico bank that was renewed in January 2003 for a 16-month period. The interest rate for the agreement is based on prime rate plus 75 basis points. At December 31, 2002, the amount borrowed was $2,380,000. The renewal increased the amount available under the line to $2.9 million.

The water business is seasonal. 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 higher and more revenue is generated. During the winter period, the need for short-term borrowings under the bank lines of credit increases. The increase in cash flow during the summer allows short-term borrowings to be paid down. Short-term borrowings that remain outstanding more than one year have generally been converted to long-term debt. In years when more than normal precipitation falls in the Company's service areas or temperatures are lower than normal, especially in the summer months, customer water usage can be lower than normal. The reduction in water usage reduces cashflow from operations and increases the need for short-term bank borrowings. During 2002 and 2001, the need for short-term borrowings was greater due to an increase in construction expenditures primarily related to construction of the Bakersfield water treatment plant. Regulatory lag, which is the delay in receiving authorization to increase customer rates to cover capital expenditures and higher operating costs, resulted in the need for increased short-term bank borrowings in both 2002 and 2001.

Credit Ratings. California Water Service Company's first mortgage bonds are rated by Moody's Investors Service (Moody's) and Standard & Poor's (S&P). The Company's bank line of credit agreement contains a provision that if the Company's Moody's or S&P's senior debt ratings falls below investment grade, the credit line may be terminated by the bank. At the end of the third quarter 2002, the Company met separately with the two credit rating agencies at annual rating reviews. Following the review, Moody's issued a news release stating that it was placing the Company's Aa3 senior secured debt rating on review for possible downgrade and subsequently lowered the rating to A1. Moody's indicated that the primary reason for the action was delayed rate relief from the CPUC and the Company's capital spending requirements for water infrastructure and environmental compliance needs. In November 2002, S&P lowered the Company's corporate credit rating from AA- to A+. In its news release, S&P stated that the change "has been caused principally by deterioration in regulatory support from the California Public Utilities Commission," noting that decisions for recovery of reasonable expenses have been delayed as much as 18 months. In the news release, S&P classified the Company's outlook as "stable," saying, "Standard & Poor's does not expect that Cal Water will experience any funding anxiety beyond that associated with regulatory tardiness." The Company believes the credit rating agencies will maintain investment grade ratings for the Company's first mortgage bonds.

Long-term Financing. Long-term financing, which includes common stock, preferred stock, first mortgage bonds, senior notes and other debt securities, has been used to replace short-term borrowings and fund construction. Internally-generated funds come from earnings not paid out as dividends, depreciation and deferred income taxes. Additional information regarding the bank borrowings and long-term debt is presented in notes 8 and 9 to the financial statements. The Company believes that long-term financing is available to it through debt and equity markets. In March 2002, the CPUC issued a decision granting Cal Water authority to complete up to $250 million of equity and debt financing through 2005, subject to certain restrictions. In addition to Company funds, construction projects are funded by developers' contributions in aid of construction which are not refundable and advances for construction which are refundable.

In both 2002 and 2001, long-term financing was provided by issuance of senior notes. During 2002, Series E, 7.11% senior notes were issued in May and Series F, 5.90% senior notes were issued in August. During 2001, Series D, 7.13% senior notes were issued in September. Each series, which is an obligation of Cal Water, was issued for $20 million. These senior note issues do not require sinking fund payments.

During 2002, the Company initiated a program to refinance a portion of Cal Water's outstanding first mortgage bonds. The refinancing is intended to take advantage of the available lower interest rates. The Company estimates that the total program, which will be completed in two phases, will save approximately $1.5 million in annual interest costs. The first phase of the program was completed in 2002 and included refinancing of Series S, BB and DD first mortgage bonds, and Series P that matured on November 1, 2002. Including Series P, the total first mortgage bond principal balance refinanced for the four series was $33,940,000. The refinancing was accomplished with funds from the issue of two new series of lower interest cost, unsecured senior notes. Series G, $20 million senior notes were issued in November 2002 and Series H, $20 million senior notes were issued in December 2002. The interest rate on both series is 5.29% and both mature in 2022. Each series requires annual sinking fund payments of $1.8 million commencing in 2012.

The second phase of the refinancing is expected to be completed in May 2003 when two $10 million senior notes are issued under Series I and J to redeem Series EE first mortgage bonds. Institutional investors have committed to these two issues. The interest rate for Series I will be determined at closing, but is expected be similar to the Series J interest rate which will be 5.54%. Depending on interest rates at the time, Series FF and GG first mortgage bonds will be considered for possible refinancing during 2003.

In 2002 and 2000, $1.9 million and $3.6 million, respectively, of net income was reinvested in the business after payment of dividends. Cash flow during 2001 was lower than expected because of lower water usage by existing customers, regulatory lag in receiving rate relief and increased operating costs, especially for purchased power costs. As a result, funds required to pay 2001 dividends exceeded net income by $2.1 million, resulting in a reduction of stockholders' equity. The reduced cash flow also required the Company to borrow additional funds under the bank line of credit agreement.

The Company has a Dividend Reinvestment and Stock Purchase Plan (Plan). Under the Plan, stockholders may reinvest dividends to purchase additional Company common stock. The Plan also allows existing stockholders and other interested investors to purchase Company common stock through the transfer agent. The Plan provides that shares required for the Plan may be purchased on the open market or be newly issued shares. During 2002 and 2001, shares were purchased on the open market. At this time, the Company intends to continue purchasing shares required for the Plan on the open market. However, if new shares were issued to satisfy future Plan requirements, the impact on earnings per share could be dilutive. Also, stockholders may experience dilution of their ownership percentage unless they participate in an offering at the same level of current ownership.

2003 Financing Plan. The Company's 2003 financing plan includes raising approximately $60 million of new capital. The plan includes issuance of $20 million in senior notes to institutional investors. The senior note financing was completed on February 28, 2003, when Series K 4.58% and Series L 5.48% notes were issued, each for $10 million. Additionally, a global shelf registration statement is being prepared. From the global shelf registration, the Company expects to issue approximately $40 million of common stock. As currently contemplated, the common stock issue will be accomplished with an initial issue during the second quarter and a second issue late in the third quarter. However, the Company does not plan to issue common stock until after the CPUC has issued a decision for the 2001 GRC applications. Therefore, if the CPUC decision is delayed, the common stock issues are also likely to be delayed. Beyond 2003, future issues from the shelf registration could include common stock, preferred stock or debt instruments sold to individual investors.

Contractual Obligations. The Company's contractual obligations are summarized in the table below. Long-term debt payments include annual sinking fund payments on first mortgage bonds, maturities of long-term debt and annual payments on other long-term obligations. Advances for Construction represent annual contract refunds to developers for the cost of water systems paid for by the developers. The contracts are non-interest bearing and refunds are generally on a straight-line basis over a 40-year period. Operating leases are generally rents for office space. The total amount presented for operating leases is for a 20-year period.

Contractual Obligations (In thousands)	*Total*	*Less Than 1 Year*	*2-3 Years*	*4-5 Years*	*After 5 Years*
Long-Term Debt	$251,365	$1,000	$ 1,896	$ 1,776	$246,693
Advances for Construction	115,459	4,605	15,243	11,146	84,465
Operating leases	21,000	833	1,834	1,834	16,499

The Company has water supply contracts with wholesale suppliers in 16 of its operating districts. For each contract, the cost of water is established by the wholesale supplier and is generally beyond the Company's control. The amount paid annually to the wholesale suppliers is charged to purchased water expense on the Company's statement of income. Three contracts noted below require minimum payments. The other contracts do not require minimum annual payments. The amount paid under the contracts, except for the contract with Stockton East Water District (SEWD), varies with the volume of water purchased from the wholesalers. The contract with SEWD requires payments totaling $3,779,000 for 2003, a 27% increase over 2002. The amount paid under this contract is fixed annually and generally does not vary with the quantity of water delivered by the district during the year. Because of the fixed price arrangement, the Company operates to receive as much water as possible from SEWD in order to minimize the cost of operating wells to supplement SEWD deliveries. Two contracts require the Company to purchase minimum quantities of water at the contractors' current wholesale rate for purchased water. Under both contracts, the Company operates so that purchases exceed the contractual minimum amount. The Company plans to continue to purchase at least the minimum water requirement under both contracts in the future.

Capital Requirements. Capital requirements consist primarily of new construction expenditures for expanding and replacing the Company's utility plant facilities and the acquisition of new water properties. They also include refunds of advances for construction and retirement of first mortgage bonds.

In 2002, utility plant expenditures totaled $88.4 million compared to $62.0 million in 2001. The 2002 construction program included $71.6 million of Company-funded projects and $16.8 million of projects funded by funds received from developers for non-refundable contributions in aid of construction and refundable advances for construction. The Company's 2002 projects were funded by internally-generated funds, borrowings under bank credit lines, and issuance of long-term debt senior notes. The Company's 2001 projects were funded by internally-generated funds, borrowings under bank credit lines, and issuance of $20 million in senior notes.

The 2003 Company-funded construction budget was authorized at $51.7 million. It includes $4.5 million for the fifth year of a five-year program to construct a water treatment plant to accommodate growth and meet water quality standards in the Bakersfield district. Construction of the plant is proceeding on-time and on-budget. Over the five-year period, the plant and related pumping and pipeline facilities are estimated to cost $49.0 million. Also in the 2003 budget is $10.7 million for new and replacement water mains and $12.1 million for new wells, pumping equipment and storage facilities. The budget will be funded by funds from operations, bank borrowings and long-term debt and equity financing. New subdivision construction will be financed by developers' non-refundable contributions-in-aid-of-construction and refundable advances for construction.

Company-funded construction budgets over the next five years are projected to be about $330 million. Included in the estimated amount is $61 million for compliance with arsenic water quality regulations, completion of the Bakersfield treatment plant and expansion and replacement of water plant infrastructure including the start of a program to replace certain wells that are nearing the end of their service life.

Capital Structure. In 2002, common stockholders' equity increased $1.9 million and in 2000 increased $3.6 million by net income not paid out as dividends. In 2001, common stockholders equity was reduced by the $2.1 million that dividends paid exceeded net income. 36,180 shares of common stock were issued in 2001 for the acquisition of the Nish water systems. The long-term debt portion of the capital structure increased in 2002, 2001 and 2000 primarily due to the issuance of new senior notes. It was reduced by first mortgage bond sinking fund payments.

The Company's total capitalization at December 31, 2002, was $453.1 million and at the end of 2001 was $402.7 million. Because of the decline in 2001 net income and issuance of additional senior notes, the debt component of capitalization has increased and the equity component has decreased. The Company expects that its planned issuance of common equity, and receipt of regulatory relief will add to the common equity portion of capitalization in 2003 and future years. At December 31 capitalization ratios were:

	2002	2001
Common equity	44.0%	48.8%
Preferred stock	0.7%	0.9%
Long-term debt	55.3%	50.3%

The return on average common equity was 9.7% in 2002 compared to 7.6% in 2001. The low return on average common equity in 2001 was directly related to the decline in net income.

Acquisitions. *Rio Grande Utility Corporation.* On July 1, 2002, after receiving state regulatory commission approval, the Company acquired certain assets of Rio Grande Utility Corporation (Rio Grande) through New Mexico Water. The purchase included the water and wastewater assets of Rio Grande, which serves 2,400 water and 1,700 wastewater customers about 30 miles south of Albuquerque. The purchase price was $2,300,000 in cash, plus assumption of $3,100,000 in outstanding debt. Rate base for the system is approximately $5,400,000.

The Rio Grande purchase price was allocated to the fair value of net assets acquired, including utility plant, water rights and assumed liabilities. The results of operations include the operating results of Rio Grande since the acquisition date. The allocation of fair value is based on management's estimate of the fair value for purchase accounting purposes at the date of acquisition. The purchase price allocations are subject to revision if management obtains additional information.

For 2001, Rio Grande had gross revenue of $1,485,000. Its gross utility plant in service at December 31, 2001, was $12,458,000 and net utility plant in service was $9,153,000. The regulatory decision authorizing the purchase included an authorization to increase annual water rates by $115,000.

National Utilities Corporation. In June 2002, New Mexico Water signed an agreement to purchase National Utilities Corporation for approximately $700,000. National Utilities serves 700 water customers located adjacent to the Rio Grande water system and another 1,000 water customers located 150 miles south of Albuquerque, New Mexico. The purchase will entitle New Mexico Water to purchase up to 2,000 acre-feet of water annually as required for its operations. The purchase is subject to the approval of the New Mexico Public Regulation Commission. Regulatory approval is expected in the third quarter of 2003. National Utilities had 2002 revenue of $554,000 and total assets of $1,410,000. Its net utility plant in service at December 31, 2001, was $1,178,000.

Kaanapali Water Corporation. In August 2002, the Company agreed to acquire the Kaanapali Water Corporation for $7.7 million in cash. Kaanapali Water provides water utility services to 500 customers on the island of Maui in Hawaii, including 10 resorts and eight condominium projects. It posted 2001 revenues of $3.3 million, and has net plant of approximately $7.3 million and current assets of $0.4 million. The transaction is subject to approval of the Hawaii Public Utilities Commission, and an application requesting approval was filed in October 2002. A decision is expected by mid-2003.

Nish Water Systems. On January 25, 2001, the CPUC approved the Company's acquisition of the Nish water systems in Visalia. The four systems serve 1,100 customers and had annual revenue of $0.2 million. The Company issued 36,180 shares of its common stock valued at $0.9 million and assumed debt of $0.3 million to complete the transaction, which was accounted for as a pooling of interests. The effect of pooling was deemed not to be material; therefore, prior year financial statements have not been restated and pro forma disclosures were not considered significant. The net equity of Nish was recorded as an adjustment to retained earnings as of January 1, 2001.

Washington Water. In 2002, Washington Water purchased the assets of eight water companies that serve 181 customers and generate $0.1 million in annual revenue. The combined purchase price was $0.1 million. During 2001, Washington Water purchased the assets of seven water companies that serve 681 customers and generate about $0.3 million in annual revenue. The combined purchase price was $0.7 million.

Real Estate Program. The Company's subsidiaries own more than 900 real estate parcels. Certain parcels are not necessary for or used in water utility operations. Most surplus properties have a low cost basis. A program has been developed to realize the value of certain surplus properties through sale or lease of those properties. The program will be ongoing for a period of several years. During the next four years, the Company estimates that gross property transactions totaling over $10 million could be completed. During 2002, the Company completed four sales totaling $3.0 million in pretax proceeds. In 2001, $4.0 million in pretax sales were completed through two sales.

Stockholder Rights Plan. As explained in Note 7 to the Consolidated Financial Statements, in January 1998, the Board of Directors adopted a Stockholder Rights Plan (Plan). In connection with the Plan, a dividend distribution of one right for each common share to purchase preferred stock under certain circumstances was also authorized. The Plan is designed to protect stockholders and maximize stockholder value in the event of an unsolicited takeover proposal by encouraging a prospective acquirer to negotiate with the Board.

FINANCIAL RISK MANAGEMENT

The Company does not participate in hedge arrangements, such as forward contracts, swap agreements, options or other contractual agreements relative to the impact of market fluctuations on its assets, liabilities, production or contractual commitments. The Company operates only in the United States, and therefore, is not subject to foreign currency exchange rate risks.

Terrorism Risk. Since the September 11, 2001, terrorist attacks, to safeguard its water supply and facilities, the Company has heightened security at its facilities and taken added precautions for the safety of our employees and the water we deliver to our customers. While the Company does not make public comments on its security programs, it has been in contact with federal, state and local law enforcement agencies to coordinate and improve water delivery systems' security. The Company has also assigned a high priority to completing work necessary to comply with new EPA requirements concerning security of water facilities. This effort encompasses all of the Company's operations.

Interest Rate Risk. The Company does have exposure to market risk that includes changes in interest rates. Interest rate risk exists because the Company's financing includes the use of long-term debt obligations with maturity dates up to 30 years from the date of issue. If interest rates increase, the Company's future long-term financing may be done at higher rates, resulting in a need to recover higher cost in customers' future rates. Cal Water's long-term obligations are first mortgage bonds and senior note obligations that are generally placed with insurance companies at fixed interest rates. Washington Water's long-term obligations are for periods of up to 10 years and are placed with two banks. New Mexico Water's long-term debt obligations are with a bank with maturities of 16 months. During 2002, the Company issued four series of $20 million senior notes with interest rates ranging from 5.29% to 7.11%. The range of interest rates is an example of changing market conditions. To expand access to capital debt markets, the Company will investigate the use of private and public markets for future debt issues. It may also consider financing on a parent company basis, rather than on a subsidiary-by-subsidiary basis.

The Company's short-term financing is provided by bank lines of credit that are discussed under the "Liquidity and Capital Resources" section of this report. Short-term borrowings that are not repaid from operating cash or funded by retained earnings are generally converted to long-term debt issues. The Company plans to continue the financing of its construction program with a combination of debt and equity issues. Financing of acquisitions have been done using Company common stock or through the debt financing vehicles available to the subsidiary companies.

Value Risk. Because the Company operates primarily in a regulated industry, its value risk is somewhat lessened; however, regulated parameters also can be recognized as limitations to operations and earnings, and the ability to respond to certain business conditions changes. During 2002 and 2001, the Company experienced value risk because of the impact on earnings of CPUC decisions or the lack of decision on earnings. Non-regulated operations are subject to risk of contract constraints and performance by the Company in achieving its objectives. Value risk management is accomplished using various financial models that consider changing business parameters. It is also supplemented by considering various risk control processes that may be available as circumstances warrant.

Stock Market Performance Risk. While the Company's stock price has not been significantly affected by poor performance of the general stock market over the past two years, the Company's performance could be affected in other areas. The Company provides its employees a defined benefit pension plan and postretirement medical benefit plan. The Company is responsible for funding both of these plans and a portion of the plans' assets are invested in stock market equities, other than Company stock. Poor performance of the equity investments could result in a need for additional future funding and cost to make up for a loss of value in the equity investments. The Company expects to recover its costs associated with the benefit plans in customer rates.

Equity Risk. The Company does not have equity investments and, therefore, it does not have equity risks.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which applies to legal obligations associated with the retirement of long-lived assets and the associated asset retirement costs. The Statement is effective for the Company in the first quarter of 2003. The Company does not expect the adoption of SFAS No. 143 to have a significant impact on its financial position or results of operations.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." This Statement requires that a liability for costs associated with an exit or disposal activity be recognized and measured initially at fair value only when the liability is incurred. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002. The Company does not expect the impact of adopting SFAS No. 146 to have a significant impact on the Company's financial position, results of operations, or cash flows.

In November 2002, the FASB issued Interpretation No. 45, "Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." Interpretation No. 45 requires a liability to be recognized at the time a company issues a guarantee for the fair value of the obligations assumed under certain guarantee agreements. Additional disclosures about guarantee agreements are also required in the interim and annual financial statements. The Company does not believe adoption of Interpretation No. 45 will have a material impact on the Company's results of operations or financial position. The recognition and measurement provision of FIN 45 are effective for the years beginning after December 31, 2002. The disclosure requirements are effective for December 31, 2002, financial statements; however, the Company is not a party to any guarantees at this time.

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation, Transition and Disclosure." This statement provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. It also requires that disclosure of the pro forma effect of using the fair-value method of accounting for stock-based employee compensation be displayed more prominently and in a table in annual financial statements. Additionally, the statement requires disclosure of the pro forma effect in interim financial statements. The transition and annual disclosure requirements of Statement No. 148 are effective for the Company for 2002. The interim disclosure requirements are effective for the Company's first quarter of 2003. The Company does not expect Statement No. 148 to have a material effect on its results of operations or financial condition.

Consolidated Balance Sheet

In thousands, except per share data

December 31, 2002 and 2001	*2002*	*2001*
ASSETS		
Utility plant:		
Land	$ 11,513	$ 10,709
Depreciable plant and equipment	927,244	859,846
Construction work in progress	48,624	26,826
Intangible assets	13,929	12,277
Total utility plant	1,001,310	909,658
Less accumulated depreciation and amortization	304,322	285,316
Net utility plant	696,988	624,342
Current assets:		
Cash and cash equivalents	1,063	953
Receivables:		
Customers	14,831	14,572
Other	9,130	8,228
Unbilled revenue	7,969	7,291
Materials and supplies at average cost	2,760	2,147
Taxes and other prepaid expenses	7,234	7,224
Total current assets	42,987	40,415
Other assets:		
Regulatory assets	46,089	38,893
Unamortized debt premium and expense	6,798	3,800
Other	7,720	2,764
Total other assets	60,607	45,457
	$800,582	$710,214

	2002	*2001*
Capitalization and Liabilities		
Capitalization:		
Common stock, $0.01 par value; 25,000 shares authorized, 15,182 outstanding in 2002 and 2001	$ 152	$ 152
Additional paid-in capital	49,984	49,984
Retained earnings	149,215	147,299
Accumulated other comprehensive loss	(134)	(816)
Total common stockholders' equity	199,217	196,619
Preferred stock without mandatory redemption provision, $25 par value, 380 shares authorized, 139 shares outstanding	3,475	3,475
Long-term debt, less current maturities	250,365	202,600
Total capitalization	453,057	402,694
Current liabilities:		
Current maturities of long-term debt	1,000	5,381
Short-term borrowings	36,379	22,000
Accounts payable	23,706	24,032
Accrued taxes	3,742	3,813
Accrued interest	2,873	2,535
Other accrued liabilities	23,841	21,228
Total current liabilities	91,541	78,989
Unamortized investment tax credits	2,774	2,882
Deferred income taxes	31,371	28,816
Regulatory and other liabilities	28,804	20,680
Advances for construction	115,459	106,657
Contributions in aid of construction	77,576	69,496
Commitments and contingencies		
	$800,582	$710,214

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statement of Income

In thousands, except per share data

For the years ended December 31, 2002, 2001 and 2000	*2002*	*2001*	*2000*
Operating revenue	$263,151	$246,820	$244,806
Operating expenses:			
Operations:			
Purchased water	76,672	73,174	73,768
Purchased power	22,897	21,130	15,136
Pump taxes	6,344	5,910	6,275
Administrative and general	37,646	36,521	32,974
Other	34,073	34,109	32,308
Maintenance	11,587	12,131	11,592
Depreciation and amortization	21,238	19,226	18,368
Income taxes	12,568	9,728	11,571
Property and other taxes	9,829	9,740	9,618
Total operating expenses	232,854	221,669	211,610
Net operating income	30,297	25,151	33,196
Other income and expenses:			
Non-regulated income, net	2,637	1,979	1,413
Gain on the sale of non-utility property	2,980	3,864	–
Total other income and expenses	5,617	5,843	1,413
Income before interest expense	35,914	30,994	34,609
Interest expense:			
Long-term debt interest	15,554	14,187	12,901
Other interest	1,287	1,842	1,745
Total interest expense	16,841	16,029	14,646
Net income	$ 19,073	$ 14,965	$ 19,963
Earnings per share:			
Basic	$ 1.25	$ 0.98	$ 1.31
Diluted	$ 1.25	$ 0.97	$ 1.31
Weighted average number of common shares outstanding:			
Basic	15,182	15,182	15,126
Diluted	15,185	15,186	15,129

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statement of Common Stockholders' Equity and Comprehensive Income

In thousands

For the years ended December 31, 2002, 2001 and 2000	*Common Stock*	*Additional Paid-in Capital*	*Retained Earnings*	*Accumulated Other Comprehensive Loss*	*Total Stockholders' Equity*
Balance at December 31, 1999	$151	$49,340	$145,610	$(517)	$194,584
Net income	–	–	19,963	–	19,963
Other comprehensive income	–	–	–	31	31
Comprehensive income	–	–	–	–	19,994
Issuance of common stock	–	644	–	–	644
Dividends paid:					
Preferred stock	–	–	153	–	153
Common stock	–	–	16,235	–	16,235
Total dividends paid	–	–	16,388	–	16,388
Balance at December 31, 2000	151	49,984	149,185	(486)	198,834
Net income	–	–	14,965	–	14,965
Other comprehensive loss	–	–	–	(330)	(330)
Comprehensive income	–	–	–	–	14,635
Acquisition	1	–	220	–	221
Dividends paid:					
Preferred stock	–	–	153	–	153
Common stock	–	–	16,918	–	16,918
Total dividends paid	–	–	17,071	–	17,071
Balance at December 31, 2001	152	49,984	147,299	(816)	196,619
Net income	–	–	19,073	–	19,073
Other comprehensive income	–	–	–	682	682
Comprehensive income	–	–	–	–	19,755
Dividends paid:					
Preferred stock	–	–	153	–	153
Common stock	–	–	17,004	–	17,004
Total dividends paid	–	–	17,157	–	17,157
Balance at December 31, 2002	$152	$49,984	$149,215	$(134)	$199,217

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statement of Cash Flows

In thousands

For the years ended December 31, 2002, 2001 and 2000	2002	2001	2000
Operating activities:			
Net income	$19,073	$14,965	$19,963
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	21,238	19,226	18,368
Deferred income taxes, investment tax credits, and regulatory assets and liabilities, net	786	2,919	(3,203)
Gain on sale of non-utility property	(2,980)	(3,864)	–
Changes in operating assets and liabilities			
Receivables	(1,088)	(2,186)	(1,503)
Unbilled revenue	(561)	673	235
Accounts payable	(431)	(2,461)	(255)
Other current assets and liabilities	1,287	6,642	1,093
Other changes, net	(3,909)	(625)	638
Net adjustments	14,342	20,324	15,373
Net cash provided by operating activities	33,415	35,289	35,336
Investing activities:			
Utility plant expenditures			
Company funded	(71,553)	(53,379)	(33,540)
Developer advances and contributions in aid of construction	(16,808)	(8,670)	(3,621)
Proceeds from sale of non-utility assets	3,006	3,999	–
Acquisitions	(2,300)	(701)	(709)
Net cash used in investing activities	(87,655)	(58,751)	(37,870)
Financing activities:			
Net short-term borrowings	12,435	7,402	599
Issuance of common stock	–	–	644
Issuance of long-term debt	80,324	20,524	20,326
Advances for construction	12,545	6,498	3,846
Refunds of advances for construction	(4,597)	(4,166)	(3,870)
Contributions in aid of construction	7,740	10,868	1,883
Retirement of long-term debt	(36,940)	(2,881)	(2,920)
Dividends paid	(17,157)	(17,071)	(16,388)
Net cash provided by financing activities	54,350	21,174	4,120
Change in cash and cash equivalents	110	(2,288)	1,586
Cash and cash equivalents at beginning of year	953	3,241	1,655
Cash and cash equivalents at end of year	$ 1,063	$ 953	$ 3,241
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest (net of amounts capitalized)	$16,527	$14,785	$14,785
Income taxes	10,205	11,775	11,775
Non-cash financing activity - common stock issued in acquisitions	–	899	–

See accompanying Notes to Consolidated Financial Statements.

December 31, 2002, 2001, and 2000

1

ORGANIZATION AND OPERATIONS

California Water Service Group (Company) is a holding company that through its wholly-owned subsidiaries provides water utility and other related services in California, Washington and New Mexico. California Water Service Company (Cal Water), Washington Water Service Company (Washington Water) and New Mexico Water Service Company (New Mexico Water) provide regulated utility services under the rules and regulations of their respective state's regulatory commissions (jointly referred to as Commissions). CWS Utility Services provides non-regulated water utility and utility-related services.

The Company operates primarily in one business segment, providing water and related utility services.

2

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany transactions and balances have been eliminated.

Reclassifications The accounting records of the Company are maintained in accordance with the uniform system of accounts prescribed by the Commissions. Certain prior years' amounts have been reclassified, where necessary, to conform to the current presentation.

Use of Estimates The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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 date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Revenue consists of monthly cycle customer billings for regulated water and waste water service at rates authorized by the Commissions and billings to certain non-regulated customers. Revenue from metered accounts includes unbilled amounts based on the estimated usage from the latest meter reading to the end of the accounting period. Flat-rate accounts, which are billed at the beginning of the service period, are included in revenue on a pro rata basis for the portion applicable to the current accounting period.

Expense balancing and memorandum accounts are used to track suppliers' rate increases for purchased water, purchased power and pump taxes that are not included in customer water rates. The cost increases are referred to as "Offsetable Expenses" because under certain circumstances they are recoverable from customers in future rate increases designed to offset the higher costs. The Company does not record the balancing and memorandum accounts until the Commission has authorized a change in customer rates and the customer has been billed.

Utility Plant Utility plant is carried at original cost when first constructed or purchased, except for certain minor units of property recorded at estimated fair values at dates of acquisition. Cost of depreciable plant retired is eliminated from utility plant accounts and such costs are charged against accumulated depreciation. Maintenance of utility plant is charged primarily to operation expenses. Interest is capitalized on plant expenditures during the construction period and amounted to $1,473,000 in 2002, $858,000 in 2001, and $703,000 in 2000.

Intangible assets acquired as part of water systems purchased are stated at amounts as prescribed by the Commissions. All other intangibles have been recorded at cost and are amortized over their useful life. Included in intangible assets is $6,515,000 paid to the City of Hawthorne in 1996 to lease the city's water system and associated water rights. The asset is being amortized on a straight-line basis over the 15-year life of the lease.

Depreciation Depreciation of utility plant for financial statement purposes is computed on the straight-line remaining life method at rates based on the estimated useful lives of the assets, ranging from 5 to

65 years. The provision for depreciation expressed as a percentage of the aggregate depreciable asset balances was 2.4% in 2002, 2001 and 2000. For income tax purposes, as applicable, the Company computes depreciation using the accelerated methods allowed by the respective taxing authorities. Plant additions since June 1996 are depreciated on a straight-line basis for tax purposes in accordance with tax regulations.

Cash Equivalents Cash equivalents include highly liquid investments, primarily U.S. Treasury and U.S. Government agency interest bearing securities, with original maturities of three months or less.

Restricted Cash Restricted cash primarily represents proceeds collected through a surcharge on certain customers' bills plus interest earned on the proceeds and is used to service California Safe Drinking Water Bond obligations. In addition, there are compensating balances at a bank in support of borrowings. All restricted cash is classified in other prepaid expenses. At December 31, 2002 and 2001, the amounts restricted were $1,131,000 and $887,000, respectively.

Regulatory Assets The Company records regulatory assets for future revenues expected to be realized as the tax effects of certain temporary differences previously passed through to customers reverse. The temporary differences relate primarily to the difference between book and income tax depreciation on utility plant that was placed in service before the regulatory Commissions adopted normalization for ratemaking purposes. The regulatory assets are net of revenue related to deferred income taxes that were provided at prior tax rates and the amount that would be provided at current tax rates. The differences will reverse over the remaining book lives of the related assets.

In addition, regulatory assets include items that are recognized as liabilities for financial statement purposes, which will be recovered in future customer rates. The liabilities relate to postretirement benefits, vacation and self-insured workers' compensation accruals.

Long-lived Assets The Company regularly reviews its long-lived assets for impairment, annually or when events or changes in business circumstances have occurred, which indicate the carrying amount of such assets may not be fully realizable. Potential impairment of assets held for use is determined by comparing the carrying amount of an asset to the future undiscounted cash flows expected to be generated by that asset. If assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying value of the assets exceeds the fair value of the assets. There have been no such impairments as of December 31, 2002.

Long-term Debt Premium, Discount and Expense The discount and issuance expense on long-term debt is amortized over the original lives of the related debt issues. Premiums paid on the early redemption of certain debt issues and unamortized original issue discount and expense of such issues are amortized over the life of new debt issued in conjunction with the early redemption.

Accumulated Other Comprehensive Loss The Company has an unfunded Supplemental Executive Retirement Plan. The unfunded accumulated benefit obligation of the plan, less the accrued benefit, exceeds the unrecognized prior service cost. Accumulated other comprehensive loss has been recorded as a separate component of Stockholders' Equity.

Advances for Construction Advances for Construction consist of payments received from developers for installation of water production and distribution facilities to serve new developments. Advances are excluded from rate base for rate setting purposes. Annual refunds are made to developers without interest over a 20-year or 40-year period. Refund amounts under the 20-year contracts are based on annual revenues from the extensions. Unrefunded balances at the end of the contract period are credited to Contributions in Aid of Construction and are no longer refundable. Refunds on contracts entered into since 1982 are made in equal annual amounts over 40 years. At December 31, 2002 and 2001, the amounts refundable under the 20-year contracts were $3,248,000 and $4,320,000, respectively, and under 40-year contracts were $111,136,000 and $102,337,000, respectively. In addition, other Advances for Construction totaling $1,075,000 at December 31, 2002, are refundable based upon customer connections. Estimated refunds for 2003 for all water main extension contracts are $4,600,000.

Contributions in Aid of Construction Contributions in Aid of Construction represent payments received from developers, primarily for fire protection purposes, which are not subject to refunds. Facilities funded by contributions are included in utility plant, but excluded from rate base. Depreciation related to contributions is charged to Contributions in Aid of Construction.

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.

It is anticipated that future rate action by the Commissions will reflect revenue requirements for the tax effects of temporary differences recognized, which have previously been flowed through to customers. The Commissions have granted the Company customer rate increases to reflect the normalization of the tax benefits of the federal accelerated methods and available Investment Tax Credits (ITC) for all assets placed in service after 1980. ITC are deferred and amortized over the lives of the related properties for book purposes.

Advances for Construction and Contributions in Aid of Construction received from developers subsequent to 1986 were taxable for federal income tax purposes and subsequent to 1991 were subject to California income tax. In 1996 the federal tax law, and in 1997 the California tax law, changed and only deposits for new services were taxable. In late 2000, federal regulations were further modified to exclude fire services from tax.

Earnings Per Share Basic earnings per share (EPS) is calculated by dividing income available to common stockholders (net income less preferred stock dividend of $153,000) by the weighted average shares outstanding during the year. Diluted EPS is calculated by dividing income available to common stockholders by the weighted average shares outstanding including potentially dilutive shares as determined by application of the treasury stock method. The difference between basic and diluted weighted average number of common stock outstanding is the effect of dilutive common stock options outstanding.

Stock-based Compensation The Company has a stockholder-approved Long-Term Incentive Plan that allows granting of nonqualified stock options. The Company has adopted the disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," and as permitted by the statement, applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," for its plan. All of the Company's outstanding options have an exercise price equal to the market price on the date they were granted. No compensation expense was recorded for the years ended December 31, 2002, 2001 or 2000.

The table below illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation.

In thousands, except per share amounts	2002	2001	2000
Net income, as reported	$19,073	$14,965	$19,963
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	86	57	24
Pro forma net income	$18,987	$14,908	$19,939
Earnings per share:			
Basic – as reported	$ 1.25	$ 0.98	$ 1.31
Basic – pro forma	$ 1.25	$ 0.98	$ 1.31
Diluted – as reported	$ 1.25	$ 0.97	$ 1.31
Diluted – pro forma	$ 1.24	$ 0.97	$ 1.30

Recent Accounting Pronouncements In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which applies to legal obligations associated with the retirement of long-lived assets and the associated asset retirement costs. The Statement is effective for the Company in the first quarter of 2003. The Company does not expect the adoption of SFAS No. 143 to have a significant impact on its financial position or results of operations.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and supersedes Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition

for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring).” This Statement requires that a liability for costs associated with an exit or disposal activity be recognized and measured initially at fair value only when the liability is incurred. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002. The Company does not expect the impact of adopting SFAS No. 146 to be significant to the Company’s financial position, results of operations, or cash flows.

In December 2002, the FASB issued Statement No. 148, “Accounting for Stock-Based Compensation, Transition and Disclosure.” This statement provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. It also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a table. Additionally, the statement requires disclosure of the pro forma effect in interim financial statements. The transition and annual disclosure requirements of Statement No. 148 are effective for the Company in 2002. The interim disclosure requirements are effective for the Company’s first quarter of 2003. The Company does not expect Statement No. 148 to have a material effect on its results of operations or financial condition.

3

MERGER WITH DOMINGUEZ SERVICES CORPORATION

The Merger between the Company and Dominguez was completed on May 25, 2000. On the merger date, each outstanding Dominguez common share was exchanged for 1.38 shares of Company common stock. The Company issued 2,210,254 new common shares in exchange for the 1,601,679 outstanding Dominguez shares. Dominguez provided water service in 21 California communities. The former Dominguez operations became districts within Cal Water. The Merger was accounted for as a pooling of interests. There were no intercompany transactions as a result of the Merger. Certain reclassifications were made to the historical financial statements of the companies to conform presentation. No adjustments were made to the Dominguez net assets in applying the accounting practices of the Company. Dominguez previously reported common stock of $1,542,000 that was reclassified by the Company to “Paid-in-Capital” in accordance with the Company’s financial statement presentation. The Company and Dominguez each had December 31 year-ends; therefore no adjustment was required to retained earnings due to a change in fiscal year-ends.

4

OTHER ACQUISITIONS

During 2002, after receiving regulatory approval, the Company acquired the assets of Rio Grande Utility Corporation (Rio Grande) through its wholly-owned subsidiary, New Mexico Water. The purchase includes the water and wastewater assets of Rio Grande, which serves water and wastewater customers in unincorporated areas of Valencia County, New Mexico. The purchase price was $2,300,000 in cash, plus assumption of $3,100,000 in outstanding debt. Rate base for the system is $5,400,000, including intangible water rights valued at $732,000.

In 2001, the Company acquired four companies operating in Cal Water’s Visalia district. The acquisitions were completed in February 2001, in exchange for 36,180 shares of Company common stock worth $899,000 and assumed debt of $218,000. The acquisitions were accounted for under the pooling of interests method of accounting; however, due to the results from operations not being material to the Company’s consolidated results from operations, prior periods were not restated. The net equity acquired was recorded as an increase to retained earnings at the beginning of the year. In addition, Washington Water purchased the assets of eight water companies for cash of $701,000.

During 2000, Washington Water purchased the assets of Mirrormount Water Services and Lacamas Farmsteads Water Company for $639,000 in cash and assumed debt. To provide in-house engineering, Washington Water also purchased the assets of Robischon Engineers, Inc. in April 2000 for $70,000 in cash.

Condensed balance sheets and pro forma results of operations for these acquisitions have not been presented since the effect of these purchases are not material. Acquisitions that involved purchase of assets were accounted for under the purchase method of accounting.

5

INTANGIBLE ASSETS

As of December 31, 2002 and 2001, intangible assets that will continue to be amortized and those not amortized were:

Amounts in thousands	*2002* Gross Carrying Value	*2002* Accumulated Amortization	*2002* Net Carrying Value	*2001* Gross Carrying Value	*2001* Accumulated Amortization	*2001* Net Carrying Value
AMORTIZED INTANGIBLE ASSETS:						
Hawthorne lease	$ 6,515	$2,968	$3,547	$ 6,515	$2,534	$3,981
Water pumping rights	1,046	2	1,044	1,046	–	1,046
Water planning studies	1,783	238	1,545	1,054	109	945
Leasehold improvements and other	2,160	1,027	1,133	1,969	920	1,049
Total	$11,504	$4,235	$7,269	$10,584	$3,563	$7,021
UNAMORTIZED INTANGIBLE ASSETS:						
Perpetual water rights	$ 2,425	–	$2,425	$ 1,693	–	$1,693

For the years ending December 31, 2002, 2001 and 2000, amortization of intangible assets was $670,000, $630,000 and $507,000. Estimated future amortization expense related to intangible assets for the succeeding five years is $671,000 per year for 2003 to 2007 and $3,243,000 beyond 2007.

6

PREFERRED STOCK

As of December 31, 2002 and 2001, 380,000 shares of preferred stock were authorized. Dividends on outstanding shares are payable quarterly at a fixed rate before any dividends can be paid on common stock.

The outstanding 139,000 shares of $25 par value cumulative, 4.4% Series C preferred shares are not convertible to common stock. A premium of $243,250 would be due upon voluntary liquidation of Series C. There is no premium in the event of an involuntary liquidation. Each Series C preferred share is entitled to sixteen votes, with the right to cumulative votes at any election of directors.

7

COMMON STOCKHOLDERS' EQUITY

The Company is authorized to issue 25,000,000 shares of $0.01 par value common stock. As of December 31, 2002 and 2001, 15,182,046 shares of common stock were issued and outstanding.

Dividend Reinvestment and Stock Repurchase Plan The Company has a Dividend Reinvestment and Stock Purchase Plan (Plan), which allows stockholders to reinvest dividends to purchase additional Company common stock. The Plan also allows stockholders and other investors to purchase Company common stock through the transfer agent. The Plan provides that shares required for the Plan may be purchased on the open market or be newly issued shares. During 2002 and 2001, shares were purchased on the open market.

Stockholder Rights Plan The Company's Stockholder Rights Plan (Plan) is designed to provide stockholders protection and to maximize stockholder value by encouraging a prospective acquirer to negotiate with the Board. The Plan was adopted in 1998 and authorized a dividend distribution of one right (Right) to purchase 1/100th share of Series D Preferred Stock for each outstanding share of Common Stock in certain circumstances. The Rights are for a ten-year period that expires in February 2008.

Each Right represents a right to purchase 1/100th share of Series D Preferred Stock at the price of $120, subject to adjustment (Purchase Price). Each share of Series D Preferred Stock is entitled to receive a dividend equal to 100 times any dividend paid on common stock and 100 votes per share in any stockholder election. The Rights become exercisable upon occurrence of a Distribution Date. A Distribution Date event occurs if (a) any person accumulates 15% of the then outstanding Common Stock, (b) any person presents a tender offer which would cause the person's ownership level to exceed 15% and the Board determines the tender offer not to be fair to the Company's stockholders, or (c) the Board determines that a stockholder maintaining a 10% interest in the Common Stock could have an adverse impact on the Company or could attempt to pressure the Company to repurchase the holder's shares at a premium.

Until the occurrence of a Distribution Date, each Right trades with the Common Stock and is not separately transferable. When a Distribution Date occurs: (a) the Company would distribute separate Rights Certificates to Common Stockholders and the Rights would subsequently trade separate from the Common Stock; and (b) each holder of a Right, other than the acquiring person (whose Rights would thereafter be void), would have the right to receive upon exercise at its then current Purchase Price that number of shares of Common Stock having a market value of two times the Purchase Price of the Right. If the Company merges into the acquiring person or enters into any transaction that unfairly favors the acquiring person or disfavors the Company's other stockholders, the Right becomes a right to purchase Common Stock of the acquiring person having a market value of two times the Purchase Price.

The Board may determine that in certain circumstances a proposal that would cause a Distribution Date is in the Company stockholders' best interest. Therefore, the Board may, at its option, redeem the Rights at a redemption price of $0.001 per Right.

8

SHORT-TERM BORROWINGS

At December 31, 2002, the Company maintained a bank line of credit providing unsecured borrowings of up to $10,000,000 at the prime lending rate or lower rates as quoted by the bank. Cal Water maintained a separate bank line of credit for an additional $50,000,000 on the same terms as the Company's line of credit. The agreements require a 30-day out-of-debt period for borrowings under the agreements in calendar year 2002. However, on September 23, 2002, the agreements were amended to extend the out-of-debt compliance period to between January 1, 2002, and April 30, 2003. As explained in Note 16 Subsequent Events, the lines of credit, which were scheduled to expire on April 30, 2003, were renegotiated on February 28, 2003. At December 31, 2002, $34,000,000 was outstanding.

Washington Water has a loan commitment for $100,000 from a bank to meet its operating and capital equipment purchase requirements at interest rates negotiated with the bank. At December 31, 2002, nothing was outstanding under the short-term commitment.

New Mexico Water has a $2.9 million credit agreement with a New Mexico bank that was renewed in January 2003 for a 16-month period. The interest rate for the agreement is based on prime rate plus 75 basis points. At December 31, 2002, the amount borrowed was $2,379,000.

The following table represents borrowings under the bank lines of credit:

Dollars in thousands	*2002*	*2001*	*2000*
Maximum short-term borrowings	$52,285	$36,800	$26,750
Average amount outstanding	$25,495	$24,453	$16,810
Weighted average interest rate	3.44%	5.29%	7.77%
Interest rate at December 31	3.61%	3.16%	7.88%

9

LONG-TERM DEBT

As of December 31, 2002 and 2001, long-term debt outstanding was:

In thousands	*Series*	*Interest Rate*	*Maturity Date*	2002	*2001*
First Mortgage Bonds:	J	8.86%	2023	$ 4,000	$ 4,000
	K	6.94%	2012	5,000	5,000
	P	7.875%	2002	–	2,565
	S	8.50%	2003	–	2,580
	BB	9.48%	2008	–	11,520
	CC	9.86%	2020	18,400	18,500
	DD	8.63%	2022	–	19,100
	EE	7.90%	2023	19,100	19,200
	FF	6.95%	2023	19,100	19,200
	GG	6.98%	2023	19,100	19,200
				84,700	120,865
Senior Notes:	A	7.28%	2025	20,000	20,000
	B	6.77%	2028	20,000	20,000
	C	8.15%	2030	20,000	20,000
	D	7.13%	2031	20,000	20,000
	E	7.11%	2032	20,000	–
	F	5.90%	2017	20,000	–
	G	5.29%	2022	20,000	–
	H	5.29%	2022	20,000	–
				160,000	80,000
California Department of Water Resources loans		3.0% to 7.4%	2003-33	2,797	2,886
Other long-term debt				3,868	4,230
Total long-term debt				251,365	207,981
Less current maturities				1,000	5,381
Long-term debt excluding current maturities				$250,365	$202,600

The first mortgage bonds and unsecured senior notes are obligations of Cal Water. All bonds are held by institutional investors and secured by substantially all of Cal Water's utility plant. The senior notes are held by institutional investors and require interest-only payments until maturity, except series G and H which have an annual sinking fund requirement of $1.8 million starting in 2012. The Department of Water Resources (DWR) loans were financed under the California Safe Drinking Water Bond Act. Repayment of principal and interest on the DWR loans is through a surcharge on customer bills. Other long-term debt is primarily equipment and system acquisition financing arrangements with financial institutions. Compensating balances of $227,000 as of December 31, 2002, are required by these institutions. Aggregate maturities and sinking fund requirements for each of the succeeding five years (2003 through 2007) are $1,000,000, $932,000, $909,000, $928,000 and $918,000.

10

OTHER ACCRUED LIABILITIES

As of December 31, 2001 and 2002, other accrued liabilities were:

In thousands	*2002*	*2001*
Accrued pension and postretirement benefits	$ 9,635	$ 9,777
Accrued and deferred compensation	6,041	4,926
Accrued insurance	2,914	1,317
Other	5,251	5,208
	$23,841	$21,228

11

INCOME TAXES

Income tax expense consists of the following:

In thousands		*Federal*	*State*	*Total*
2002	Current	$8,797	$2,406	$11,203
	Deferred	1,039	326	1,365
	Total	$9,836	$2,732	$12,568
2001	Current	$6,472	$2,136	$ 8,608
	Deferred	1,456	(336)	1,120
	Total	$7,928	$1,800	$ 9,728
2000	Current	$7,961	$2,519	$10,480
	Deferred	1,554	(463)	1,091
	Total	$9,515	$2,056	$11,571

Income tax expense computed by applying the current federal 35% tax rate to pretax book income differs from the amount shown in the Consolidated Statement of Income. The difference is reconciled in the table below:

In thousands	*2002*	*2001*	*2000*
Computed "expected" tax expense	$11,074	$8,643	$11,037
Increase (reduction) in taxes due to:			
State income taxes net of federal tax benefit	1,818	1,170	1,336
Investment tax credits	(191)	(156)	(155)
Other	(133)	71	(647)
Total income tax	$12,568	$9,728	$11,571

The components of deferred income tax expense were:

In thousands	*2002*	*2001*	*2000*
Depreciation	$2,405	$2,337	$2,031
Developer advances and contributions	(789)	(783)	(814)
Bond redemption premiums	806	(42)	(61)
Investment tax credits	(95)	(94)	(61)
Other	(962)	(298)	(4)
Total deferred income tax expense	$1,365	$1,120	$1,091

The tax effects of differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2002 and 2001 are presented in the following table:

In thousands	*2002*	*2001*
Deferred tax assets:		
Developer deposits for extension agreements and contributions in aid of construction	$37,923	$41,531
Federal benefit of state tax deductions	6,325	5,744
Book plant cost reduction for future deferred ITC amortization	1,639	1,703
Insurance loss provisions	876	537
Pension plan	1,136	938
Other	4,703	868
Total deferred tax assets	52,602	51,321
Deferred tax liabilities:		
Utility plant, principally due to depreciation differences	82,130	79,348
Premium on early retirement of bonds	1,843	789
Total deferred tax liabilities	83,973	80,137
Net deferred tax liabilities	$31,371	$28,816

A valuation allowance was not required at December 31, 2002 and 2001. Based on historical taxable income and future taxable income projections over the period in which the deferred assets are deductible, management believes it is more likely than not that the Company will realize the benefits of the deductible differences.

12

EMPLOYEE BENEFIT PLANS

Pension Plan The Company provides a qualified defined benefit, non-contributory pension plan for substantially all employees. The cost of the plan was charged to expense and utility plant. The Company makes annual contributions to fund the amounts accrued for pension cost. Plan assets are invested in mutual funds, pooled equity, bonds and short-term investment accounts. The data in the tables below includes the unfunded, non-qualified, supplemental executive retirement plan. In addition, the tables reflect a plan amendment effective January 1, 2003, that increased the annual minimum benefit, which is recognized over the working life of the employees.

Benefits earned by Dominguez employees under the Dominguez pension plan were frozen as of the merger date and future pension benefits to those employees will be provided under the Company pension plan. The Dominguez plan was curtailed. The Dominguez plan was fully funded and additional contributions to the plan could not be funded, although plan annual expense was recorded. As a result of the curtailment, accrued pension liability of $1,218,000 that had been expensed by Dominguez in prior years was reversed by the Company in 2000. The amount was offset against other operations expense.

Savings Plan The Company sponsors a 401(k) qualified, defined contribution savings plan that allowed participants to contribute up to 18% of pre-tax compensation. The Company matches fifty cents for each dollar contributed by the employee up to a maximum Company match of 4.0%. Company contributions were $1,422,000, $1,425,000, and $1,298,000, for the years 2002, 2001 and 2000, respectively.

Other Postretirement Plans The Company provides substantially all active, permanent employees with medical, dental and vision benefits through a self-insured plan. Employees retiring at or after age 58 with 10 or more years of service are offered, along with their spouses and dependents, continued participation in the plan by payment of a premium. Plan assets are invested in mutual funds, short-term money market instruments and commercial paper. Retired employees are also provided with a $5,000 life insurance benefit.

The Company records the costs of postretirement benefits during the employees' years of active service. The Commissions have issued decisions that authorize rate recovery of tax deductible funding of postretirement benefits and permit recording of a regulatory asset for the portion of costs that will be recoverable in future rates.

The following table reconciles the funded status of the plans with the accrued pension liability and the net postretirement benefit liability as of December 31, 2002 and 2001:

	Pension Benefits		*Other Benefits*	
In thousands	*2002*	*2001*	*2002*	*2001*
Change in benefit obligation:				
Beginning of year	$ 60,359	$59,098	$ 14,708	$ 12,052
Service cost	2,968	2,786	815	625
Interest cost	4,404	4,333	1,037	858
Assumption change	30	1,326	699	1,943
Plan amendment	15,424	11	40	–
Experience loss	660	2,289	845	15
Benefits paid	(4,276)	(9,484)	(641)	(785)
End of year	$ 79,569	$60,359	$ 17,503	$ 14,708
Change in plan assets:				
Fair value of plan assets at beginning of year	$ 57,340	$63,648	$ 2,300	$ 2,067
Actual return on plan assets	(2,377)	1,356	(79)	237
Employer contributions	5,616	1,820	885	781
Retiree contributions	–	–	470	415
Benefits paid	(4,276)	(9,484)	(1,111)	(1,200)
Fair value of plan assets at end of year	$ 56,303	$57,340	$ 2,465	$ 2,300
Funded status	$(23,266)	$ (3,019)	$(15,038)	$(12,408)
Unrecognized actuarial (gain) or loss	1,281	(6,191)	5,025	3,339
Unrecognized prior service cost	18,875	4,525	786	817
Unrecognized transition obligation	–	–	3,045	3,321
Unrecognized net initial asset	–	–	(276)	(276)
Net amount recognized	$ (3,110)	$ (4,685)	$ (6,458)	$ (5,207)

Amounts recognized on the balance sheet consist of:

	Pension Benefits		*Other Benefits*	
In thousands	*2002*	*2001*	*2002*	*2001*
Accrued benefit costs	$(3,110)	$(4,685)	$(6,458)	$(5,207)
Additional minimum liability	(4,784)	(1,396)	–	–
Intangible asset	4,650	580	–	–
Accumulated other comprehensive loss	134	816	–	–
Net amount recognized	$(3,110)	$(4,685)	$(6,458)	$(5,207)

	Pension Benefits		*Other Benefits*	
	2002	*2001*	*2002*	*2001*
Weighted average assumptions as of December 31:				
Discount rate	6.70%	7.00%	6.70%	7.00%
Long-term rate of return on plan assets	8.00%	8.00%	8.00%	8.00%
Rate of compensation increases	1.00 to 4.25%	4.25%	–	–

Net periodic benefit costs for the pension and other postretirement plans for the years ending December 31, 2002, 2001 and 2000 included the following components:

	Pension Plan			Other Benefits		
In thousands	2002	2001	2000	2002	2001	2000
Service cost	$ 2,968	$ 2,786	$ 2,846	$ 815	$ 625	$ 544
Interest cost	4,404	4,333	4,079	1,037	858	790
Expected return on plan assets	(4,497)	(4,946)	(4,498)	(216)	(212)	(152)
Net amortization and deferral	1,166	855	486	500	363	357
Net periodic benefit cost	$ 4,041	$ 3,028	$ 2,913	$2,136	$1,634	$1,539

Postretirement benefit expense recorded in 2002, 2001, and 2000 was $1,157,000, $885,000, and $781,000, respectively. $5,165,000, which is recoverable through future customer rates, is recorded as a regulatory asset. The Company intends to make annual contributions to the plan up to the amount deductible for tax purposes.

For 2002 measurement purposes, the Company assumed a 7% annual rate of increase in the per capita cost of covered benefits with the rate decreasing 1% per year to a long-term annual rate of 5% per year after two years. The health care cost trend rate assumption has a significant effect on the amounts reported. A one-percentage point change in assumed health care cost trends is estimated to have the following effect:

In thousands	1-percentage Point Increase	1-percentage Point Decrease
Effect on total service and interest costs	$ 354	$ (279)
Effect on accumulated postretirement benefit obligation	$2,742	$(2,216)

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STOCK-BASED COMPENSATION PLANS

The Company has a stockholder-approved Long-Term Incentive Plan that allows granting of nonqualified stock options, performance shares and dividend units. Under the plan, a total of 1,500,000 common shares are authorized for option grants. Options are granted at an exercise price that is not less than the per share common stock market price on the date of grant. The options vest at a 25% rate on their anniversary date over their first four years and are exercisable over a ten-year period. At December 31, 2002, 36,750 options were exercisable at a weighted average price of $24.08.

Certain key Dominguez executives participated in the Dominguez 1997 Stock Incentive Plan that was terminated at the time Dominguez merged with the Company. The plan provided that in the event of a merger of Dominguez into another entity, granted but unexercised stock options issued became exercisable. Prior to the Merger, all outstanding Dominguez options were exercised and converted into Dominguez shares, and subsequently converted to 52,357 shares of Company common stock.

The fair value of stock options used to compute pro forma net income and earnings per share disclosures is the estimated fair value at grant date using the Black-Scholes option-pricing model with the following assumptions:

	2002	2001	2000
Expected dividend	4.5%	4.3%	4.3%
Expected volatility	27.7%	30.4%	22.0%
Risk-free interest rate	3.25%	4.6%	4.9%
Expected holding period in years	5.0	5.0	5.0

The following table summarizes the activity for the stock option plans:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Options Exercisable	Weighted Average Fair Value
Outstanding at December 31, 1999	52,357	$23.45	–	19,092	–
Granted	53,500	23.06			$3.74
Exercised	(52,357)	23.45			
Outstanding at December 31, 2000	53,500	23.06	9.5	–	–
Granted	58,000	25.94			5.65
Cancelled	(12,000)	24.50			
Outstanding at December 31, 2001	99,500	24.57	8.8	11,875	–
Granted	55,000	25.15			4.41
Outstanding at December 31, 2002	154,500	24.77	8.2	36,750	–

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FAIR VALUE OF FINANCIAL INSTRUMENTS

For those financial instruments for which it is practicable to estimate a fair value, the following methods and assumptions were used. For cash equivalents, the carrying amount approximates fair value because of the short-term maturity of the instruments. The fair value of the Company's long-term debt is estimated at $306,140,000 as of December 31, 2002, and $214,046,000 as of December 31, 2001, using a discounted cash flow analysis, based on the current rates available to the Company for debt of similar maturities. The fair value of advances for construction contracts is estimated at $34,000,000 as of December 31, 2002 and $32,000,000 as of December 31, 2001, based on data provided by brokers.

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COMMITMENTS AND CONTINGENCIES

Commitments The Company leases office facilities in many of its operating districts. The total paid and charged to operations for such leases was $800,000 in 2002, $720,000 in 2001 and $760,000 in 2000. Payments under the lease commitments over the succeeding five years 2003 through 2007 are estimated to be $833,000, $893,000, $941,000, $943,000 and $891,000. Over the 20-year period through 2023, payments under lease commitments, assuming renewal of existing or replacement leases, is estimated to be $21,000,000.

The Company has long-term contracts with two wholesale water suppliers that require the Company to purchase minimum annual water quantities. Purchases are priced at the suppliers' then current wholesale water rate. The Company operates to purchase sufficient water to equal or exceed the minimum quantities under both contracts. The total paid under the contracts was $6,816,000 in 2002, $6,208,000 in 2001 and $5,400,000 in 2000. The estimated payments under the contracts for the five years 2003 through 2007 are $8,000,000, $8,300,000, $8,600,000, $9,000,000 and $9,300,000.

The water supply contract with Stockton East Water District (SEWD) requires a fixed, annual payment and does not vary during the year with the quantity of water delivered by the district. Because of the fixed price arrangement, the Company operates to receive as much water as possible from SEWD in order to minimize the cost of operating Company-owned wells used to supplement SEWD deliveries. The total paid under the contract was $2,967,000 in 2002, $3,496,000 in 2001 and $3,269,000 in 2000. Pricing under the contract varies annually. For 2003, the estimated payment is $3,779,000.

During 2001 and 2002, the Company committed up to $7.6 million of the its bank line of credit to a contractor for construction of a customer and operation center. The tax-free exchange of seven surplus Company properties to the contractor for the new customer and operations center was completed on September 30, 2002. Because the transaction was structured as a property exchange, acquiring the new facility did not require a significant expenditure of cash. Under terms of the exchange agreement, during the construction period the Company had guaranteed the contractor's bank loan. The new facility, which is valued at over $7 million, served as security to the Company for the guarantee. When the property exchange was completed, the contractor paid off the bank loan, and the Company was released from its guarantee.

In 2002, the Company agreed to acquire the Kaanapali Water Corporation for $7,700,000 in cash. The acquisition is subject to approval of the Hawaii Public Utilities Commission, which is expected in mid-2003. Also in 2002, the New Mexico Water signed an agreement to purchase National Utilities Corporation for approximately $700,000 in cash. The purchase of National Utilities is subject to the approval of the New Mexico Public Regulation Commission, which is expected in the third quarter of 2003.

Contingencies In 1995, the State of California's Department of Toxic Substances Control (DTSC) named the Company as a potential responsible party for cleanup of a toxic contamination plume in the Chico groundwater. The toxic spill occurred when cleaning solvents, which were discharged into the city's sewer system by local dry cleaners, leaked into the underground water supply due to breaks in the city's sewer pipes. The DTSC contends that the Company's responsibility stems from its operation of wells in the surrounding vicinity that caused the contamination plume to spread. While the Company intends to cooperate with the cleanup effort, it denies any responsibility for the contamination or the resulting cleanup and intends to vigorously resist any action that may be brought against it. The Company has negotiated with DTSC regarding dismissal of the Company from the claim in exchange for the Company's cooperation in the cleanup effort. However, no agreement was reached with DTSC regarding dismissal of the Company from the DTSC action. In December 2002, the Company was named along with eight other defendants in a lawsuit filed by DTSC for the cleanup of the plume. The suit asserts that the defendants are jointly and severally liable for the estimated cleanup of $8.7 million. The Company believes that it has insurance coverage for this claim and that if it were ultimately held responsible for a portion of the cleanup costs, there would not be a material adverse effect on the Company's financial position or results of operations.

In July 2002, the Company was served with a lawsuit in state court naming it as one of several defendants for damages alleged to have resulted from waste oil contamination in the Company's drinking water. The suit did not specify a dollar amount. The Company does not believe that the complaint alleges any facts under which it may be held liable. The Company has filed a motion to dismiss the suit on various grounds. The Court has not ruled on the Company's motion. If necessary, the Company intends to vigorously defend the suit. In 2000, the plaintiff in this action brought a suit against the Company in federal court with similar allegations concerning drinking water contamination. That suit was dismissed; however, the Court did not bar the plaintiff from filing an amended complaint. The Company's insurance carrier is paying for legal defense costs and the Company believes that its insurance policy will cover all costs related to this matter.

In December 2001, the Company and several other defendants were served with a lawsuit by the estate and immediate family members of a deceased employee of a pipeline construction contractor. The contractor's employee had worked on various Company projects over a number of years. The plaintiffs allege that the Company and other defendants are responsible for an asbestos-related disease that is claimed to have caused the death of the contractor's employee. The complaint seeks damages in excess of $50,000, in addition to unspecified punitive damages. The Company denies responsibility in the case and intends to vigorously defend itself. Pursuant to an indemnity provision in the contracts between the contractor and the Company, the contractor has accepted liability for the claim against the Company and is reimbursing the Company for its defense costs.

The Company and City of Stockton (City) purchase water from Stockton East Water District (SEWD). The City has discussed with SEWD its belief that SEWD's meter, which recorded water deliveries to the City's system, malfunctioned for some period of time, and as a result the City overpaid for water

deliveries from SEWD. The City has told SEWD that it believes it was overcharged between $800,000 and $2,300,000. If the City's assertion is correct, it could mean that the Company was undercharged. The Company cannot determine whether SEWD agrees with the City's assertion or whether and in what amount SEWD will make a refund to the City. If SEWD were to make a refund to the City, it could have a future operating fund shortfall, which might result in higher future purchased water costs for the Company's Stockton district. However, the Company believes that if purchased water costs increased, the increase would be recovered in customers' future billings.

The Company is involved in other proceedings or litigation arising in the ordinary course of operations. The Company believes the ultimate resolution of such matters will not materially affect its financial position, results of operations or cash flows.

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Subsequent Events

Negotiations to renew separate bank credit agreements for the Company and Cal Water that were scheduled to expire on April 30, 2003, have been completed. The new agreements, which replace a combined $60 million credit line, became effective on February 28, 2003, and expire on April 30, 2005. Under the new agreements the Company will have available a total of $65 million. Of the total, $55 million is designated for Cal Water and $10 million for the Company including funding of its subsidiaries' operations. Cal Water's $55 million portion can be used solely for purposes of the regulated California utility. On July 1, 2003, the credit facility available to Cal Water will be reduced to $45 million. The reduction will lower the commitment fee paid by Cal Water on the unused portion of the credit line. Like the prior agreements, the new agreements also have a 30-day out-of-debt requirement that must be met by December 31, 2003.

On February 28, 2003, the Company issued two series of senior notes to institutional investors, each for $10 million. The 5.48% Series L notes mature in February 2018. The 4.58% Series K notes mature in December 2010. Proceeds from the notes were used to repay outstanding short-term bank borrowings.

In February 2003, the Commission staff recommended that the Company be fined up to $9,600,000 and refund $470,000 in revenue for failing to report two acquisitions as required by the Commission. One acquisition was completed prior to adoption of the reporting requirement by the Commission; the other was inadvertently not reported. The Company acquired the two water systems, which serve 283 customers, for approximately $140,000. The Company is preparing its response to the staff report. The Company does not believe that the staff's recommendation will be upheld when this matter is considered by the Commission; accordingly, no liability has been accrued.

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QUARTERLY FINANCIAL DATA (UNAUDITED)

The Company's common stock is traded on the New York Stock Exchange under the symbol "CWT." Through 2002, quarterly dividends have been paid on common stock for 232 consecutive quarters and the quarterly rate has been increased each year since 1968.

2002 – in thousands except per share amounts	*First*	*Second*	*Third*	*Fourth*
Operating revenue	$51,611	$69,183	$81,440	$60,917
Net operating income	5,281	8,300	11,515	5,201
Net income	1,928	6,619	7,675	2,852
Diluted earnings per share	0.12	0.43	0.50	0.19
Common stock market price range:				
High	26.25	26.69	26.45	25.95
Low	23.20	23.40	21.60	23.65
Dividends paid	.2800	.2800	.2800	.2800

2001 – in thousands except per share amounts				
Operating revenue	$47,008	$66,958	$76,310	$56,544
Net operating income	3,792	8,050	9,517	3,792
Net income	221	5,764	5,920	3,060
Diluted earnings per share	0.01	0.37	0.39	0.20
Common stock market price range:				
High	28.60	27.70	27.00	27.50
Low	23.38	24.10	23.77	24.00
Dividends paid	.27875	.27875	.27875	.27875

Independent Auditors' Report

THE BOARD OF DIRECTORS
CALIFORNIA WATER SERVICE GROUP:

We have audited the accompanying consolidated balance sheet of California Water Service Group and subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of income, common stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of California Water Service Group and subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

Mountain View, California
January 29, 2003, except as to Note 16, which is as of February 28,2003

Corporate Information

STOCK TRANSFER, DIVIDEND DISBURSING AND REINVESTMENT AGENT

Fleet National Bank
c/o EquiServe L.P.
P.O. Box 43010
Providence, RI 02940-3010
(800) 736-3001

TO TRANSFER STOCK

A change of ownership of shares (such as when stock is sold or gifted or when owners are deleted from or added to stock certificates) requires a transfer of stock. To transfer stock, the owner must complete the assignment on the back of the certificate and sign it exactly as his or her name appears on the front. This signature must be guaranteed by an eligible guarantor institution (banks, stock brokers, savings and loan associations and credit unions with membership in approved signature medallion programs) pursuant to SEC Rule 17Ad-15. A notary's acknowledgement is not acceptable. This certificate should then be sent to EquiServe, L. P. Stockholder Services, by registered or certified mail with complete transfer instructions.

BOND REGISTRAR

US Bank Trust, N.A.
One California Street
San Francisco, CA 94111-5402
(415) 273-4580

EXECUTIVE OFFICE

California Water Service Group
1720 North First Street
San Jose, CA 95112-4598
(408) 367-8200

ANNUAL MEETING

The Annual Meeting of Stockholders will be held on Wednesday, April 23, 2003, at 10 a.m. at the Company's Executive Office, located at 1720 North First Street in San Jose, California. Details of the business to be transacted during the meeting will be contained in the proxy material, which will be mailed to stockholders on or about March 26, 2003.

DIVIDEND DATES FOR 2003

Quarter	*Declaration*	*Record Date*	*Payment Date*
First	January 29	February 7	February 21
Second	April 23	May 2	May 16
Third	July 23	August 1	August 15
Fourth	October 22	October 31	November 14

ANNUAL REPORT FOR 2002 ON FORM 10-K

A copy of the Company's report for 2002 filed with the Securities and Exchange Commission (SEC) on Form 10-K will be available in April 2003 and can be obtained by any stockholder at no charge upon written request to the address below. The Company's filings with the SEC can viewed via the link to the SEC's EDGAR system on the Company's web site.

STOCKHOLDER INFORMATION

California Water Service Group
Attn: Stockholder Relations
1720 North First Street
San Jose, CA 95112-4598
(408) 367-8200 or (800) 750-8200
http://www.calwater.com

Officers

CALIFORNIA WATER SERVICE COMPANY

Robert W. Foy [1,2,3] *Chairman of the Board*

Peter C. Nelson [1,2,3] *President and Chief Executive Officer*

Paul G. Ekstrom [4] *Vice President, Customer Service, and Corporate Secretary*

Richard D. Nye [1,2,3] *Vice President, Chief Financial Officer and Treasurer*

Francis S. Ferraro [2,5] *Vice President, Regulatory Matters and Corporate Development*

Robert R. Guzzetta [2] *Vice President, Engineering and Water Quality*

Christine L. McFarlane *Vice President, Human Resources*

Raymond H. Taylor *Vice President, Operations*

Dan L. Stockton *Vice President, Chief Information Officer*

Calvin L. Breed [1] *Controller, Assistant Secretary and Assistant Treasurer*

WASHINGTON WATER SERVICE COMPANY

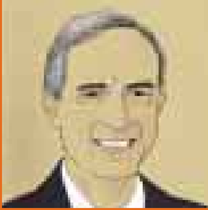
Michael P. Ireland *President*

NEW MEXICO WATER SERVICE COMPANY

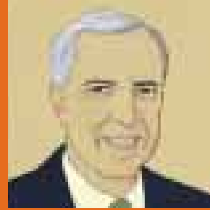
Robert J. Davey *President*

1 Holds the same position with California Water Service Group
2 Also an officer of CWS Utility Services
3 Also an officer of Washington Water Service Company and New Mexico Water Service Company
4 Also Corporate Secretary of California Water Service Group, CWS Utility Services, Washington Water Service Company and New Mexico Water Service Company
5 Holds the same position with New Mexico Water Service Company

Board of Directors



Peter C. Nelson*
President and Chief Executive Officer



Robert W. Foy*
Chairman of the Board

C. H. Stump
Director Emeritus
Former Chairman of the Board and former CEO of California Water Service Company

George A. Vera†
Vice President and Chief Financial Officer, the David & Lucile Packard Foundation

Langdon W. Owen†
President, Don Owen & Associates; Member of the Board of Directors, Metropolitan Water District of Southern California

Richard P. Magnuson†‡§
Private Venture Capital Investor

Edward D. Harris, Jr., M.D.‡*§
Professor of Medicine, Emeritus, Stanford University Medical Center

Douglas M. Brown†‡§
President and Chief Executive Officer of Tuition Plan Consortium

Linda R. Meier†‡§
Member, National Advisory Board, Haas Public Service Center; Member of the Board of Directors, Greater Bay Bancorp; Chair of the Western Regional Advisory Board of International Education; Member of the National Board of the Institute of International Education; and Member of the Board of Directors, Stanford Alumni Association

† Member of the Audit Committee
‡ Member of the Compensation Committee
* Member of the Executive Committee
§ Member of the Nominating/Corporate Governance Committee

DESIGN: Douglas Joseph Partners, Los Angeles

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