

*California Water
Service Group
Annual Report
2005*

*Life's Key
Ingredient*



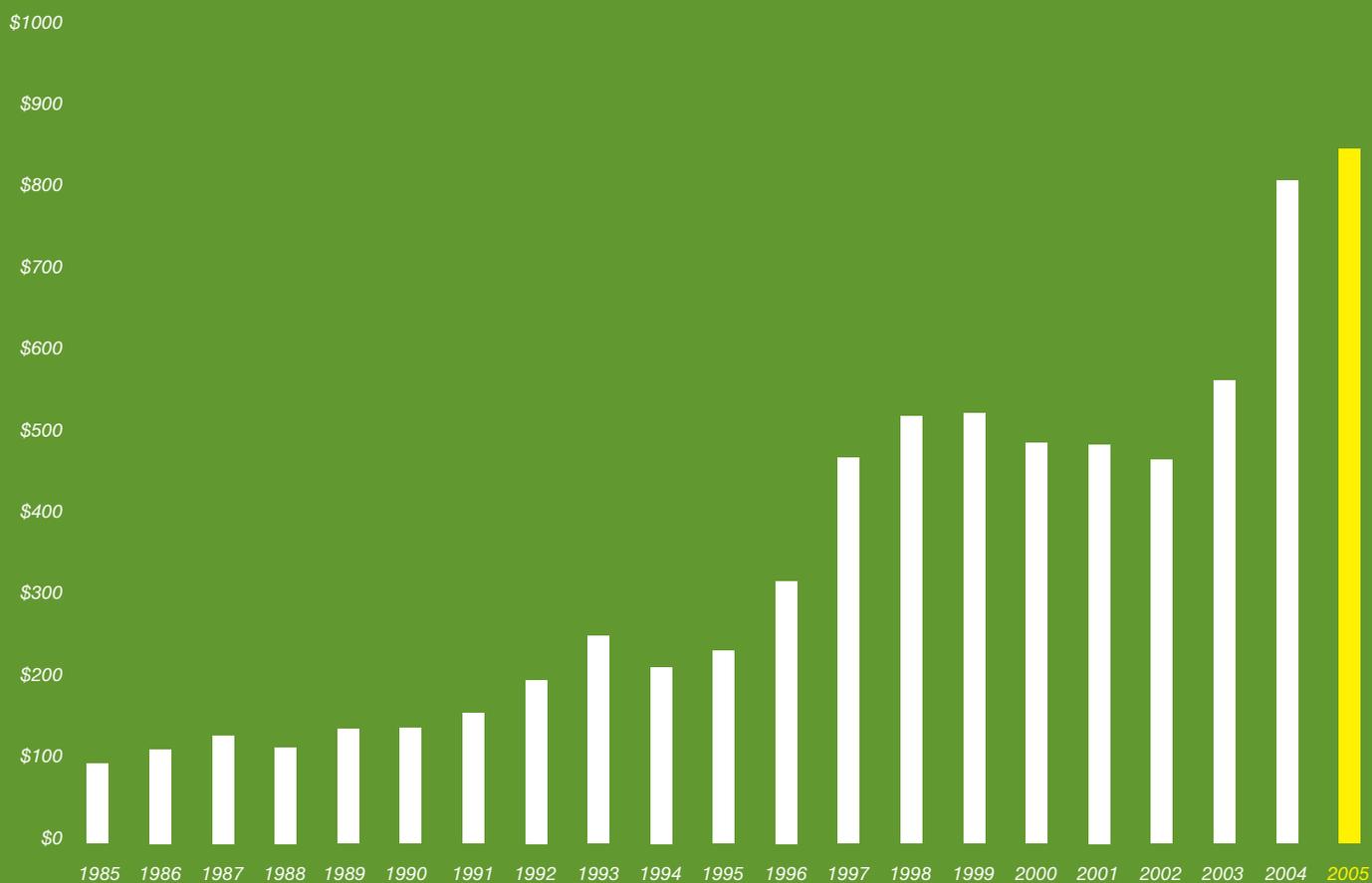
1 cup
flour

*Annette White with granddaughters,
Kelly, Sydney, and Mandy.
Employee since 1970*

Financial Highlights

CWT 20-Year Total Return on Investment

(On Stock Purchased December 31, 1985, with Dividends Reinvested)



Selected Financial Highlights

In thousands, except common share data

<i>Year ended December 31</i>	2005	2004	2003	2002	2001
<i>Market price at year-end</i>	\$ 38.23	\$ 37.65	\$ 27.40	\$ 23.65	\$ 25.75
<i>Book value</i>	15.98	15.66	14.44	13.12	12.95
<i>Earnings per share (diluted)</i>	1.47	1.46	1.21	1.25	0.97
<i>Dividends per share</i>	1.140	1.130	1.125	1.120	1.115
<i>Revenue</i>	320,728	315,567	277,128	263,151	246,820
<i>Net income</i>	27,223	26,026	19,417	19,073	14,965

Industry and Company Overview

Like their municipal and privately owned counterparts, investor-owned water utilities deliver water to homes and businesses through systems of wells, pumps, reservoirs, treatment plants, and pipelines. Investor-owned water utilities typically appeal to conservative investors because their rates are regulated, their earnings drivers are straightforward, their dividends are steady, and their product is both essential and irreplaceable.

California Water Service Group (NYSE: CWT) is the second largest investor-owned water utility in the United States, providing high-quality water utility services to more than 2 million people in 100 communities through five subsidiaries: California Water Service Company (Cal Water), Hawaii Water Service Company, Inc. (Hawaii Water), New Mexico Water Service Company (New Mexico Water), Washington Water Service Company (Washington Water), and CWS Utility Services (Utility Services). Cal Water, Hawaii Water, New Mexico Water, and Washington Water provide regulated water utility services, while Utility Services conducts the Company's non-regulated business, which includes providing billing, water quality testing, and water system operations and management services to cities and other companies.



*Ramesh Dhullipaua with wife, Vijaya,
and daughters, Lasya and Bhavya.
Employee since 2003*

*1/2 teaspoon
green chili sauce*



*1 teaspoon
oregano*

*Kim Mygatt with her husband, Phil,
and Maggie, a terrier mix.
Employee since 1982*

*We drink it, we use it to
grow our food, and we
cook with it. Water—it's
life's key ingredient.*



*2 teaspoons
sugar*

*Yvonne Kingman
Employee since 2004*



*Colette Mathewson with her daughter, Crystal, and her soon-to-be-born granddaughter, Natalie.
Employee since 1977*

*4 teaspoons
salt*

By adding their own unique ingredients, our employees turn the water we provide into something even more special.

Following are some of their most delicious recipes...

Strawberry-Mango Smoothie



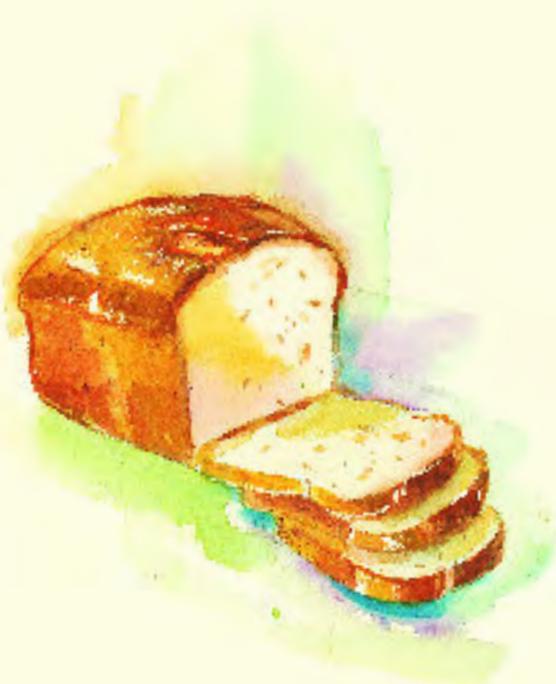
*Submitted by Yvonne Kingman
Employee since 2004*

Beans and Kapusta (Cabbage) Soup



*Submitted by Annette White
Employee since 1970*

Portuguese Sweet Bread



*Submitted by Colette Mathewson
Employee since 1977*

Sweet Corn Vegetable Soup



*Submitted by Ramesh Dhullipaua
Employee since 2003*

Beans and Kapusta (Cabbage) Soup

Makes 8 to 10 servings

4 c. pink beans
4 c. water
1 ham hock
1 lb. can sauerkraut with juice
1/3 c. vegetable oil
8 stalks celery, including leaves (optional)
1 large onion, diced
1 c. flour
Water as needed
Salt to taste

Rinse beans thoroughly. Soak overnight in the water. If all of the water is absorbed, add 4 more cups in the morning. Boil until beans are tender. Add sauerkraut with juice. In a frying pan, brown the oil, celery, and onion until tender. Add to the soup. In a separate bowl, mix flour with enough water to make it liquidy. Add to the soup mixture and boil slowly until slightly thickened. You may need to add more of the flour and water mixture to thicken to your liking. Add salt to taste.

Cook's note: This recipe was made by my mom's Austrian/Russian family as a staple when times were tough. But it is delicious, and can easily be frozen.

Sweet Corn Vegetable Soup

Makes 4 servings

1 c. tender corn kernels or 1 c. cream-style canned corn
1 carrot, finely chopped
1 T. cabbage, chopped
1 spring onion, finely chopped
1/2 t. sugar
1/2 t. green chili sauce
1/2 t. soya sauce
1 T. corn flour
4 c. water

If you are using fresh corn, pressure cook until tender. Place the corn in a deep pan. Meanwhile, mix the corn flour in 1/2 cup water. Add water, salt, sugar, vegetables, and chili sauce to the corn. Mix well and heat to boiling. Once boiling, add corn flour paste and stir continuously. Keep stirring until the soup is thick and clear. Stir in the soya sauce and remove from heat. Serve steaming hot with garlic rolls and more chili sauce or chillies in vinegar.

Cook's note: If you use canned corn, this Asian recipe takes only 15 minutes to cook. It's great for teatime, lunch, dinner, or parties.

Strawberry-Mango Smoothie

Makes 2 servings

4 strawberries, stemmed
1/2 mango, peeled
1/4 c. plain or vanilla yogurt
3 T. water
2 t. sugar
Ice cubes as needed

Place strawberries, mango, yogurt, water, and sugar in blender and puree until smooth. Add ice until desired consistency is reached. Garnish with additional strawberries if desired.

Cook's note: I love to play tennis, and my husband is the director of a tennis club, so needless to say, we spend a lot of time running around on the court. After a good game, we enjoy these refreshing and healthy smoothies!

Portuguese Sweet Bread

Makes "lots!" of servings

3 pkg. yeast
3 T. sugar
3/4 c. warm water
6 eggs
3 c. warm water
2 sticks butter
4 t. salt
3/4 c. powdered milk
2 c. sugar
1/4 t. yellow food coloring
Almost 5 lbs. flour

Mix first three ingredients and put on pilot to rise. Mix remaining ingredients except flour and add to risen yeast mixture. Add flour and knead until bubbles are visible. Put on pilot light to rise, then make into buns and let rise again. Bake 10 to 15 minutes at 325 degrees.

Cook's note: This recipe has been a favorite part of every family gathering for as long as I can remember. My mom still makes it best, but she has passed the tradition on to me and my daughter, Crystal. Crystal is expecting a little girl, and we plan to pass it on to her, too!

Strawberry Nut Salad



*Submitted by Joan Angel
Employee since 1998*

Albondigas (Meatball Soup)



*Submitted by Kim Mygatt
Employee since 1982*

Agua de Fresa



*Submitted by Susana Marin
Employee since 2005*

Rice Pudding



*Submitted by Roxanne Brown
Employee since 2004*

Albondigas (Meatball Soup)

Makes 6 to 8 servings

1 lb. ground round or turkey
1 pkg. meatloaf seasoning mix (Lawry's is cook's favorite)
1 t. oregano
1 14-oz. can stewed tomatoes
1/2 c. celery, diced
1 c. rice, uncooked

Mix ground round or turkey, meatloaf seasoning mix, and oregano. Form meatballs. Place in a 6-quart pan and cover with water. Cover and cook until meatballs turn brown. Add tomatoes, celery, and rice, along with enough water to fill the pan two-thirds. Turn up the heat and cover. Cook until rice is tender, approximately 1 1/2 hours, adding water as necessary and stirring regularly. Add salt and pepper to taste.

Strawberry Nut Salad

Makes 10 to 12 servings

1 6-oz. package strawberry gelatin
1 c. boiling water
2 10-oz. packages frozen sliced strawberries, partially thawed
20 oz. crushed pineapple, drained
1 c. coarsely chopped walnuts
3 medium bananas, mashed (1 c.)
1 pt. sour cream

Dissolve gelatin in boiling water. Add strawberries, pineapple, walnuts, and bananas. Put half of strawberry mixture into 9 X 13-inch pan. Refrigerate until firm, about 45 minutes. Spread sour cream on firm strawberry mixture in pan. Gently spoon on rest of strawberry mixture. Cover and allow to set several hours or overnight. To serve, cut into squares.

Cook's note: This recipe comes from my favorite cookbook. It was assembled by a New York Chapter of the Junior League and was given to me by my mom, who is a great cook and caterer.

Rice Pudding

Makes 6 to 8 servings

1 qt. water
1 qt. milk
1 c. rice
1 c. sugar
1 t. vanilla
Cinnamon to taste

Put all ingredients in a large pan and bring to a low boil. Stir well and turn down to a low simmer. Cook uncovered for about one hour or until rice is done, stirring frequently. Add more water, if needed, to continue cooking rice. Pour into large bowl or individual dessert dishes and sprinkle with cinnamon.

Cook's note: This recipe was handed down from my dad, who was a cook in the Army. Of course, the quantities he used were much larger!

Agua de Fresa

Makes 1 pitcher

2 baskets of fresh strawberries, cleaned and stemmed
8 c. water
1 c. sugar

Place strawberries in blender with 4 cups water and blend until pureed. Pour mixture through a fine sifter to remove pulp. Pour into a pitcher and add the remaining water, or less or more, to your taste. Add sugar and stir. Serve over ice.

Homemade Mint Iced Tea



*Submitted by Jane Smith
Employee since 2001*

Avocado Cucumber Soup



*Submitted by Pat Briley
Employee since 1993*

Soupe Au Pistou



*Submitted by Mike Rossi
Employee since 1977*

Veggie Soup



*Submitted by Lisa Bryning
Employee since 2005*

Avocado Cucumber Soup

Makes 2 servings

1 cucumber, peeled and cut into chunks
2 avocados, peeled with seed discarded
1 t. cumin
1 t. curry
1 pinch red pepper flakes
Salt and pepper to taste
2 to 3 t. chicken bouillon powder
1 1/2 c. ice cubes
1/4 c. yellow onion, diced
3/4 c. heavy cream

Combine all ingredients in a blender and blend until desired consistency. Serve cold with a sprig of cilantro or hot with grated Romano cheese.

Cook's note: My wife, Barbara, and I used this soup to nurse our kids back to health when they had their tonsils out or had sore throats. It has stayed with us and has become a great appetizer for dinners or accompaniment to sandwiches for lunch.

Homemade Mint Iced Tea

Makes 1 gallon

Mint leaves to taste (cook uses several)
1 gallon water
4 tea bags
Sugar to taste (optional)
4 c. ice

Wash mint leaves thoroughly. Add mint leaves and tea bags to pan containing 1 gallon water. Bring to a boil, then simmer for 1/2 hour. Pour through a strainer and discard tea bags and mint leaves. Pour tea into pitcher and add sugar if desired. Add ice and refrigerate until cold.

Cook's note: Mint is good for the digestive system!

Veggie Soup

Makes 6 servings

6 c. water
3 chicken bouillon cubes
4 potatoes, diced
4 carrots, diced
1 28-oz. can stewed tomatoes
4 stalks celery, diced
Macaroni to taste
2 bay leaves
Salt, pepper, and basil to taste

Combine all ingredients and bring to a boil. Simmer for 3 hours. Remove bay leaves and serve.

Soupe Au Pistou

Makes 8 to 10 servings

2 qt. water	Sauce:
8 chicken bouillon cubes	4 cloves garlic, mashed
3 medium potatoes, peeled and cut into 1-inch pieces	1 6-oz. can tomato paste
1/2 lb. fresh green beans, cut up	1 T. dried basil
3 carrots, sliced	1/2 c. grated parmesan cheese
1 medium onion, chopped	1/2 c. chopped parsley
1 T. salt	1/8 c. olive oil
1/4 t. pepper	
1/2 lb. zucchini, sliced	
1 16-oz. can kidney or navy beans, drained	

Combine first 8 ingredients in a large kettle. Bring to a boil and simmer covered for 10 minutes. Add zucchini and beans and simmer another 10 minutes or until all vegetables are tender. Meanwhile, prepare sauce by mixing garlic, tomato paste, basil, parmesan cheese, and parsley. Using a wire whip, gradually beat in oil, one teaspoon at a time, until mixture resembles a thick sauce. Just before serving, put a teaspoon (or to taste) of sauce in a bowl, pour soup over, and stir.

Letter To Stockholders



*Robert W. Foy
Chairman of the Board*

*Peter C. Nelson
President and Chief Executive Officer*

Letter To Stockholders

Dear Fellow Stockholder:

Isn't it great to be part of a company that provides a product that is essential to life? Our bodies are 50-70% water, and we couldn't live without it. But it not only sustains us; it is also used to make many things that give us comfort and pleasure in life, from hot chicken noodle soup to ice-cold sun tea. We hope you will enjoy the family recipes provided here by our employees, all of which feature water, life's key ingredient.

Our Recipe for Success

While our employees have been cooking up good things at home, they have also been following the Company's recipe for success at work. It is a basic recipe, like most family favorites, calling for just the right combination of prudent fiscal management, excellent customer service, persistent regulatory affairs management, and strategic growth.

By following this time-tested recipe, we posted improved results for 2005. Our net income increased to \$27.2 million, up from the \$26.0 million posted in 2004, and our earnings per share rose to \$1.47, up from \$1.46 in the prior year. Revenue was up 2% to \$320.7 million, with rate increases adding \$12.2 million and sales to new customers adding \$3.8 million. And, in January 2006, our Board declared the Company's 61st consecutive annual dividend, increasing it for the 39th consecutive year to \$1.15 per share.

Too Much Rain Can Water Down the Recipe, So Adjust Accordingly

While rate increases and sales to new customers added to 2005 revenues, revenues from

sales to existing customers decreased by \$10.9 million, due largely to record-setting rains in California in the first half of the year. Success in the water industry boils down to a few things, and customer water usage is one of them. In our 2005 General Rate Case filings, we proposed an innovative rate adjustment mechanism that would allow us to promote conservation more aggressively. Based upon the Water Action Plan recently issued by the California Public Utilities Commission (CPUC), we have reason to believe that our proposal will be given serious consideration. If adopted, it will lessen the impact that water usage variations have on our financial results. Until then, however, we will strive to offset earnings fluctuations from conservation and weather by achieving positive results in the other areas that drive financial performance: fiscal management, regulatory treatment, and growth.

Know When to Invest in Your Appliances, and When to Tighten Your Apron Strings

At California Water Service Group, we cannot manage the weather, but we can manage our resources. For us, that means operating efficiently and investing wisely in our water systems.

In 2005, total operating expense increased just 3%, despite the fact that maintenance demands and resulting costs for repairing wells, water mains, and water treatment equipment were up 15%. We believe that we must be diligent in our maintenance programs in order to provide the reliable water service that our customers deserve and expect. While we cannot and do not cut corners on programs that are necessary for maintaining high levels of service and water quality, we are ever-mindful of the need

Letter To Stockholders

to operate efficiently and spend cautiously. We spent \$78 million on capital improvements in 2005, part of which was needed to meet the United States Environmental Protection Agency's new standard for arsenic that became effective in January of this year. We have budgeted \$85 million for capital improvements in 2006.

Use Only the Finest Ingredients and Serve with a Smile

Two major capital projects planned for 2006 are a new membrane treatment plant in Bakersfield, California, and renovation of an existing treatment plant in Lucerne, California. Both projects will use state-of-the-art technologies to enhance the quality of water we serve to our customers. Going forward, water quality will continue to be a top priority for us, as we strive to meet every state and federal water quality standard, every day, in every system.

But customers require more than safe, high-quality water; they also expect responsive customer service. So, when they told us that they wanted to interact with us online and pay their bills electronically, we responded with a new e-billing service that allows them to view and pay their bills on our web site. We will refine the program, which we introduced in September 2005, throughout the coming year. Also in 2006, we plan to provide our Customer Service Representatives with a new, comprehensive training program. And finally, we will expand our efforts to communicate with customers about the many things we do to ensure that when they turn on a faucet, they get what they expect. Helping customers understand the true value of water and the services we provide will be

important, particularly as we continue to pursue fair and reasonable water rates.

If Your Recipe Isn't Turning Out Right, Keep at It—Persistence Pays Off

Fair regulatory treatment is an important ingredient for success for all regulated water utilities. For the past few years in California, it was an ingredient that was in short supply. Fortunately, we are beginning to see signs of an improved regulatory climate. This improvement is partially due to changes at the CPUC, and partially due to the persistence of our industry and our own Regulatory Affairs team.

Through the California Water Association (CWA), the investor-owned water utility industry has stepped up efforts to advocate for fair regulatory decisions. In 2005, CWA opened an office directly across the street from the CPUC in San Francisco and hired a seasoned, well-qualified Executive Director to promote the industry's interests on a full-time basis.

Even more important, our own Regulatory Affairs team has continued to work diligently for rates that accurately reflect the costs of providing water service. As a result, the CPUC issued timely decisions on the eight General Rate Cases filed in 2004, and we expect the same for the eight General Rate Cases filed in 2005. In 2006, we will file for eight more districts, with decisions expected in mid-2007.

Our cautious optimism about the regulatory environment in California comes partly from the timeliness of the decisions being issued by the CPUC, and partly from the nature of those decisions. As we mentioned earlier, the CPUC has developed a Water Action Plan for California that is

viewed favorably by the water industry. In addition, in 2005, the CPUC ruled that we had indeed managed our surplus property sales program in accordance with the Water Utility Infrastructure Act of 1995, as we had maintained. We expect the CPUC to issue a final ruling on how such gains on surplus property sales should be treated on an industry-wide basis in the near future.

With regard to another type of regulation, and one that is faced by all publicly traded companies, we continued in 2005 to take the steps necessary to comply with the Sarbanes-Oxley Act. We are pleased with our performance in this area, and are confident that we will continue to meet both the letter and the spirit of the law.

It's More Fun to Cook for a Crowd, But You Can't Invite Everyone to Dinner

If persistence is the key when it comes to regulatory affairs, then discipline is the key when it comes to growth. We continue to pursue only those growth opportunities that make sense for our stockholders and our customers. On the regulated side of the business, we completed three acquisitions in 2005: a 350-connection system called Cypress Gardens in New Mexico; a 270-connection system serving areas of Portola Valley and unincorporated San Mateo County in California; and a 169-connection company called Gamble Bay Water, Inc., in Kitsap County, Washington.

On the non-regulated side of the business, we launched our Extended Service Protection (ESP) Program. For a monthly fee of \$4.95, customers can be protected if the water line between the meter and their home needs repair. The program

was introduced in three California districts in 2005, and more than 1,800 customers have already enrolled. We plan to offer it in our remaining California districts by the middle of 2006. We think ESP is an ideal way for us to leverage our expertise in the water business to provide a new, unregulated service to our regulated customers.

Also in 2005, we entered into an agreement to operate the water, wastewater, and recycled water systems of Tejon Ranch, the largest piece of private land in the state of California. Currently, the system serves 12 large customers, but the area is expected to be developed further in the next 25 years.

Finally, we realized \$2.2 million in gains from sales of properties no longer used or necessary for serving our customers. We predict that our surplus property sales program will continue to allow us to maximize the value of excess real estate in future years.

Looking forward, we will continue our disciplined approach, pursuing regulated growth in the western United States and seeking opportunities to increase non-regulated revenues through ESP, our surplus property sales program, lease of certain sites for cell phone antennas, and innovative arrangements to provide water quality testing, billing, and other services to third parties.

Professional Chefs Get the Best Results

With the retirement of Ray Taylor, Vice President of Operations, several Officers assumed new responsibilities: Dan L. Stockton was named Vice President, Corporate Development and Corporate Secretary; Robert R. Guzzetta was named Vice President, Operations; Francis S.

Letter To Stockholders

Ferraro was named Vice President, Regulatory Matters and Corporate Relations; and Paul G. Ekstrom was named Vice President, Customer Service and Information Systems. Joining the Officer team, Michael J. Rossi was promoted from Chief Engineer to Vice President, Engineering and Water Quality. Finally, Martin A. Kropelnicki was named Vice President, Chief Financial Officer and Treasurer.

Offering opportunities for new responsibilities is just one way that we develop and further energize our people, and it is not limited to our Officers. Temporary assignments are offered throughout the Company to give employees the chance to learn and grow. We also offer more traditional training opportunities, such as the Project Management course offered to managers and supervisors in 2005. And, our Continuous Improvement approach to the business continues to yield excellent results, both in terms of the improvements in service and efficiency that result, and in terms of the skills it enables every employee to build, including critical thinking, public speaking, and problem solving.

What Makes It Taste So Good?

California Water Service Group is a regulated utility providing an essential, irreplaceable product to a growing population. Having a time-tested recipe for success, we are well-positioned to take advantage of growth opportunities in the future. Most importantly, we have delivered solid results and reliable dividends to our stockholders for years.

We know that as a stockholder, you have sampled our recipe for success, and on behalf of

your dedicated Board of Directors, we thank you for your continued confidence in California Water Service Group.



*Robert W. Foy
Chairman of the Board*



*Peter C. Nelson
President and Chief Executive Officer*

The Numbers

Customer Service Areas*

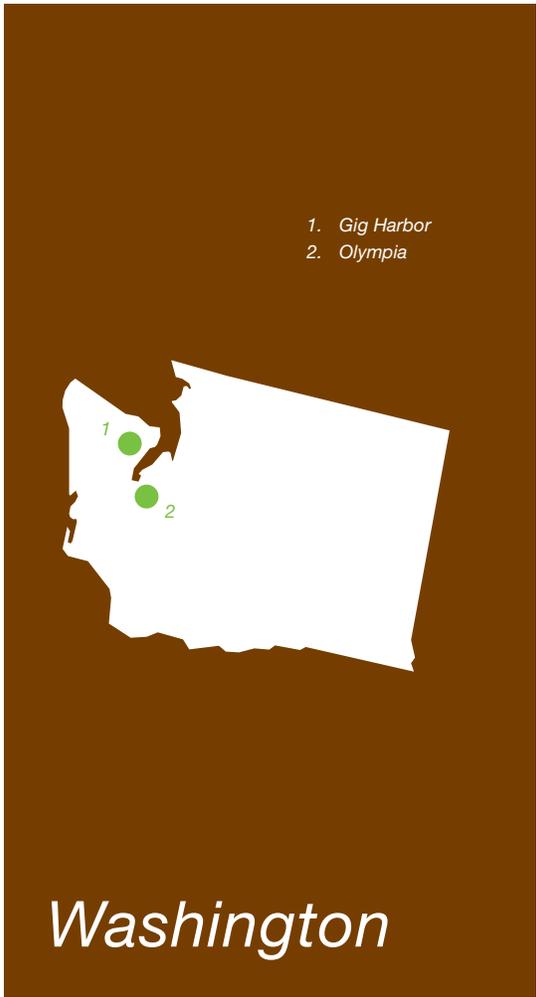
District Name	Including	2005	2004
California			
Antelope Valley	Fremont Valley, Lake Hughes, Lancaster & Leona Valley	1,400	1,400
Bakersfield		63,600	62,400
Bear Gulch	Atherton, Woodside, Portola Valley & portions of Menlo Park	18,000	17,700
Chico	Hamilton City	26,400	25,900
Dixon		2,900	2,900
Dominguez	Carson & portions of Compton, Harbor City, Long Beach, Los Angeles & Torrance	33,600	33,500
East Los Angeles	City of Commerce	27,800	27,700
Hawthorne		6,100	6,100
Hermosa-Redondo	Hermosa Beach, Redondo Beach & a portion of Torrance	26,100	26,000
Kern River Valley	Bodfish, Kernville, Lakeland, Mountain Shadows, Onyx, Squirrel Valley, South Lake & Wofford Heights	4,300	4,200
King City		2,400	2,300
Livermore		18,100	17,900
Los Altos	Portions of Cupertino, Los Altos Hills, Mountain View & Sunnyvale	18,500	18,500
Marysville		3,800	3,800
Mid-Peninsula	San Mateo & San Carlos	36,100	36,100
Oroville		3,600	3,500
Palos Verdes	Palos Verdes Estates, Rancho Palos Verdes, Rolling Hills & Rolling Hills Estates	24,000	24,000
Redwood Valley	Lucerne & portions of Duncans Mills, Guerneville, Dillon Beach, Noel Heights & Santa Rosa	2,000	2,000
Salinas		27,800	27,800
Selma		6,000	5,800
South San Francisco	Colma & Broadmoor	16,800	16,700
Stockton		42,300	41,800
Visalia		35,800	34,500
Westlake	Westlake Village & a portion of Thousand Oaks	7,000	7,000
Willows		2,300	2,300
	Subtotal	456,700	451,800
Hawaii		500	500
New Mexico		6,500	5,800
Washington		15,300	15,000
	Total	479,000	473,100

*Includes customers from regulated operations and full-system, non-regulated operations in Commerce and Hawthorne. Numbers are rounded to the nearest hundred.



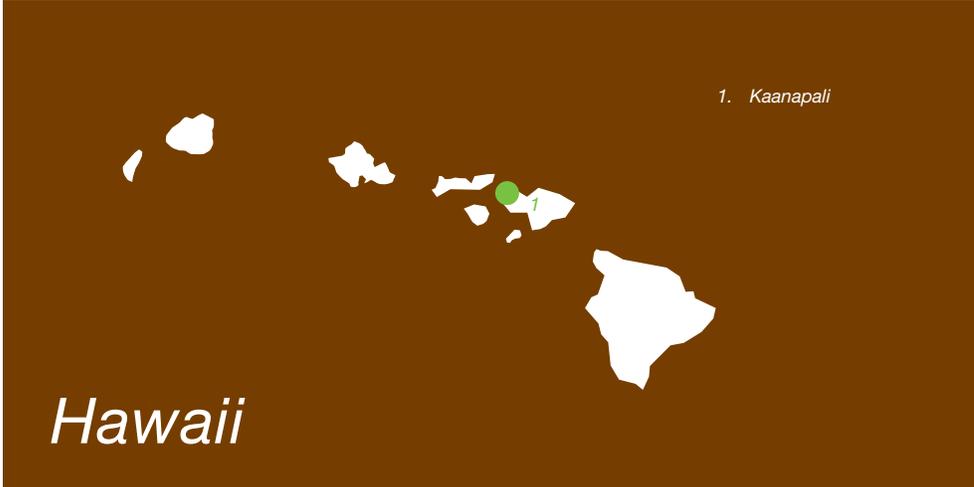
1. Antelope Valley
2. Bakersfield
3. Bear Gulch
4. Chico
5. Dixon
6. Dominguez
7. East Los Angeles
8. Hawthorne
9. Hermosa-Redondo
10. Kern River Valley
11. King City
12. Livermore
13. Los Altos
14. Marysville
15. Mid-Peninsula
16. Oroville
17. Palos Verdes
18. Redwood Valley
19. Salinas
20. Selma
21. South San Francisco
22. Stockton
23. Visalia
24. Westlake
25. Willows
26. Headquarters
(General Office)

California



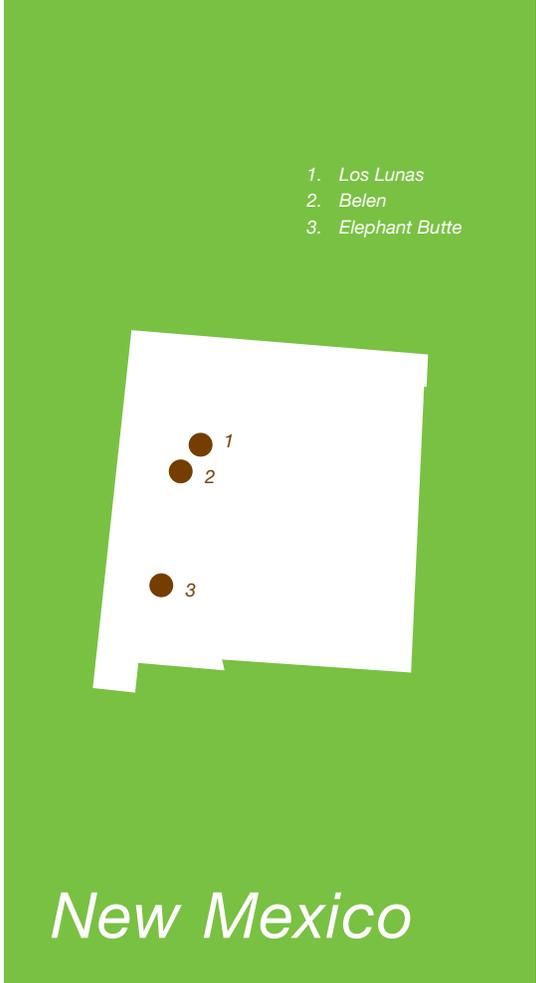
1. Gig Harbor
2. Olympia

Washington



1. Kaanapali

Hawaii



1. Los Lunas
2. Belen
3. Elephant Butte

New Mexico

Ten-Year Financial Review

Dollars in thousands, except common share data

	2005	2004	2003
Summary of Operations			
Operating Revenue			
Residential	\$ 222,634	\$ 221,323	\$ 194,903
Business	56,962	55,803	49,666
Industrial	14,241	13,592	11,255
Public authorities	14,965	15,118	12,789
Other	11,926	9,731	8,515
Total operating revenue	320,728	315,567	277,128
Operating expenses	280,918	274,084	246,894
Interest expense, other income and expenses, net	12,587	15,457	10,817
Net income	\$ 27,223	\$ 26,026	\$ 19,417

Common Share Data

Earnings per share - diluted	\$ 1.47	\$ 1.46	\$ 1.21
Dividend declared	1.140	1.130	1.125
Dividend payout ratio	78 %	77 %	93 %
Book value	\$ 15.98	\$ 15.66	\$ 14.44
Market price at year-end	38.23	37.65	27.40
Common shares outstanding at year-end (in thousands)	18,390	18,367	16,932
Return on average common stockholders' equity	9.3 %	9.8 %	9.1 %
Long-term debt interest coverage	3.61	3.38	2.78

Balance Sheet Data

Net utility plant	\$ 862,731	\$ 800,305	\$ 759,498
Utility plant expenditures			
(Company-funded and developer-funded)	94,517	68,573	74,253
Total assets	996,945	942,853	873,035
Long-term debt including current portion	275,275	275,921	273,130
Capitalization ratios:			
Common stockholders' equity	51.4 %	50.8 %	47.0 %
Preferred stock	0.6 %	0.6 %	0.7 %
Long-term debt	48.0 %	48.6 %	52.3 %

Other Data

Water production (million gallons)			
Wells and surface supply	68,162	72,279	68,416
Purchased	64,028	66,760	63,264
Total water production	132,190	139,039	131,680
Metered customers	402,191	395,286	387,579
Flat-rate customers	76,810	77,869	78,843
Customers at year-end	479,001	473,155	466,422
New customers added	5,846	6,733	7,434
Revenue per customer	\$ 670	\$ 667	\$ 594
Utility plant per customer	2,578	2,418	2,313
Employees at year-end	840	837	813

	2002	2001	2000	1999	1998	1997	1996
	\$ 184,894	\$ 173,823	\$ 171,234	\$ 163,681	\$ 150,491	\$ 158,210	\$ 148,313
	46,404	44,944	44,211	41,246	38,854	40,520	37,605
	11,043	9,907	11,014	12,695	10,150	10,376	9,748
	12,706	11,860	11,609	10,898	9,654	11,173	10,509
	8,104	6,286	6,738	6,417	5,777	4,886	4,083
	263,151	246,820	244,806	234,937	214,926	225,165	210,258
	232,404	221,116	211,610	201,890	183,245	188,020	177,356
	11,674	10,739	13,233	11,076	11,821	11,388	11,502
	\$ 19,073	\$ 14,965	\$ 19,963	\$ 21,971	\$ 19,860	\$ 25,757	\$ 21,400
	\$ 1.25	\$ 0.97	\$ 1.31	\$ 1.44	\$ 1.31	\$ 1.71	\$ 1.42
	1.120	1.115	1.100	1.085	1.070	1.055	1.040
	90%	115%	84%	75%	82%	62%	73%
	\$ 13.12	\$ 12.95	\$ 13.13	\$ 12.89	\$ 12.49	\$ 12.15	\$ 11.47
	23.65	25.75	27.00	30.31	31.31	29.53	21.00
	15,182	15,182	15,146	15,094	15,015	15,015	15,015
	9.7%	7.6%	10.1%	11.5%	10.8%	14.5%	12.8%
	2.73	2.64	3.31	3.79	3.64	4.37	3.81
	\$ 696,988	\$ 624,342	\$ 582,782	\$ 564,390	\$ 538,741	\$ 515,917	\$ 495,985
	88,361	62,049	37,161	48,599	41,061	37,511	40,310
	798,478	710,214	666,605	645,507	613,143	594,444	569,745
	251,365	207,981	189,979	171,613	152,674	153,271	151,725
	44.0%	48.8%	51.1%	53.0%	54.6%	53.8%	52.7%
	0.7%	0.9%	0.9%	0.9%	1.0%	1.0%	1.1%
	55.3%	50.3%	48.0%	46.1%	44.4%	45.2%	46.2%
	69,414	65,283	65,408	65,144	57,482	63,736	60,964
	62,811	61,343	62,237	58,618	54,661	59,646	56,769
	132,225	126,626	127,645	123,762	112,143	123,382	117,733
	380,087	371,281	366,242	361,235	354,832	350,139	345,307
	78,901	79,146	78,104	77,892	77,568	77,878	77,991
	458,988	450,427	444,346	439,127	432,400	428,017	423,298
	8,561	6,081	5,219	6,727	4,383	4,719	9,730
	\$ 579	\$ 552	\$ 554	\$ 539	\$ 500	\$ 529	\$ 502
	2,182	2,020	1,916	1,851	1,768	1,694	1,632
	802	783	797	790	759	752	740

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

Forward-Looking Statements

This annual report, including the Letter to Stockholders and Management's Discussion and Analysis, (including, but not limited to, the section entitled "Critical Accounting Policies and Estimates" found below, and the section entitled "Risk Factors" in Item 1A on Form 10-K filed with the Securities and Exchange Commission), 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, projections, and management's judgment about the Company, the water utility industry, and general economic conditions. Such words as expects, intends, plans, believes, estimates, assumes, anticipates, projects, predicts, forecasts, 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: governmental and regulatory commissions' decisions, including decisions on proper disposition of property and collection of regulatory assets; changes in regulatory commissions' policies and procedures; the timeliness of regulatory commissions' actions concerning rate relief; new legislation; changes in accounting valuations and estimates; the ability to satisfy requirements related to the Sarbanes-Oxley Act and other regulations on internal controls; electric power interruptions; increases in suppliers' prices and the availability of supplies, including water and power; fluctuations in interest rates; changes in environmental compliance and water quality requirements; acquisitions and the ability to successfully integrate acquired companies; the ability to successfully implement business plans; changes in customer water use patterns; the impact of weather on watersales and operating results; access to sufficient capital on satisfactory terms; civil disturbances or terrorist threats or acts, or apprehension about the possible future occurrences of acts of this type; the involvement of the United States in war or other hostilities; restrictive covenants in or changes to the credit ratings on current or future debt that could increase financing costs or affect the ability to borrow, make payments on debt, or pay dividends; and other risks and unforeseen events. 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 on forward-looking statements.

Overview

California Water Service Group (Company) provides water utility services to customers in California, Washington, New Mexico, and Hawaii. The majority of the business is regulated by the respective state's public utility commission. The Company's California water utility service operations comprise the majority of the business and contributed 96 % of revenues and 95 % of net income in 2005. The Company also has a regulated wastewater business in New Mexico. Non-regulated activities relate primarily to the water utility business and include operating, maintenance, billing, meter reading, water testing services, and a new Extended Service Protection (ESP) Program covering repairs to the customer water line between the meter and the home. Further information on the Company's operations may be found in the Company's Form 10-K filed with the Securities and Exchange Commission (SEC). See page 68 of this Annual Report for information on how to obtain a copy of Form 10-K.

The state regulatory entities governing the Company's regulated operations are referred to as "Commission(s)" in this report. Revenues, income, and cash flows are earned primarily through delivering potable water through pipes to homes, businesses, industries, and public authorities. Rates charged to customers for the regulated business are determined by the Commissions, which also set operating and customer service standards. The rates are intended to allow recovery of operating costs and a reasonable rate of return on invested capital.

Major risk factors affecting the financial performance of the Company are: extensive regulation, decisions by state regulatory commissions, and changes in laws and regulations; increased costs, such as electricity, not recoverable from ratepayers; operating costs affected by increased environmental regulations; lack of control over water supply; inability to finance capital expenditures; acquisitions, divestitures, or restructuring; failure and circumvention of controls and procedures; and judgments and estimates regarding financial and accounting matters. For additional information on "Risk Factors," see Item 1A of the Form 10-K on file with the SEC. See page 68 of this Annual Report for information on how to obtain Form 10-K.

The most significant risk and challenge to the business during the past several years has been obtaining timely rate relief to cover increased costs and investments. The Company addresses this risk by having an experienced team dedicated solely to

pursuing rate increases and managing Commission issues. The business can also be impacted by weather. Weather risk is partially mitigated by having operations in both northern and southern California, as well as in three other states. Another risk in the water industry is obtaining adequate financing, as the capital expenditures needed for infrastructure replacements and improvements may significantly exceed the cash flow generated by operations. Management believes that the Company has a strong balance sheet and is capable of supporting the financing needs of the business through use of debt and equity. Finally, the water industry is highly regulated and must comply with a multitude of standards related to water quality and service. To address the compliance issues, the Company has a highly trained, focused team that uses state-of-the-art technology and works closely with government agencies to monitor supplies and operations.

For 2005, net income was \$27.2 million compared to \$26.0 million in 2004, an increase of 4.6%. Diluted earnings per share for 2005 were \$1.47 compared to \$1.46 in 2004, an increase of 0.7%. The increase in earnings per share was primarily due to higher rates approved by the Commissions, sales to new customers, and increased gains from property sales. Partially offsetting increased earnings were decreased sales to existing customers due to wetter than normal weather conditions, higher maintenance costs, higher depreciation, higher income taxes, and the dilutive effect of having more weighted average shares outstanding than the prior year. The Company plans to continue to seek additional rate increases to recover its operating cost increases and receive reasonable returns on invested capital. For each of the five years subsequent to 2005, capital expenditures are expected to continue to increase generally at the same rate as inflation and remain at much higher levels than depreciation expense. Cash from operations is not expected to be sufficient to fund the cash needs of the Company (capital expenditures, dividends, and other cash requirements); therefore, the Company expects to fund anticipated cash shortfalls through a combination of debt and common stock offerings in the next five years.

In 2005 and 2004, the Company received many different types of rate increases, some of which were temporary in nature. As such, the growth in earnings due solely to rate relief in 2005 and 2004 is not expected to recur in 2006. A significant factor in 2006 affecting earnings will be the timing and the amount of the General Rate Case (GRC) filings that are expected to be approved in the second quarter of 2006. See the "Rates and Regulation" section of this report for more information on regulatory activity occurring in 2004, 2005, and through February 21, 2006.

Business

California Water Service Group is a holding company incorporated in Delaware with five operating subsidiaries: California Water Service Company (Cal Water), CWS Utility Services (Utility Services), New Mexico Water Service Company (New Mexico Water), Washington Water Service Company (Washington Water), and Hawaii Water Service Company, Inc. (Hawaii Water). Cal Water, New Mexico Water, Washington Water, and Hawaii Water are regulated public utilities. The regulated utility entities also provide some non-regulated services. Utility Services provides non-regulated water operations and related services to private companies and municipalities.

California water operations are conducted by Cal Water and Utility Services, which serve 456,674 customers in 75 California communities through 26 separate districts. Of these 26 districts, 24 districts are regulated water systems, subject to regulation by the California Public Utilities Commission (CPUC). The other two districts, the City of Hawthorne and the City of Commerce, are governed through their respective city councils and are considered non-regulated because they are outside of the CPUC's jurisdiction. Their activities are reflected in operating revenue and operating costs, as the risks and rewards of these operations are similar to those of the regulated activities. California water operations account for 95% of the total customers and 96% of the total operating revenue.

Washington Water provides domestic water service to 15,311 customers in the Tacoma and Olympia areas. Washington Water's utility operations are regulated by the Washington Utilities and Transportation Commission. Washington Water accounts for 3% of the total customers and 2% of the total operating revenue.

New Mexico Water provides service to 6,480 water and wastewater customers in the Belen, Los Lunas, and Elephant Butte areas in New Mexico. Its regulated operations are subject to the jurisdiction of the New Mexico Public Regulation Commission. New Mexico Water accounts for 1% of the total customers and 1% of the total operating revenue.

Hawaii Water provides water service to 537 customers on the island of Maui, including several large resorts and condominium complexes. Its regulated operations are subject to the jurisdiction of the Hawaii Public Utilities Commission. Hawaii Water accounts for less than 1% of the total customers and 1% of the total operating revenue.

Other non-regulated activities consist primarily of operating water systems owned by other entities; providing meter reading and billing services; leasing communication antenna sites on the Company's properties; operating recycled water systems; providing brokerage services for water rights; providing lab services; selling non-utility property; and ESP. These activities are reported below

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

operating net income on the income statement, gross of income taxes; therefore, the revenue is not included in operating revenue. Due to the variety of services provided and the fact that the activities are outside of the Company's core business, the number of customers is not tracked for these non-regulated activities. Non-regulated activities, excluding gain on sale of non-utility property, comprised 6% of the total net income in 2005.

Rates and operations for regulated customers are subject to the jurisdiction of the respective state's regulatory commission. The Commissions require that water and wastewater rates for each regulated district be independently determined. The Commissions are expected to authorize rates sufficient to recover normal operating expenses, and allow the utility the opportunity to earn a fair and reasonable return on invested capital. Rates for the City of Hawthorne and City of Commerce water systems are established in accordance with operating agreements and are subject to ratification by the respective city councils. Fees for other non-regulated activities are based on contracts negotiated between the parties.

Results of Operations

Earnings and Dividends Net income in 2005 was \$27.2 million compared to \$26.0 million in 2004 and \$19.4 million in 2003. Diluted earnings per common share were \$1.47 in 2005, \$1.46 in 2004, and \$1.21 in 2003. The weighted average number of common shares outstanding used in the diluted earnings per share calculation was 18,402,000 in 2005, 17,674,000 in 2004, and 15,893,000 in 2003. As explained below, the increase in 2005 earnings per share resulted from these primary factors: receiving rate relief on GRC filings and balancing accounts; customer growth; and gains on sale of non-utility properties. Partially offsetting these positive factors were: higher maintenance costs; higher depreciation costs; decreased water usage by existing customers due to wetter than normal weather; higher income taxes; and increased common shares outstanding.

At the January 2006 meeting, the Board of Directors declared the quarterly dividend, increasing it for the 39th consecutive year. The quarterly dividend was raised from \$0.2850 to \$0.2875 per common share, an annual rate of \$1.15 per common share. Dividends have been paid for 61 consecutive years. The annual dividends paid per common share in 2005, 2004, and 2003 were \$1.14, \$1.13, and \$1.125, respectively. The dividend increases were based on projections that the higher dividend could be sustained while still providing adequate financial resources and flexibility. Earnings not paid as dividends are reinvested in the business for the benefit of stockholders. In its long-term consideration, the Board of Directors plan to achieve a payout ratio in the range of 60%. The dividend payout ratio was 78% in 2005, 77% in 2004, and 93% in 2003, an average of 83% over the three-year period.

Operating Revenue Operating revenue in 2005 was \$320.7 million, an increase of \$5.1 million, or 1.6%, over 2004. Operating revenue in 2004 was \$315.6 million, an increase of \$38.5 million, or 14%, above 2003. The estimated sources of changes in operating revenue were:

Dollars in millions	2005	2004
Customer usage	\$ (10.9)	\$ 3.3
Rate increases	12.2	29.8
Usage by new customers	3.8	5.4
Net change	\$ 5.1	\$ 38.5
Average revenue per customer per year (in dollars)	\$ 670	\$ 667
New customers added	5,846	6,733

Overall, temperatures in our service areas for 2005 were comparable to 2004; however, rainfall was significantly higher, particularly in the first half of the year. Southern California had one of its wettest years on record. For 2004, rainfall was lower than 2003 in our California service areas, which positively impacted the Company's revenues and earnings. For Washington Water service areas, rainfall was significantly lower in 2005. As a result, state officials mandated water conservation, resulting in decreased revenues compared to 2004.

In 2005, rate relief increased revenues by \$12.2 million. See the "Rates and Regulation" section of this report for more information on regulatory activity occurring in 2004, 2005, and through February 21, 2006.

The number of customers in 2005 increased by 5,846, or 1.2%, from 2004 levels. This increase includes 645 customers in New Mexico, 37 customers in Hawaii, 296 customers in Washington, and 4,868 additional customers in California. Approximately 350, 270, and 169 were added through acquisitions in New Mexico, California, and Washington, respectively, with the remaining new customers resulting from growth in existing service areas. In 2004, customer growth was 6,733, which included approximately 1,700 new customers added through an acquisition in New Mexico.

Water Production Expenses Water production expenses, which consist of purchased water, purchased power, and pump taxes, comprise the largest segment of total operating expenses. Water production costs accounted for 41.2%, 43.5%, and 44.2% of total operating costs in 2005, 2004, and 2003, respectively. The rates charged for wholesale water supplies, electricity, and pump taxes are established by various public agencies. As such, these rates are beyond our control. The table below provides the amount of increases (decreases), and percentage changes in water production costs during the past two years:

Dollars in millions	2005			2004		
	Amount	Change	% Change	Amount	Change	% Change
Purchased water	\$ 87.5	\$ (2.2)	(3%)	\$ 89.7	\$ 8.9	11%
Purchased power	20.5	(1.3)	(6%)	21.8	(0.1)	(1%)
Pump taxes	7.6	-	-	7.6	1.3	20%
Total water production expenses	\$ 115.6	\$ (3.5)	(3%)	\$ 119.1	\$ 10.1	9%

Two of the principal factors affecting water production expenses are the amount of water produced and the source of the water. Generally, water from wells costs less than water purchased from wholesale suppliers. The table below provides the amounts, percentage change, and source mix for the respective years:

Millions of gallons (MG)	2005		2004		2003	
	MG	% of Total	MG	% of Total	MG	% of Total
Source:						
Wells	63,101	47.7%	66,951	48.2%	66,009	50.0%
% change from prior year	(6%)		1%		(4%)	
Purchased	64,028	48.5%	66,760	48.0%	63,264	48.2%
% change from prior year	(4%)		6%		1%	
Surface	5,061	3.8%	5,328	3.8%	2,407	1.8%
% change from prior year	(5%)		121%		221%	
Total	132,190	100.0%	139,039	100.0%	131,680	100.0%
% change from prior year	(5%)		6%		(1%)	

Purchased water expenses are affected by changes in quantities purchased, supplier prices, and cost differences between wholesale suppliers. For 2005, the \$2.2 million decrease in purchased water costs is due to a 4% decrease in quantities purchased, partially offset by overall higher wholesale water rates. On an overall blended basis, wholesale water rates increased 1.4% on a cost-per-million-gallon basis. In 2004, purchased water expenses included an additional adjustment of \$0.9 million, which related to the settlement of a meter malfunction issue in the Stockton district. Purchased power expenses are affected by the quantity of water pumped from wells and moved through the distribution system, rates charged by electric utility companies, and rate structures applied to usage during peak and non-peak times of the day or season. The purchased power expense decrease of \$1.3 million was primarily due to decreased well production. Pump taxes were the same in 2005 as in 2004, as higher rates offset the decreased pumping.

Administrative and General Expenses Administrative and general expenses include payroll related to administrative and general functions, all Company benefits charged to expense accounts, insurance expenses, legal fees, audit fees, regulatory utility commissions' expenses, board of directors' fees, and general corporate expenses.

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

During 2005, administrative and general expenses increased \$1.6 million, or 3.4 %, compared to 2004. Payroll expense charged to administrative and general expense remained constant due to a decrease in the number of employees offset by higher wages. Employee/retiree health care costs increased \$1.6 million, or 19 %, due to increased medical claims. The Company is self-insured and experienced several large-dollar medical claims (claims over \$200,000), which primarily caused the increase. Increases in other costs, including legal and outside services, were substantially offset by a decrease in workers' compensation of \$1.1 million, which was due to fewer claims and a refund from the Company's stop-loss insurance carrier.

During 2004, administrative and general expenses increased \$6.1 million, or 15 %, compared to 2003. Payroll expense charged to administrative and general expense increased \$1.0 million, or 13 %, due to the addition of new employees and wage increases. Employee benefits increased \$1.4 million, due primarily to increases in employee/retiree health care expenses. The Company also experienced higher costs for workers' compensation, general liability claims, and insurance premiums, which increased \$1.3 million, or 40 %. Higher expenses were incurred to comply with Sarbanes-Oxley Section 404 on internal controls, which increased expenses by \$0.9 million for consultants and auditors. Fees to the CPUC increased \$0.5 million due to the increased revenue, as these fees are calculated as a percentage of revenue. Other expense elements contributed to the balance of the change, but none were individually significant.

Other Operations Expenses The components of other operations expenses include payroll, material and supplies, and contract services costs of operating the regulated water systems, including the costs associated with water transmission and distribution, pumping, water quality, meter reading, billing, and operations of district offices.

For 2005, other operating expenses increased \$0.1 million, or 0.2 %, from 2004. Payroll costs charged to other operating expenses increased \$0.7 million, or 2.2 %, due to general wage increases. Expenses were offset by a decrease of \$0.5 million, or 64 %, for changing the process for disposing of by-products for the Bakersfield Treatment Plant. Other expense elements contributed to the balance of the change, but none were individually significant.

For 2004, other operating expenses increased \$2.5 million, or 7 %, from 2003. Payroll costs charged to other operating expenses increased \$1.3 million, or 6 %, due to general wage increases and increases in the number of employees. Other major cost increases were operations of the Bakersfield Treatment Plant of \$0.6 million and additional lease cost of \$0.4 million for the City of Commerce operation. Other expense elements contributed to the balance of the change, but none were individually significant.

Maintenance Maintenance expenses increased \$2.0 million, or 15 %, in 2005 compared to 2004. For 2004, maintenance expenses increased \$0.5 million, or 4 %, compared to 2003. In 2005, maintenance expense increased due to repairs of water treatment equipment, water main, and wells. In 2004, expenses increased primarily for service line repairs, which are pipes from the main to the meter box.

Depreciation and Amortization Depreciation and amortization increased due to the level of Company-funded capital expenditures and a higher depreciation rate authorized by the CPUC.

Income Taxes For 2005, income taxes increased \$2.9 million. The significant items include provision for taxes on gain on sale of non-utility properties of \$0.9 million, provision for taxes on increased income from operations of \$0.5 million, and \$0.7 million for the reversal of federal tax depreciation on pre-1982 assets, which was previously flowed-through to ratepayers. The Company anticipates the reversal of federal tax depreciation on pre-1982 assets to continue in future years; however, its effect on the Company's tax provision is uncertain due to the offsetting flow-through of state tax depreciation, which continues to increase with capital additions.

Property and Other Taxes For 2005, expenses increased \$1.1 million, or 10 %, compared to 2004. For 2004, expenses increased \$1.0 million, or 9 %. Increased property taxes were the primary cause for the increase in both years.

Non-Regulated Income, Net The major components of non-regulated income are revenue and operating expenses related to the following activities: operating and maintenance services (O&M), meter reading and billing services, antenna site leases, water rights brokering, and design and construction services. For 2005, non-regulated income increased \$0.5 million, or 18 %, compared to 2004, with increases primarily from O&M contracts, antenna site leases, and reduced expenses related to business development. For 2004, non-regulated income increased compared to 2003, with increases primarily from O&M and antenna site leases offset by decreases in water rights brokerage income. Water rights brokerage income is sporadic and is affected by market opportunities and price volatility. See Note 3 of the Notes to Consolidated Financial Statements for additional information.

Gain on Sale of Non-Utility Property For 2005, pretax gains from non-utility property sales were \$2.2 million compared to insignificant gains in 2004. The 2005 gains were primarily from three properties sold in the Los Altos and Chico districts. Earnings

and cash flow from these transactions are sporadic and may or may not continue in future periods, depending upon market conditions. The Company has other non-utility properties that may be marketed in the future based on real estate market conditions.

In 2005, interest expenses decreased by \$0.1 million, or 1 %, as there were no short-term borrowings in 2005. In 2004, interest expense increased \$0.3 million, or 2 %, due to a decrease in capitalized interest, which was a result of lower value of capitalized projects. Capitalized interest in 2005 was comparable to 2004. See the "Liquidity and Capital Resources" section for more information.

Rates and Regulation

The state regulatory commissions have plenary powers setting rates and operating standards. As such, state commission decisions significantly impact revenues, earnings, and cash flow of the Company. The amounts discussed are generally annual amounts, unless specifically stated, and the financial impact to recorded revenue is expected to occur over a 12-month period from the effective date of the decision. In California, water utilities are required to make several different types of filings. Most filings result in rate changes that remain in place until the next GRC. As explained below, surcharges and surcredits to recover balancing and memorandum accounts as well as the catch-up are temporary rate changes, which have specific time frames for recovery.

General Rate Cases (GRCs) GRCs, step rate increase filings, and offset filings change rates to amounts that will remain in effect until the next GRC. The CPUC follows a rate case plan, which requires Cal Water to file a GRC for each of its 24 regulated operating districts every three years. In a GRC proceeding, the CPUC not only considers the utility's rate-setting requests, but may consider other issues that affect the utility's rates and operations. Effective in 2004, Cal Water's GRC schedule was shifted from a calendar year to a fiscal year with test years commencing July 1. The CPUC is generally required to issue its GRC decision prior to the first day of the test year or authorize interim rates. As such, Cal Water's GRC decisions, which prior to 2005 were generally issued in the fourth quarter, are expected to be issued in the second quarter of each year. Cal Water expects decisions on the eight GRCs filed in August of 2005 to be issued in June of 2006.

Step Rate Increases Between GRC filings, utilities may file step rate increases, which allow the utility to recover cost increases, primarily from inflation and incremental investment, during the second and third years of the rate case cycle. However, step rate increases are subject to a weather-normalized earnings test. Under the earnings test, the CPUC may reduce the step rate increase to prevent the utility from earning in excess of the authorized rate of return for that district. Step rate increases, which were previously approved in January, should be approved in July under the new rate case schedule.

Offset Filings In addition, utilities are entitled to file offset filings. Offset filings may be filed to adjust revenues for construction projects authorized in GRCs when the plant is placed in service or for rate changes charged to the Company for purchased water, purchased power, and pump taxes (referred to as "offsettable expenses"). Such rate changes approved in offset filings remain in effect until a GRC is approved.

Surcharges and Surcredits Surcharges and surcredits, which are usually effective for a 12-month period, are authorized by the CPUC to recover the memorandum and balancing accounts under- and over-collections usually due to changes in offsettable expenses. However, significant under-collections may be authorized over multiple years. Currently, filings to recover offsettable expenses are subject to a non-weather-adjusted earnings test. Under the earnings test, the CPUC may reduce recovery of an offsettable expense to prevent the utility from earning in excess of its authorized rate of return. Typically, an expense difference occurs during the time period from when an offsettable expense changes and the Company is allowed to adjust its water rates. Expense changes for this regulatory lag period, which is about two months, are booked into memorandum and balancing accounts for later recovery. However, in 2001, the CPUC changed its procedures and did not permit water companies to immediately adjust water rates for offsettable expense changes. As a result, the amount accrued in memorandum and balancing accounts, due primarily to the major increases in electric power costs in 2001, grew to \$9.2 million at the end of 2004. Beginning in November 2002, the CPUC allowed water companies to file for recovery of memorandum and balancing account under-collections subject to a non-weather-adjusted earnings test. However, the Company did not receive authorization to collect a significant portion of the under-collection from its ratepayers until the fourth quarter of 2004.

Timing of Expense Balancing and Memorandum Accounts The Company does not record an asset (or liability) for the recovery (or refund) of expense balancing or memorandum accounts in its financial statements as revenue (refunds), nor as a receivable (or payable), until the CPUC and other regulators have authorized recovery and the customer is billed. Therefore, a timing difference may occur between when costs are recorded as an expense and the associated revenues are received (or refunds are made) and booked.

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

Summary of Rate Decisions and Resolutions The following is a summary of rate filings and the anticipated annual impact on revenues. California decisions and resolutions may be found on the CPUC website at www.cpuc.ca.gov.

Type of Filing	Decision/Resolution	Approval Date	Increase (Decrease) Annual Revenue	CA District/Subsidiary
GRC, Step Rate, and Offset Filings				
Offset	AL1748A	February 2006	\$0.2 million	Selma
Step Rate	Various ¹	January 2006	\$1.9 million	13 districts
GRC 2004	D.05-07-022	July 2005	\$7.6 million	8 districts
Offset	AL 1732	July 2005	\$0.6 million	Westlake
Offset	AL 1708	May 2005	\$0.8 million	Stockton
GRC 2004	04-00247-UT	April 2005	\$0.3 million	New Mexico
GRC 2004	21644	August 2005	(\$0.05 million)	Hawaii
Step Rate	Various ²	January 2005	\$4.8 million	19 districts
Offset	Res. W-4495	October 2004	\$0.5 million	Los Altos
GRC 2003	D.04-09-038	September 2004	\$0.4 million	2 districts
Step Rate	D.04-04-041	August 2004	\$0.5 million	4 districts
GRC 2001	D.04-07-033	July 2004	\$1.1 million	Salinas
GRC 2002	D.04-04-041	April 2004	\$3.6 million	4 districts
Offset	Res. W-4458	February 2004	\$0.7 million	Stockton
Step Rate	Various ³	January-April 2004	\$4.4 million	14 districts
Surcharges and Surcredits				
Memorandum	AL1734A	February 2006	\$1.1 million	Salinas
Balancing	AL1711A	February 2006	(\$0.3 million)	Visalia
Balancing	AL1718A	February 2006	(\$0.4 million)	Hermosa-Redondo
Balancing	AL1710	September 2005	\$0.9 million	Stockton
Balancing	Various ⁴	4th Quarter 2004	\$9.2 million	15 districts
Balancing	AL 1622	September 2004	\$0.4 million	Salinas
Balancing	Various ⁴	May 2004	(\$1.5 million)	2 districts

During 2005 and 2004, no rate filings were approved for Washington Water. In 2004 and 2003, Cal Water collected a catch-up surcharge for its 2001 GRC. In Cal Water's 2001 GRC, the CPUC-authorized effective date for rates was April 2003; however, a final decision was not approved until September 2003. As a result, the Company was authorized to collect approximately \$4.5 million of the revenue not billed between April and September of 2003. In 2005, revenues dropped compared to the prior year, due in part to the discontinuance of the catch-up surcharge. In 2005 and 2004, the Company's revenues were favorably impacted by approximately \$3.9 million and \$0.4 million, respectively, from the net recovery of memorandum and balancing accounts.

1. Step rate increases were granted in compliance with D.03-09-021, D.03-10-005, D.04-04-041, and D.04-09-038.

2. Step rate increases were granted in compliance with D.03-09-021, D.03-10-005, D.04-04-041, D.04-07-033, and D.04-09-038.

3. Step rate increases were granted in compliance with D.01-08-039, D.03-09-021, and D.03-10-005.

4. Various advice letters are approved in aggregate.

The Company expects that the net effect of surcharges and surcredits will reduce revenue by approximately \$2.3 million in 2006, assuming similar usage. The estimated impact of rate changes compared to the prior years is listed in the following table:

Dollars in millions	2005	2004	2003
Step rate increases	\$ 4.8	\$ 4.4	\$ 2.2
Bakersfield Treatment Plant	-	4.2	2.3
General Rate Case (GRC)	5.8	13.3	3.7
Offset (purchased water/pump taxes)	1.2	4.7	0.9
Balancing accounts, net	3.9	0.4	1.9
Catch-up surcharge, net	(3.5)	2.2	1.3
Other	-	0.6	0.3
Rate increases	\$ 12.2	\$ 29.8	\$ 12.6

Remaining Unrecorded Balances from Previously Authorized Balancing Account Recoveries/Refunds For the balancing accounts authorized in May 2004, the amount remaining to be refunded as of December 2005 was \$0.2 million and December 2004 was \$0.6 million. The balance is expected to be refunded by May 2006.

For the balancing accounts authorized in September 2004, the amount remaining to be collected in rates as of December 2005 was \$0.2 million and December 2004 was \$0.3 million. The balance is expected to be recovered by June 2006.

For the balancing accounts authorized in the fourth quarter of 2004, the net amount remaining to be collected in rates as of December 2005 was \$3.1 million and December 2004 was \$8.3 million. The net balance is expected to be fully recovered by January 2008.

For the balancing accounts authorized in September 2005, the amount remaining to be collected in rates as of December 2005 was \$0.8 million. The balance is expected to be recovered by the third quarter of 2006.

The total amount of unrecorded, under-collected memorandum and balancing accounts was \$2.6 million and \$8.5 million, as of December 31, 2005 and 2004, respectively. Included in this amount, Cal Water has pending memorandum account filings for 2005 and previously authorized balancing accounts approved for collection as stated above.

Pending Filings as of February 21, 2006 Cal Water has pending its 2005 GRC filings covering eight districts. Cal Water expects decisions regarding its 2005 GRCs to be issued in the second quarter of 2006. The amount requested in the 2005 GRCs is approximately \$10.6 million in 2006/2007, \$5.5 million in 2007/2008, and \$5.5 million in 2008/2009. The amounts granted may vary due to a variety of factors. Over the past few years, the amount approved by the CPUC has been substantially less than the requested amount. The GRCs also requested the CPUC to consider several modifications to CPUC rate-setting procedures. The GRCs request a water revenue adjustment mechanism that would allow the Company to recover (refund) water revenues when actual water sales are below (above) adopted water sales in the GRCs. This proposal would decouple the Company's revenues from conservation efforts and inaccurate weather forecasts, putting in place a mechanism similar to that employed by California's investor-owned electric utilities. The GRCs also request a full-cost balancing account that would allow the Company to recover changes in source of supply mix as well as price changes under current procedures. The Company requested a rate base equalization account to minimize the impact on rates of large capital projects in small water systems. Finally, the Company requested that the Commission adjust its authorized rate of return if modifications are not adopted to change certain rate-setting procedures. The Company is unable to predict the timing and final outcome of the filings at this time.

2006 Regulatory Activity In accordance with the rate case plan, Cal Water will file a GRC for eight districts in May of 2006. At this time, Cal Water does not know the amounts to be requested. In January 2006, the Company was granted step rate increases for 13 districts and was authorized an increase of \$1.9 million. In February 2006, Cal Water received authorization to recover (refund) various balancing and memorandum accounts. Memorandum account decision AL1734A will be collected over a 36-month period. Cal Water also intends to file for step rate increases in July for eight districts. Cal Water is authorized to request up to \$5.5 million; however, the request may be adjusted downward by the weather-adjusted earnings test.

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

In the first quarter of 2006, Cal Water will file an advice letter to allow it to track in a memorandum account additional funding associated with its retiree health care plan. Currently, Cal Water funds and recognizes expenses associated with the plan on a pay-as-you-go basis. The excess expense between pay-as-you-go and accrual during the employees' expected service period has been recognized as a regulatory asset. As of December 31, 2005, the regulatory asset was approximately \$9.8 million. Cal Water intends to increase its funding so the plan is funded during the employee's service period. Cal Water has established two Voluntary Employee Beneficiary Associations (VEBAs) to allow for increased funding and a current-period income tax deduction. Cal Water will also file an application to recover its regulatory asset. Cal Water believes that the CPUC will recognize in rates the recovery of the regulatory asset and the additional funding of the plan. If the CPUC does not permit the Company to recover the full amount of its regulatory asset, the regulatory asset, to the extent not allowed in recovery, will be written off. If the CPUC does not approve the memorandum account, the Company will not be able to recover the higher expenses of approximately \$0.6 million per year until such expenses are recognized in its GRC applications.

Washington Water is planning to submit a rate filing in the first quarter of 2006, but has not filed as of the date of this report.

Review of Property Sales by CPUC In 1995, the California Legislature enacted the Water Utility Infrastructure Improvement Act of 1995 (Infrastructure Act) to encourage water utilities to sell surplus properties and reinvest in needed water utility facilities. In September 2003, the CPUC issued Decision (D.) 03-09-021 in Cal Water's 2001 GRC filing. In this decision, the CPUC ordered Cal Water to file an application setting up an Infrastructure Act memorandum account with an up-to-date accounting of all real property that was at any time in rate base and that Cal Water had sold since the effective date of the Infrastructure Act. The decision also ordered Cal Water to file an application for approval to replace the operations and customer centers in its Chico district and for treatment of the gain on sale proceeds.

D.03-09-021 also directed the CPUC staff to file a detailed report on its review of Cal Water's application. On January 11, 2005, the Office of Ratepayer Advocates (ORA) issued a report expressing its opinion that Cal Water had not proven that surplus properties sold since 1996 were no longer necessary and useful to provide utility service. ORA also recommended that Cal Water be fined \$160,000 and that gains from property sales should generally benefit ratepayers. During the period under review, Cal Water's cumulative gains from surplus property sales were \$19.2 million.

On December 1, 2005, the CPUC issued its D.05-12-002. This decision found that Cal Water appropriately reclassified all properties as non-utility property prior to being sold and the criteria Cal Water followed to reclassify its properties were reasonable and consistent with the requirements of the CPUC. Since the properties were properly reclassified, the CPUC found that approval of the property sales was not required and no penalty was warranted. Furthermore, the decision found that Cal Water should be allowed to include in rate base the full cost of the Chico customer center.

Although the decision concluded that all gains for the property sales qualified for reinvestment in accordance with the Infrastructure Act, the decision deferred the rate-making issue regarding treatment of sale proceeds to its Order Instituting Rulemaking (R.) 04-09-003. On November 5, 2005, the Commission issued its draft decision regarding the allocation of proceeds from the sale of utility assets. The draft decision states that the CPUC has limited discretion in how it allocates between ratepayers and utility shareholders the gains on sale of real property that meet the criteria in the Infrastructure Act, provided that water utilities reinvest the proceeds in new water infrastructure. If the draft decision is adopted, the Company will be entitled to earn its full authorized return on the proceeds reinvested in utility plant from the gains on surplus property sales that were under review.

Based on D.05-12-002 and the draft decision, Cal Water has not recorded any adjustments in its financial statements. Cal Water does not know when the CPUC will issue its decision in the matter of R.04-09-003. If the CPUC rules that any portion of the property sales should be allocated to the ratepayers, Cal Water's rate base could be reduced, which would lower future revenues, net income, and cash flows.

Elimination of the Earnings Test on Balancing Accounts On January 23, 2006, the CPUC issued a draft decision to suspend, until further notice, the non-weather-adjusted earnings test that applies to memorandum and balancing account recovery for water utilities. The elimination of the earnings test should significantly improve Cal Water's opportunity to earn its authorized rate of return. Over the past three years, Cal Water has been unable to recover \$3.5 million in offsettable expenses. The draft decision does not address the weather-adjusted earnings test, which is required for step rate increases.

Water Supply

Our source of supply varies among our operating districts. Certain districts obtain all of their supply from wells; some districts purchase all of their supply from wholesale suppliers; and other districts obtain supply from a combination of wells and wholesale suppliers. A small portion of supply comes from surface sources and is processed through Company-owned water treatment plants. The Company is meeting water quality, environmental, and other regulatory standards.

California's normal weather pattern yields little precipitation between mid-spring and mid-fall. The Washington Water service areas receive precipitation in all seasons, with the heaviest amounts during the winter. New Mexico Water's rainfall is heaviest in the summer monsoon season. Hawaii Water receives precipitation throughout the year, with the largest amounts in the winter months. Water usage in all service areas is highest during the warm and dry summers and declines in the cool winter months. Rain and snow during the winter months replenish underground water aquifers and fill reservoirs, providing the water supply for subsequent delivery to customers. To date, snow and rainfall accumulation during the 2005-2006 water year has been above average. Precipitation in the prior year was also above average. Water storage in California's reservoirs at the end of 2005 was at above-average levels. Management believes that supply pumped from underground aquifers and purchased from wholesale suppliers will be adequate to meet customer demand during 2006 and beyond. Long-term water supply plans are developed for each of the Company's districts to help assure an adequate water supply under various operating and supply conditions. Some districts have unique challenges in meeting water quality standards, but management believes that supplies will meet current standards using current treatment processes. The Company is in compliance with the new Environmental Protection Agency (EPA) standard related to arsenic, which became effective in January 2006.

Liquidity and Capital Resources

Short-Term Financing Short-term liquidity is provided by bank lines of credit and internally generated funds. Long-term financing is accomplished through use of both debt and equity. Short-term bank borrowings were zero at December 31, 2005 and 2004. Cash and cash equivalents were \$9.5 million at December 31, 2005 and \$18.8 million at December 31, 2004. In January 2005, the Company received a \$7.2 million tax refund due to federal bonus depreciation allowed one time in 2004. The Company does not expect to receive a similar refund in 2006. Given the Company's ability to access its lines of credit on a daily basis, cash balances are managed to levels required for daily cash needs, and excess cash is invested in short-term or cash equivalent instruments. Minimal operating levels of cash are maintained for Washington Water, New Mexico Water, and Hawaii Water.

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. 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. 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 cash flow from operations and increases the need for short-term bank borrowings. In addition, short-term borrowings are used to finance capital expenditures until long-term financing is arranged.

Cal Water has a \$45 million credit facility. The term of the current agreement expires in April 2007. The agreement requires a 30-day out-of-debt consecutive period during any 24 consecutive months and that outstanding balances be below \$10 million for a 30-day consecutive period during any 12-consecutive-month period. In addition, the agreement requires debt as a percentage of total capitalization to be less than 67%. The Company has met all covenant requirements and is eligible to use the full amount of the commitment. In addition to borrowings, the credit facility allows for letters of credit up to \$10 million. One letter of credit was outstanding at December 31, 2005, for \$0.5 million related to an insurance policy, which reduces the amount available to borrow. Interest is charged on a variable basis and fees are charged for unused amounts. As of December 31, 2005, there were no borrowings against the credit facility.

A \$10 million credit facility exists for the Company, Utility Services, Washington Water, New Mexico Water, and Hawaii Water. The term of the current agreement expires in April 2007. The agreement requires a 30-day out-of-debt consecutive period during any 24 consecutive months and that outstanding balances be below \$5 million for a 30-day consecutive period during any 12-consecutive-month period. In addition, the agreement requires debt as a percentage of total capitalization to be less than 67%. The Company has met all covenant requirements and is eligible to use the full amount of the commitment. In addition to borrowings, the credit facility allows for letters of credit up to \$5 million, which would reduce the amount available to borrow. No letters of

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

credit were outstanding at December 31, 2005. Interest is charged on a variable basis and fees are charged for unused amounts. As of December 31, 2005, there were no borrowings against the credit facility.

Credit Ratings Cal Water's first mortgage bonds are rated by Moody's Investors Service (Moody's) and Standard & Poor's (S&P). Previously, the two major credit facility agreements contained covenants related to these debt ratings. The current agreements do not contain such covenants. During 2005, management met separately with the two credit rating agencies, and both agencies have maintained their ratings of A2 for Moody's and A+ for S&P as of the filing date of this report. The last time ratings were changed was in February 2004, when Moody's issued a report lowering Cal Water's senior secured debt from A1 to A2 and characterizing the rating as stable. In November 2003, S&P did not change its rating of A+, but changed its outlook from stable to negative. Although the Company's financial performance and capitalization structure improved in 2004 compared to 2003, which was recognized by both agencies, both agencies noted concerns related to the rate-setting process and decisions by the CPUC. Also, concerns were raised about the Company's level of capital expenditures, which will need to be partially financed through long-term borrowings or equity offerings. Management believes the Company would be able to meet financing needs even if ratings were downgraded, but a rating change could result in a higher interest rate on new debt.

Long-Term Financing Long-term financing, which includes senior notes, other debt securities, and common stock, has been used to replace short-term borrowings and fund capital expenditures. Internally generated funds, after making dividend payments, provide positive cash flow, but have not been at a level to meet all of the Company's capital expenditure needs. Management expects this trend to continue given the Company's capital expenditures plan for the next five years. In addition to Company-funded capital expenditures, some capital expenditures are funded by developers' Contributions in Aid of Construction, which are not refundable, and Advances for Construction, which are refundable. Management believes long-term financing is available to meet the Company's cash flow needs through issuances in both debt and equity markets. The Company did not issue any significant long-term debt or additional stock in 2005.

In June 2004, the Company issued 1,409,700 shares of its common stock at \$27.25 per share. The net proceeds were \$36.8 million and the transaction was closed on June 29, 2004. The funds were used to pay down short-term borrowings and invest in short-term money market instruments, pending their use for general corporate purposes. After issuance of these shares, \$35.6 million remains in securities under the Company's shelf registration, which are available for future issuance.

In September 2004, the CPUC issued a decision granting Cal Water authority to complete up to \$250 million of equity and debt financing through 2010, subject to certain restrictions. No financing had been applied against this authorization as of December 31, 2005.

In November 2004, New Mexico Water entered into a long-term debt arrangement for \$3.4 million. The interest rate is 5.65%, the loan terminates in May 2014, and principal payments are required during the term of the loan. The funds were used to retire debt of \$2.3 million, fund an acquisition, fund capital expenditures, and for general corporate purposes.

Washington Water has long-term debt primarily from two banks to meet its operating and capital equipment purchase requirements at interest rates negotiated with the banks. Both Washington Water and Hawaii Water have inter-company debt with the holding company, which is eliminated at consolidation. Hawaii Water does not have any debt with third parties.

The Company does not utilize off-balance-sheet financing or utilize special purpose entity arrangements for financing. The Company does not have equity ownership through joint ventures or partnership arrangements.

Additional information regarding the bank borrowings and long-term debt is presented in Notes 8 and 9 of the Notes to Consolidated Financial Statements.

Dividend Reinvestment and Stock Purchase Plan The Company's transfer agent offers stockholders a Dividend Reinvestment and Stock Purchase Plan (Plan). Under the Plan, stockholders may reinvest dividends to purchase additional Company common stock without brokerage fees. The Plan also allows existing stockholders and other interested investors to purchase Company common stock without brokerage fees through the transfer agent up to certain limits. Our transfer agent operates the Plan and purchases shares on the open market to provide shares for the Plan.

2006 Financing Plan The Company's 2006 financing plan includes raising approximately \$40-\$50 million of new capital. The plan includes issuance of long-term debt and additional equity, although this may change depending on a variety of factors. Beyond 2006, management intends to fund capital needs through a relatively balanced approach between long-term debt and equity.

Contractual Obligations The Company's contractual obligations are summarized in the following table. 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. System and Office leases include obligations associated with leasing water systems and rents for office space.

Contractual Obligations (in thousands)	Total	Less Than			After
		1 Year	1-3 Years	3-5 Years	5 Years
Long-term debt	\$275,275	\$ 1,133	\$ 2,210	\$ 1,991	\$269,941
Advances for Construction	141,842	5,077	9,777	9,588	117,400
Office leases	1,880	662	844	309	65
System leases	11,232	961	1,922	1,922	6,427
Water Supply Contracts	403,124	12,731	26,671	27,880	335,842

Cal Water 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 our control. The amount paid annually to the wholesale suppliers is charged to purchased water expense on our statement of income. Most contracts do not require minimum annual payments and vary with the volume of water purchased.

The Company has a contract with the Santa Clara Water District that contains minimal purchase provisions. The contract payment varies with the volume of water purchased above the minimal level. Management plans to continue to purchase and use at least the minimum water requirement under this contract in the future. The total paid under this contract was \$4,763 in 2005, \$4,610 in 2004, and \$4,452 in 2003.

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 \$4,300 in 2005, \$4,392 in 2004, and \$3,779 in 2003. Pricing under the contract varies annually. Estimated annual contractual obligations in the table above are based on the same payment levels as 2005. Future increased costs by SEWD are expected to be offset by a decline in the allocation of costs to the Company, as other customers of SEWD are expected to receive a larger allocation based upon growth of their service areas.

On September 21, 2005, the Company entered into an agreement with Kern County Water Agency (Agency) to obtain treated water for the Company's operations. The term of the agreement is to January 1, 2035, or until the repayment of the Agency's bonds (described below) occurs. Under the terms of the agreement, the Company is obligated to purchase 20,500 acre-feet of treated water per year. The Company is obligated to pay a Capital Facilities Charge and a Treated Water Charge, both of which will be expensed as invoiced, regardless of whether it can use the water in its operation, and is obligated for these charges even if the Agency cannot produce an adequate amount to supply the 20,500 acre-feet in the year. (This agreement supersedes a prior agreement with Kern County Water Agency for the supply of 11,500 acre-feet of water per year. The total paid, under the prior agreement, was \$3,288 in 2005, \$3,308 in 2004, and \$2,691 in 2003.)

Three other parties, including the City of Bakersfield, are also obligated to purchase a total of 32,500 acre-feet per year under separate agreements with the Agency. Furthermore, the Agency has the right to proportionally reduce the water supply provided to all of the participants if it cannot produce adequate supplies. The participation of all parties in the transaction for expansion of the Agency's facilities, including the Water Purification Plant, purchase of the water, and payment of interest and principal on the bonds being issued by the Agency to finance the transaction, is required as a condition to the obligation of the Agency to proceed with expansion of the Agency's facilities. If any of the other parties does not use its allocation, that party is obligated to pay its contracted amount.

The Agency is planning to issue bonds to fund the project and will use the payments of the Capital Facilities Charges by the Company and the other contracted parties to meet the Agency's obligations to pay interest and repay principal on the bonds. If any of the parties were to default on making payments of the Capital Facilities Charge, then the other parties are obligated to pay for the defaulting party's share on a pro-rata basis. If there is a payment default by a party and the remaining parties have to make payments, they are also entitled to a pro-rata share of the defaulting party's water allocation.

The Company expects to use all its contracted amount of water in its operations every year. In addition, if the Company were to pay for and receive additional amounts of water due to a default of another participating party, the Company believes it could use this

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

additional water in its operations without incurring substantial incremental cost increases. If additional treated water is available, all parties have an option to purchase this additional treated water, subject to the Agency's right to allocate the water among the parties.

The total obligation of all parties, excluding the Company, is approximately \$108 million to the Agency. Based on the credit-worthiness of the other participants, which are government entities, it is believed to be highly unlikely that the Company would be required to assume any other party's obligations under the contract due to its default. In the event of default by a party, the Company would receive entitlement to the additional water for assuming the additional obligation.

Once the project is complete, the Company is obligated to pay a Capital Facilities Charge and a Treated Water Charge that together total \$4.7 million annually, which equates to \$231 per acre-foot. Annual payments of \$2.0 million for the Capital Facilities Charge will begin when the Agency issues bonds to fund the project. Some of the Treated Water Charge of \$2.8 million is expected to begin July 1, 2007, when a portion of the planned capacity is expected to be available. The expanded water treatment plant is expected to be at full capacity by July 1, 2008, and at that time, the full annual payments of \$4.7 million would be made and continue through the term of the agreement. Once treated water is being delivered, the Company will also be obligated for its portion of the operating costs; that portion is currently estimated to be \$69 per acre-foot. The actual amount will vary due to variations from estimates, inflation, and other changes in the cost structure. The Company's overall estimated cost of \$300 per acre-foot is less than the estimated cost of procuring untreated water (assuming water rights could be obtained) and then providing treatment.

Capital Requirements Capital requirements consist primarily of new construction expenditures for expanding and replacing utility plant facilities and the acquisition of water systems. They also include refunds of Advances for Construction.

Company-funded utility plant expenditures were \$77.6 million, \$50.4 million, and \$53.9 million in 2005, 2004, and 2003, respectively. A majority of capital expenditures was associated with mains and water treatment equipment.

For 2006, Company-funded capital expenditures are budgeted at approximately \$85 million. The 2006 capital budget is the same as the 2005 capital budget. For the years 2006 through 2010, capital expenditures are estimated at \$75-\$85 million per year, and will be primarily for mains, related water distribution equipment, water quality equipment, and pumping.

Other capital expenditures are funded through developer Advances and Contributions in Aid of Construction (non-Company funded). The expenditure amounts were \$16.9 million, \$18.2 million, and \$20.4 million in 2005, 2004, and 2003, respectively. The changes from year to year reflect expansion projects by developers in our service areas.

Management expects the Company to incur non-Company funded expenditures in 2006. These expenditures will be financed by developers through refundable Advances for Construction and non-refundable Contributions in Aid of Construction. Developers are required to deposit the cost of a water construction project with the Company prior to our commencing construction work, or the developers may construct the facilities themselves and deed the completed facilities to the Company. Funds are generally received in advance of incurring costs for these projects. Advances are normally refunded over a 40-year period without interest. Future payments for Advances received are listed under contractual obligations above. Because non-Company-funded construction activity is solely at the discretion of developers, management cannot predict the level of future activity. The cash flow impact is expected to be minor due to the structure of the arrangements.

Capital Structure In 2005, common stockholders' equity increased by \$6.3 million, due primarily to an increase in retained earnings. In 2004, common stockholders' equity increased \$43.1 million, or 18%, due primarily to earnings and the issuance of new shares of common stock. The long-term debt decreased by \$0.7 million, due primarily to sinking fund payments. See the "Long-Term Financing" section above for additional information.

Total capitalization at December 31, 2005 was \$571.5 million and at December 31, 2004 was \$565.9 million. The Company intends to issue common stock and long-term debt to maintain the Company's current capitalization structure, taking into account reinvestment of earnings above dividends. At December 31, capitalization ratios were:

	2005	2004
Common equity	51.4 %	50.8 %
Preferred stock	0.6 %	0.6 %
Long-term debt	48.0 %	48.6 %

The return (from both regulated and non-regulated operations) on average common equity was 9.3% in 2005 compared to 9.8% in 2004.

Acquisitions Although there were no significant acquisitions in the periods presented, the following acquisitions were completed in 2005 and 2004:

In April 2005, the Company acquired the water system assets of the Los Trancos Water District for \$125,000 in cash. The Los Trancos water system and its 270 customers were merged into Cal Water's Bear Gulch district. The purchase price was approximately equal to rate base and no goodwill was recorded in the transaction.

In June 2005, the Company acquired the water system assets of Gamble Bay for \$370,000. The Company assumed net liabilities of \$336,000 and the balance was paid in cash. The Company merged the water system and its 169 customers into Washington Water. The Company recorded an acquisition adjustment of \$18,000, which it believes will be included in rate base. As such, the purchase price is approximately equal to rate base and no goodwill was recorded.

In June 2005, the Company acquired the water system assets of the Cypress Gardens Water Company for \$312,000 in cash. The Company merged the water system and its 350 customers into New Mexico Water. The purchase price is approximately equal to rate base and no goodwill was recorded.

In April 2004, the Company acquired the stock of National Utility Company (NUC) and land from owners of NUC for \$0.9 million in cash. The Company retired NUC's stock and merged it into New Mexico Water. Revenue for NUC for the eight-month period in 2004 was \$0.4 million and net income was zero. The purchase price is approximately equal to rate base and an immaterial amount of goodwill was recorded in the transaction.

Real Estate Program The Company owns a certain amount of real estate. From time to time, certain parcels are deemed unnecessary for and are not used in water utility operations. Most surplus properties have a low cost basis. A program was 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. Property sales produced pretax gains of \$2.2 million in 2005, minimal pretax gains were recorded in 2004, and \$4.6 million was recorded in 2003. As sales are dependent on real estate market conditions, future sales, if any, may or may not be at prior year levels. As discussed in the "Rates and Regulation" section, future sales may be impacted by the CPUC ruling in its proceeding regarding sales of utility assets.

Critical Accounting Policies and Estimates

The Company maintains its accounting records in accordance with accounting principles generally accepted in the United States of America and as directed by the Commissions to which its 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. A summary of our significant accounting policies is listed in Note 2 of the Notes to Consolidated Financial Statements and other Notes provide additional information. The following sections describe the level of subjectivity, judgment, and variability of estimates that could have a material impact on the financial condition, operating performance, and cash flows of the business.

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." Application of SFAS No. 71 requires accounting for certain transactions in accordance with regulations defined by the respective Commission of that state. Under SFAS No. 71, a utility may defer certain costs of providing services if the rates established by its regulators are designed to recover the utility's specific costs and the economic environment gives reasonable assurance that those rates can be charged and collected throughout the periods necessary to recover the costs. In the event that 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 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 was no such asset impairment as of December 31, 2005. Additional information relating to regulatory assets and liabilities are listed in Note 2 of the Notes to Consolidated Financial Statements.

Unbilled Revenue Unbilled revenue is estimated for metered customers for water used between the last reading of the customer's meter and the end of the accounting period. This estimate is based on the usage from the last bill to the customer, which

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

normally covers a 30-day period, and is prorated from the last meter-read date to the end of the accounting period. The amount of variability is low at December 31, as this is one of the lowest usage months of the year and usage for the previous 30-day period is relatively consistent during this time of the year. Actual usage may vary from this estimate.

Flat-rate customers are billed in advance at the beginning of the service period. Since these are constant amounts, appropriate adjustments can be calculated to determine the revenue related to the applicable period.

Estimated Expenses Some expenses are recorded using estimates, as actual payments are not known or processed by the accounting deadline. Estimates are made for unbilled purchased water, unbilled purchased power, unbilled pump taxes, payroll, and other types of similar expenses. While management believes its estimates are reasonable, actual results could vary. Differences between actual results and estimates are recorded in the period when the information is known.

Expense Balancing and Memorandum Accounts Expense balancing accounts and memorandum accounts (offsettable expenses) represent recoverable costs incurred but not billed to customers. The amounts included in these accounts relate to rate changes charged to the Company for purchased water, purchased power, and pump taxes that are different from amounts incorporated into the rates approved by the CPUC. The Company does not record expense balancing or memorandum accounts in its financial statements as revenue, nor as a receivable, until the CPUC and other regulators have authorized recovery of the higher costs and customers have been billed. Therefore, a timing difference may occur between when costs and associated revenues are recognized. The balancing and memorandum accounts are only used to track the specific costs outside of the financial statements. The cost changes, which are beyond the Company's control, are referred to as "offsettable expenses" because under certain circumstances, they are recoverable from customers in future offset rate increases. During 2004 and 2005, the CPUC gave approval to charge customers for a portion of the offsettable expenses. Additionally, the Company may file with the CPUC for its offsettable expenses incurred in 2005. The amounts requested may not be ultimately collected through rates, as amounts may be disallowed during the review process or subject to a non-weather-adjusted earnings test. While the adjustments would not impact previously recorded amounts, the adjustments may change future earnings and cash flows. At this time, the Company cannot predict the actual recovery (refund) associated with 2005 offsettable expenses to be requested in 2006. (See "Rates and Regulation.")

Washington Water, New Mexico Water, and Hawaii Water did not have material amounts in expense balancing or memorandum accounts.

Income Taxes Significant judgment is required in determining the provision for income taxes. The process involves estimating current tax exposure and assessing temporary differences resulting from 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. Management 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 required. If a valuation allowance was required, it could significantly increase income tax expense. In management's view, a valuation allowance was not required at December 31, 2005. Detailed schedules relating to income taxes are provided in Note 11 of the Notes to Consolidated Financial Statements.

Employee Benefit Plans The Company incurs costs associated with its pension and postretirement health care benefit 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. Management works with independent actuaries to measure these benefits. Different estimates and/or actual amounts could result in significant variances in the costs and liabilities recognized for these 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 for managing investments in these plans. To diversify investment risk, the plan's goal is to invest 40%-60% of the assets in domestic equity mutual funds, 5%-15% in foreign equity mutual funds, and 35%-45% in bond funds. At December 31, 2005, 51.9% of the assets were invested in domestic equity mutual funds, 11.7% in foreign equity mutual funds, and 36.4% in bond funds. Based on the market values of the investment funds for the year ended December 31, 2005, the total return on the pension plan assets was 6.0%. For 2004 and 2003, returns were 13% and 19%, respectively. Future returns on investments could vary significantly from estimates and could impact earnings and cash flows. Management expects any changes to these costs to be recovered in future rate filings, mitigating the financial impact.

For measurement in 2005, management estimated the discount rate at 5.60%, which approximates the average return on long-term corporate bonds as of year-end. Using the interest rate curve developed by Citigroup as of December 31, 2004 and 2005, the equivalent level discount rates were 5.74% and 5.58%, respectively. Accordingly, the discount rate was lowered in 2005

from 6% to 5.60%. Management assumed the rate of compensation to increase 3% in its 2005 calculation. Any change in these assumptions would have an effect on the service costs, interest costs, and accumulated benefit obligations. Additional information related to employee benefit plans is listed in Note 12 of the Notes to Consolidated Financial Statements.

Workers' Compensation, General Liability, and Other Claims The Company is self-insured for a portion of workers' compensation and general liability claims. Excess amounts are covered by insurance policies. For workers' compensation, the Company utilizes an actuary firm to estimate the discounted liability associated with claims submitted and claims not yet submitted based on historical data. These estimates could vary significantly from actual claims paid, which could impact earnings and cash flows. For general liability claims and other claims, management estimates the cost incurred but not yet paid using historical information. Actual costs could vary from these estimates. Management believes actual costs incurred would be allowed in future rates, mitigating the financial impact.

Contingencies The Company did not record any provisions relating to the contingencies reported in Note 15 of the Notes to Consolidated Financial Statements, as these did not qualify for recording under SFAS No. 5 or other accounting standards. If management's assessment is incorrect, these items could have a material impact on the financial condition, results of operations, and cash flows of the Company.

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 Due to terrorist risks, the Company has heightened security at its facilities over the past few years and has taken added precautions to protect its employees and the water delivered to customers. The Company has complied with EPA regulations concerning vulnerability assessments and has made filings to the EPA as required. In addition, communication plans have been developed as a component of the Company's procedures related to this risk. While the Company does not make public comments on its security programs, the Company has been in contact with federal, state, and local law enforcement agencies to coordinate and improve water delivery systems' security.

Interest Rate Risk The Company is subject to interest rate risk, although this risk is lessened because the Company operates in a regulated industry. If interest rates were to increase, management believes customer rates would increase accordingly, subject to Commission approval in future GRC filings. The majority of debt is long-term, fixed rate. Interest rate risk does exist on short-term borrowings within the Company's credit facilities, as these interest rates are variable. The Company also has interest rate risk on new financing, as higher interest cost may occur on new debt if interest rates increase.

Stock Price Risk Because the Company operates primarily in a regulated industry, its stock price risk is somewhat lessened; however, regulated parameters also can be recognized as limitations to operations, earnings, and the ability to respond to certain business condition changes. For example, prior to 2004, the Company believes its stock price was adversely affected by analyst reports, which stated the Company's earnings were negatively impacted by the delays of certain CPUC decisions. An adverse change in the stock price could make issuance of common stock less attractive in the future.

Stock Market Performance Risk The Company's stock price could be impacted by changes in the general market. This could impact the costs of obtaining funds through the equity markets. Stock market performance could also impact the Company through the investments by the Company's defined benefit plan and postretirement medical benefit plan. The Company is responsible for funding these plans. Plan investments are made in stock market equities using mutual funds and in corporate bonds. Poor performance of the equity and bond markets could result in increased costs and additional funding requirements due to lower investment returns. Management believes the Company would be able to recover these higher costs in customer rates.

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

Recent Accounting Pronouncements and Law Changes

The description and impact of recent accounting pronouncements that are effective for the period reported are described in Note 2 of the Notes to Consolidated Financial Statements.

As of the filing date, there were no other accounting pronouncements affecting future periods that are expected to have a material impact on the Company's financial condition, results of operations, or cash flows.

Consolidated Balance Sheets

In thousands, except per share data

December 31,	2005	2004
Assets		
Utility plant:		
Land	\$ 14,274	\$ 13,070
Depreciable plant and equipment	1,171,218	1,102,932
Construction work in progress	35,372	13,248
Intangible assets	14,226	14,824
Total utility plant	1,235,090	1,144,074
Less accumulated depreciation and amortization	372,359	343,769
Net utility plant	862,731	800,305
Current assets:		
Cash and cash equivalents	9,533	18,820
Receivables, net of allowance for uncollectible accounts		
Customers	16,061	15,867
Income taxes	-	7,298
Other	4,700	3,147
Unbilled revenue	11,445	9,307
Materials and supplies at weighted average cost	4,182	3,161
Prepaid pension expense	1,696	3,671
Taxes and other prepaid expenses	4,607	9,122
Total current assets	52,224	70,393
Other assets:		
Regulatory assets	58,213	53,477
Unamortized debt premium and expense	7,746	8,411
Other	16,031	10,267
Total other assets	81,990	72,155
	\$ 996,945	\$ 942,853

	2005	2004
Capitalization and Liabilities		
Capitalization:		
Common stock, \$0.01 par value; 25,000 shares authorized, 18,390 and 18,867, outstanding in 2005 and 2004, respectively	\$ 184	\$ 184
Additional paid-in capital	131,991	131,271
Retained earnings	162,968	156,851
Accumulated other comprehensive loss	(1,202)	(701)
Total common stockholders' equity	293,941	287,605
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	274,142	274,821
Total capitalization	571,558	565,901
Current liabilities:		
Current maturities of long-term debt	1,133	1,100
Accounts payable	36,120	19,745
Accrued taxes	1,791	1,912
Accrued interest	2,715	2,676
Other accrued liabilities	35,057	31,779
Total current liabilities	76,816	57,212
Unamortized investment tax credits	2,615	2,721
Deferred income taxes	63,920	54,826
Regulatory liabilities	18,782	18,811
Advances for Construction	141,842	131,292
Contributions in Aid of Construction	99,958	94,915
Other long-term liabilities	21,454	17,175
Commitments and contingencies	-	-
	\$ 996,945	\$ 942,853

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Income

In thousands, except per share data

For the years ended December 31,

	2005	2004	2003
Operating revenue	\$820,728	\$815,567	\$277,128
Operating expenses:			
Operations			
Purchased water	87,504	89,787	80,831
Purchased power	20,541	21,801	21,921
Pump taxes	7,620	7,555	6,272
Administrative and general	48,655	47,078	40,969
Other	40,082	39,929	37,476
Maintenance	15,216	13,228	12,717
Depreciation and amortization	28,731	26,114	23,256
Income taxes	20,006	17,084	12,898
Property and other taxes	12,613	11,508	10,554
Total operating expenses	280,918	274,084	246,894
Net operating income	39,810	41,483	30,234
Other income and expenses:			
Non-regulated income, net	2,863	2,375	2,097
Gain on the sale of non-utility property	2,250	8	4,603
Total other income and expenses	5,113	2,383	6,700
Interest expense:			
Interest expense	18,600	18,664	19,512
Less capitalized interest	900	824	1,995
Net interest expense	17,700	17,840	17,517
Net income	\$ 27,223	\$ 26,026	\$ 19,417
Earnings per share:			
Basic	\$ 1.47	\$ 1.46	\$ 1.21
Diluted	\$ 1.47	\$ 1.46	\$ 1.21
Weighted average number of common shares outstanding:			
Basic	18,379	17,652	15,882
Diluted	18,402	17,674	15,893

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Common Stockholders' Equity and Comprehensive Income

In thousands

For the years ended December 31, 2005, 2004, and 2003

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
Balance at December 31, 2002	\$ 152	\$ 49,984	\$149,215	\$ (134)	\$199,217
Net income	-	-	19,417	-	19,417
Net other comprehensive loss	-	-	-	(167)	(167)
Comprehensive income	-	-	-	-	19,250
Issuance of common stock	17	43,764	-	-	43,781
Dividends paid:					
Preferred stock	-	-	(153)	-	(153)
Common stock	-	-	(17,571)	-	(17,571)
Total dividends paid	-	-	(17,724)	-	(17,724)
Balance at December 31, 2003	169	93,748	150,908	(301)	244,524
Net income	-	-	26,026	-	26,026
Net other comprehensive loss	-	-	-	(400)	(400)
Comprehensive income	-	-	-	-	25,626
Issuance of common stock	15	37,523	-	-	37,538
Dividends paid:					
Preferred stock	-	-	(153)	-	(153)
Common stock	-	-	(19,930)	-	(19,930)
Total dividends paid	-	-	(20,083)	-	(20,083)
Balance at December 31, 2004	184	131,271	156,851	(701)	287,605
Net income	-	-	27,223	-	27,223
Net other comprehensive loss	-	-	-	(501)	(501)
Comprehensive income	-	-	-	-	26,722
Issuance of common stock	-	720	-	-	720
Dividends paid:					
Preferred stock	-	-	(153)	-	(153)
Common stock	-	-	(20,953)	-	(20,953)
Total dividends paid	-	-	(21,106)	-	(21,106)
Balance at December 31, 2005	\$ 184	\$131,991	\$162,968	\$ (1,202)	\$293,941

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

In thousands

For the years ended December 31,

Operating activities:

	2005	2004	2003
Net income	\$ 27,223	\$ 26,026	\$ 19,417
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	28,731	26,114	23,256
Net change in deferred income taxes, investment tax credits, regulatory assets and liabilities	3,908	17,637	2,834
Gain on sale of non-utility property	(2,250)	(8)	(4,603)
Changes in operating assets and liabilities:			
Receivables	5,545	(2,720)	1,292
Unbilled revenue	(2,138)	(771)	(554)
Taxes and other prepaid expenses	6,491	(7,168)	(2,876)
Accounts payable	16,374	(4,042)	(301)
Other current assets	(1,021)	(203)	(197)
Other current liabilities	3,841	2,713	7,537
Other changes, net	(445)	(2,167)	(1,374)
Net adjustments	59,036	29,385	25,014
Net cash provided by operating activities	86,259	55,411	44,431

Investing activities:

Utility plant expenditures:			
Company-funded	(77,569)	(50,388)	(53,884)
Developer advances and contributions in aid of construction	(16,948)	(18,185)	(20,369)
Proceeds from sale of non-utility assets	2,316	14	4,803
Acquisitions	(471)	(900)	(6,094)
Net cash used in investing activities	(92,672)	(69,459)	(75,544)

Financing activities:

Net changes in short-term borrowings	-	(6,454)	(29,925)
Issuance of common stock, net of expenses	720	37,538	43,781
Issuance of long-term debt, net of expenses	227	3,501	80,114
Advances for construction	15,389	14,388	13,248
Refunds of advances for construction	(4,840)	(5,049)	(4,838)
Contributions in aid of construction	7,924	6,882	9,311
Retirement of long-term debt	(1,188)	(711)	(61,061)
Dividends paid	(21,106)	(20,083)	(17,724)
Net cash (used in) provided by financing activities	(2,874)	30,012	32,906
Change in cash and cash equivalents	(9,287)	15,964	1,793
Cash and cash equivalents at beginning of year	18,820	2,856	1,063
Cash and cash equivalents at end of year	\$ 9,533	\$ 18,820	\$ 2,856

Supplemental disclosures of cash flow information:

Cash paid during the year for

Interest (net of amounts capitalized)	\$ 16,811	\$ 17,202	\$ 16,873
Income taxes	12,411	8,026	6,188

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

December 31, 2005, 2004, and 2003

Amounts in thousands, except per share data and share data

Note 1. Organization and Operations

California Water Service Group (Company) is a holding company that provides water utility and other related services in California, Washington, New Mexico, and Hawaii through its wholly owned subsidiaries. California Water Service Company (Cal Water), Washington Water Service Company (Washington Water), New Mexico Water Service Company (New Mexico Water), and Hawaii Water Service Company, Inc. (Hawaii Water) provide regulated utility services under the rules and regulations of their respective state's regulatory commissions (jointly referred to as the Commissions). CWS Utility Services (Utility Services) provides non-regulated water utility and utility-related services. At Cal Water, as of December 31, 2005, there were 566 union employees covered by two-year agreements with the Utility Workers Union of America, AFL-CIO, and the International Federation of Professional and Technical Engineers, AFL-CIO. The agreements include a 3.5% wage increase for 2006, with wage increases for 2007 to be negotiated in the fall of 2006. The Company believes that it maintains good relationships with the unions. Employees at Washington Water, Hawaii Water and New Mexico Water do not belong to Unions.

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

Note 2. Summary of Significant Accounting Policies

Principles of Consolidation and Accounting Records The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. Inter-company transactions and balances have been eliminated. The accounting records of the Company are maintained in accordance with the uniform system of accounts prescribed by the Commissions.

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 wastewater services 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.

The Company provides an allowance for doubtful accounts. The balance of customer receivables, net of the allowance for doubtful accounts was \$272 and \$287 at December 31, 2005 and 2004, respectively. The activity in the reserve account is as follows:

	2005	2004
Beginning Balance	\$ 287	\$ 289
Provision for uncollectible accounts	756	1,073
Net write-off of uncollectible accounts	(771)	(1,075)
Ending Balance	\$ 272	\$ 287

Non-Regulated Revenue Revenues from non-regulated operations and maintenance agreements are recognized when services have been rendered to companies or municipalities under such agreements. Expenses are netted against the revenue billed and are reported in Other Income and Expenses on the Consolidated Statements of Income. Other non-regulated revenue is recognized when title has transferred to the buyer, or ratably over the term of the lease. For construction and design services, revenue is generally recognized on the completed contract method, as most projects are completed in less than three months.

Expense Balancing and Memorandum Accounts Expense balancing and memorandum accounts are used to track suppliers' rate changes for purchased water, purchased power, and pump taxes that are not included in customer water rates. The cost changes are referred to as "Offsettable Expenses" because under certain circumstances they are recoverable from customers (or refunded to customers) in future rates designed to offset the cost changes from the suppliers. The Company does not record the balancing

Notes to Consolidated Financial Statements

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 the date of acquisition. When depreciable plant is retired, the cost is eliminated from utility plant accounts and such costs are charged against accumulated depreciation. Maintenance of utility plant is charged to operating expenses as incurred. Maintenance projects are not accrued for in advance. Interest is capitalized on plant expenditures during the construction period and amounted to \$900 in 2005, \$824 in 2004, and \$1,995 in 2003.

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 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.

The following table represents depreciable plant and equipment as of December 31:

	2005	2004
Equipment	\$ 234,073	\$ 214,202
Transmission and distribution plant	864,450	819,793
Office buildings and other structures	72,695	68,937
Total	\$1,171,218	\$1,102,932

Depreciation of utility plant for financial statement purposes is computed on a straight-line basis over the assets' estimated useful lives and provides for asset retirement costs as follows:

	Useful Lives
Equipment	5 to 50 years
Transmission and distribution plant	40 to 65 years
Office buildings and other structures	50 years

The provision for depreciation expressed as a percentage of the aggregate depreciable asset balances was 2.7% in 2005, 2.6% in 2004, and 2.5% in 2003. 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 with original maturities of three months or less. As of December 31, 2005 and 2004, cash equivalents included investments in money market funds in the amount of \$4,003 and \$6,133, respectively, and investment in high-quality commercial paper in the amount of zero and \$4,997, respectively.

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. All restricted cash is classified in other prepaid expenses. At December 31, 2005 and 2004, restricted cash was \$1,200 and \$1,337, respectively.

Regulatory Assets and Liabilities The Company records regulatory assets for future revenues expected to be realized in customers' rates when certain items are recognized as expenses for rate-making purposes. The income tax temporary differences relate primarily to the difference between book and federal income tax depreciation on utility plant that was placed in service before the regulatory Commissions adopted normalization for rate-making purposes. Previously, the tax benefit of tax depreciation was passed onto customers (flow-through). For state income tax purposes, the Commission continues to use the flow-through method. As such timing differences reverse, the Company will be able to include the impact of such differences in customer rates. These federal tax differences will continue to 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. Asset retirement obligations are recorded net of depreciation, which has been recorded and recognized through the regulatory process. The liabilities relate to asset retirement obligations, postretirement benefits other than pensions, and accrued benefits for vacation, self-insured workers' compensation, and directors' retirement benefits.

Regulatory liabilities represent future benefits to ratepayers for tax deductions that will be allowed in the future. Regulatory liabilities also reflect timing differences provided at higher than the current tax rate, which will flow through to future ratepayers.

Regulatory assets and liabilities are comprised of the following as of December 31:

	2005	2004
Regulatory Assets		
Income tax temporary differences	\$ 32,856	\$ 29,196
Asset retirement obligations, net	1,538	2,540
Postretirement benefits other than pensions	9,791	9,019
Other accrued benefits	14,028	12,722
Total regulatory assets	\$ 58,213	\$ 53,477
Regulatory Liabilities		
Future tax benefits due ratepayers	\$ 18,782	\$ 18,811

Long-Lived Assets The Company regularly reviews its long-lived assets for impairment, annually or when events or changes in business circumstances have occurred that 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 the asset. If assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying value of the asset exceeds its fair value. There have been no asset impairments as of December 31, 2005 and 2004.

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 the unamortized original issue discount and expense are amortized over the life of new debt issued in conjunction with the early redemption. These amounts were zero in 2005 and 2004 and \$3,154 in 2003. Amortization expense included in interest expense was \$661, \$660, and \$415 for 2005, 2004, and 2003, respectively.

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, resulting in an accumulated other comprehensive loss that has been recorded net of tax 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. Advances of \$141,168 and \$130,558 at December 31, 2005 and 2004, respectively, are refunded primarily over a 40-year period in equal annual amounts. In addition, other Advances for Construction totaling \$674 and \$734 at December 31, 2005 and 2004, respectively, are refundable based upon customer connections. Estimated refunds of advances for each succeeding year (2006 through 2010) are \$5,077, \$4,921, \$4,856, \$4,795, \$4,793, and \$117,400 thereafter.

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 assets acquired from contributions is charged to Contributions in Aid of Construction account.

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 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. ITCs 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

Notes to Consolidated Financial Statements

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 contributions of fire services from taxable income.

Workers' Compensation, General Liability and Other Claims For workers' compensation, the Company utilized an actuary firm to estimate the discounted liability associated with claims submitted and claims not yet submitted based on historical data. For general liability claims and other claims, the Company estimates the cost incurred but not yet paid using historical information.

Earnings Per Share The computations of basic and diluted earnings per share are noted below. Common stock options outstanding to purchase common shares were 98,000, 121,500, and 149,250 at December 31, 2005, 2004, and 2003, respectively. All options are dilutive and the dilutive effect is shown in the table below.

	2005	2004	2003
Net income, as reported	\$ 27,223	\$ 26,026	\$ 19,417
Less preferred dividends	153	153	153
Net income available to common stockholders	\$ 27,070	\$ 25,873	\$ 19,264
Weighted average common shares, basic	18,379	17,652	15,882
Dilutive common stock options (treasury method)	23	22	11
Shares used for dilutive calculation	18,402	17,674	15,893
Earnings per share – basic	\$ 1.47	\$ 1.46	\$ 1.21
Earnings per share – dilutive	\$ 1.47	\$ 1.46	\$ 1.21

Stock-Based Compensation The Company has a stockholder-approved Long-Term Incentive Plan under which non-qualified stock options are outstanding. The Company has adopted the disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition Disclosure – An Amendment to SFAS No. 123," 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, 2005, 2004, or 2003.

In 2005, the Company adopted a stockholder-approved Equity Incentive Plan that allows certain stock-based compensation awards. There were no awards during 2005. The Company adopted SFAS No. 123 (revised 2004) "Share-Based Payment," effective January 1, 2006, and will be recording compensation expense in accordance with that standard for any awards granted in the future.

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 SFAS No. 123 to stock-based employee compensation under the Long-Term Incentive Plan.

	2005	2004	2003
Net income available to common stockholders	\$ 27,070	\$ 25,873	\$ 19,264
Deduct: Total stock-based employee compensation expense determined under fair-value-based method for all awards, net of related tax effects	46	67	68
Pro forma net income available to common stockholders	\$ 27,024	\$ 25,806	\$ 19,196
Earnings per share:			
Basic – as reported	\$ 1.47	\$ 1.46	\$ 1.21
Basic – pro forma	\$ 1.47	\$ 1.46	\$ 1.21
Diluted – as reported	\$ 1.47	\$ 1.46	\$ 1.21
Diluted – pro forma	\$ 1.47	\$ 1.46	\$ 1.21

Recent Accounting Pronouncements In May 2004, the FASB issued FASB Staff Position (FSP) No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." FSP No. 106-2 was effective for the first quarter after June 15, 2004, and replaces FSP No. 106-1. FSP No. 106-1 was effective for the Company's consolidated financial statements for the year ended December 31, 2003. The Company has determined its retiree health plan is actuarially equivalent and would qualify for the subsidy that would begin in 2006. Because the Company is regulated, FSP No. 106-2 did not have an impact on the income statement or cash flows in 2004. The adjustment for FSP No. 106-2 impacted the balance sheet only, decreasing liabilities and regulatory assets by \$663 in 2004. In 2005, the Company elected to apply the entire subsidy to reduce the cost of the retiree health care expense. The impact on the net periodic postretirement benefit costs for 2005 was to reduce the expense by \$1,574.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs – an Amendment to ARB No. 43, Chapter 4." The statement clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material. The statement is effective for fiscal years beginning after June 15, 2005. The adoption of this statement is not expected to impact the Company's financial position, results of operations, or cash flows.

In December 2004, the FASB issued SFAS No. 153, "Exchange of Nonmonetary Assets." The statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. The statement is effective for fiscal years beginning after June 15, 2005. The adoption of this statement is not expected to impact the Company's financial position, results of operations, or cash flows.

In December 2004, the FASB issued SFAS No. 123 (revised 2004) "Share-Based Payment," which revises SFAS No. 123, "Accounting for Stock-Based Compensation." The statement requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). The statement is effective for the Company in the first quarter of 2006. The adoption of this statement is not expected to materially impact the Company's financial position, results of operations, or cash flows for equity instruments based upon the level of options previously granted and the level of awards granted in January 2006. In January 2006, Restrict Stock Awards were granted for 9,142 shares of common stock and Stock Appreciation Rights Awards were granted for 37,500 shares of common stock.

In December 2004, the FASB issued FSP No. 109-1, "Application of FASB Statement No. 109, *Accounting for Income Tax*, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creations Act of 2004." FSP No. 109-1 provides guidance on the application of SFAS No. 109 to the provision within the American Jobs Creation Act of 2004 (Act) that provides a

Notes to Consolidated Financial Statements

tax deduction on qualified production activities. The guidance states that the deduction should be accounted for as a special deduction in accordance with SFAS No. 109. The adoption of this guidance did not have a material impact on the Company's financial position, results of operations, or cash flows.

In March 2005, the FASB issued Interpretation No. 46R-5, "Implicit Variable Interests under FASB Interpretation No. 46 (revised December 2003)," which amends Interpretation No. 46, "Consolidation of Variable Interest Entities." The revision relates to issues commonly arising in leasing arrangements among related parties and other types of arrangements involving related and unrelated parties. The original guidance under Interpretation No. 46 in January 2003 is still applicable. Interpretation Nos. 46 and 46R-5 provide guidance for determining when a primary beneficiary should consolidate a variable interest entity or equivalent structure that functions to support the activities of a primary beneficiary. Interpretation No. 46R-5 is effective for the first reporting period beginning after March 3, 2005. The adoption of Interpretation No. 46R-5 did not impact the Company's financial position, results of operations, or cash flows.

In March 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations – an Interpretation of FASB Statement No. 143." Interpretation No. 47 provides guidelines as to when a company is required to record a conditional asset retirement obligation. In general, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The fair value of a liability for the conditional asset retirement obligation should be recognized when incurred – generally upon acquisition, construction, or development and (or) through the normal operation of the asset. The Interpretation is effective no later than the end of fiscal years ending after December 15, 2005 (December 31, 2005, for calendar-year enterprises). The adoption of this Interpretation did not have a material impact on the Company's financial position, results of operations, or cash flows. The Company has been allowed to collect retirement obligation costs from ratepayers through depreciation expense. As of December 31, 2005, the Company estimates its retirement obligation costs to be \$4,480, of which \$2,942 has been collected from ratepayers. The balance is recorded as a regulatory asset.

In May 2005, the FASB issued Statement No. 154, "Accounting Changes and Error Corrections – a Replacement of APB Opinion No. 20 and FASB Statement No. 3." Statement No. 154 replaces APB Opinion No. 20, "Accounting Changes," and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirements for and the reporting of a change of an accounting principle. This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The Statement is effective for all fiscal years beginning after December 15, 2005. The adoption of this Statement did not have a material impact on the Company's financial position, results of operations, or cash flows.

Note 3. Other Income and Expenses

The Company conducts various non-regulated activities as reflected in the table below. Income reflects revenue less direct and allocated costs. Income taxes are not included.

	2005		2004		2003	
	Revenue	Income	Revenue	Income	Revenue	Income
Operating and maintenance	\$ 4,931	\$ 1,142	\$ 4,536	\$ 997	\$ 4,137	\$ 939
Meter reading and billing	1,112	473	1,261	622	1,337	473
Leases	1,457	958	1,285	818	1,190	781
Water rights brokering	-	-	-	(96)	196	112
Design and construction	929	232	606	209	1,305	204
Other and non-regulated expenses	831	58	385	(175)	320	(412)
Total	\$ 9,260	\$ 2,863	\$ 8,073	\$ 2,375	\$ 8,485	\$ 2,097

Operating and maintenance services and meter reading and billing services are provided for water and wastewater systems owned by private companies and municipalities. The agreements call for a fee-per-service or a flat-rate amount per month. Leases have been entered into with telecommunications companies for cellular phone antennas placed on the Company's property. Water rights brokering activity involves purchasing water rights from third parties and reselling those rights to other third parties. Design

and construction services are for the design and installation of water mains and other water infrastructure for others outside the Company's regulated service areas.

Note 4. Acquisitions

In 2005, after receiving regulatory approval, the Company's subsidiaries acquired three water systems for a combined purchase price of \$807, including liabilities assumed of \$336, which was the approximate value of the rate base in aggregate of the assets acquired.

In 2004, after receiving regulatory approval, the Company's wholly owned subsidiary, New Mexico Water, acquired the stock of National Utilities Corporation. The purchase was for \$900, which was the approximate amount of rate base of the assets acquired and for certain real estate used by the water system.

In 2003, after receiving regulatory approval, the Company acquired the Kaanapali Water Corporation and renamed the corporation Hawaii Water Service Company, Inc. The purchase was for \$6,094, which was the approximate amount of the rate base of assets acquired.

Condensed balance sheets and pro forma results of operations for these acquisitions have not been presented since the impact of the purchases was not material. Minimal or no goodwill was recorded in connection with the acquisitions.

Note 5. Intangible Assets

As of December 31, 2005 and 2004, intangible assets that will continue to be amortized and those not amortized were:

	Weighted Average Amortization Period	2005			2004		
		Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Amortized intangible assets:							
Hawthorne lease	15	\$ 6,515	\$ 4,271	\$ 2,244	\$ 6,515	\$ 3,837	\$ 2,678
Water pumping rights	usage	1,084	11	1,073	1,046	8	1,038
Water planning studies	14	2,873	605	2,268	3,164	763	2,401
Leasehold improvements & other	24	876	515	361	1,130	624	506
Total	16	\$ 11,348	\$ 5,402	\$ 5,946	\$ 11,855	\$ 5,232	\$ 6,623
Unamortized intangible assets:							
Perpetual water rights and other		\$ 2,878	-	\$ 2,878	\$ 2,969	-	\$ 2,969

For the years ending December 31, 2005, 2004, and 2003, amortization of intangible assets was \$876, \$799, and \$713, respectively. Estimated future amortization expense related to intangible assets for the succeeding five years is \$749, \$706, \$677, \$652, and \$624, and \$2,537 thereafter.

Note 6. Preferred Stock

As of December 31, 2005 and 2004, 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 would be due to preferred stock shareholders 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 16 votes, with the right to cumulative votes at any election of directors.

Notes to Consolidated Financial Statements

Note 7. Common Stockholders' Equity

The Company is authorized to issue 25 million shares of \$0.01 par value common stock. As of December 31, 2005 and 2004, 18,389,996 shares and 18,367,246 shares, respectively, of common stock were issued and outstanding.

Dividend Reinvestment and Stock Repurchase Plan The Company has a Dividend Reinvestment and Stock Purchase Plan (Plan). Under the Plan, stockholders may reinvest dividends to purchase additional Company common stock without commission fees. The Plan also allows existing stockholders and other interested investors to purchase Company common stock through the transfer agent up to certain limits. The Company's transfer agent operates the Plan and purchases shares on the open market to provide shares for the Plan.

Stockholder Rights Plan The Company's Stockholder Rights Plan (Plan) is designed to protect stockholders 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 10-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.

Note 8. Short-Term Borrowings

At December 31, 2005, the Company maintained a bank line of credit providing unsecured borrowings of up to \$10 million 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 \$45 million on the same terms as the Company's line of credit. Both agreements required a 30-day out-of-debt period during any 24 consecutive months. The \$10 million and \$45 million lines have a requirement where the outstanding balance must be below \$10 million and \$5 million, respectively, for a 30-day consecutive period during any 12-month period. Both agreements have a covenant requiring debt as a percentage of total capitalization to be less than 67%. At December 31, 2005, there were no borrowings on the Company or Cal Water line, and one letter of credit for \$0.5 million is outstanding under the Cal Water line.

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

Dollars in thousands	2005	2004	2003
Maximum short-term borrowings	\$ -	\$ 18,800	\$ 58,633
Average amount outstanding	\$ -	\$ 4,330	\$ 30,388
Weighted average interest rate	n/a	2.94 %	2.96 %
Interest rate at December 31	n/a	n/a	4.08 %

Note 9. Long-Term Debt

As of December 31, 2005 and 2004, long-term debt outstanding was:

	Series	Interest Rate	Maturity Date	2005	2004
First Mortgage Bonds:	J	8.86%	2023	\$ 3,600	\$ 3,800
	K	6.94%	2012	5,000	5,000
	CC	9.86%	2020	18,100	18,200
Total First Mortgage Bonds				26,700	27,000
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	20,000
	F	5.90%	2017	20,000	20,000
	G	5.29%	2022	20,000	20,000
	H	5.29%	2022	20,000	20,000
	I	5.54%	2023	10,000	10,000
	J	5.44%	2018	10,000	10,000
	K	4.58%	2010	10,000	10,000
	L	5.48%	2018	10,000	10,000
	M	5.52%	2013	20,000	20,000
	N	5.55%	2013	20,000	20,000
Total Senior Notes				240,000	240,000
California Department of Water Resources loans		3.0% to 7.4%	2008-32	2,546	2,673
Other long-term debt				6,029	6,248
Total long-term debt				275,275	275,921
Less current maturities				1,133	1,100
Long-term debt excluding current maturities				\$ 274,142	\$274,821

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 includes a term loan of \$3.4 million for New Mexico Water and other equipment and system acquisition financing arrangements with financial institutions. Aggregate maturities and sinking fund requirements for each of the succeeding five years (2006 through 2010) are \$1,133, \$1,115, \$1,095, \$1,026, and \$965, and \$269,941 thereafter.

Notes to Consolidated Financial Statements

Note 10. Other Accrued Liabilities

As of December 31, 2005 and 2004, other accrued liabilities were:

	2005	2004
Accrued pension and postretirement benefits	\$ 14,272	\$ 13,032
Accrued and deferred compensation	9,370	7,953
Accrued benefit and workers' compensation claims	4,533	4,142
Other	6,882	6,652
Total other accrued liabilities	\$ 35,057	\$ 31,779

Note 11. Income Taxes

Income tax expense consists of the following:

		Federal	State	Total
2005	Current	\$ 12,275	\$ 3,433	\$ 15,708
	Deferred	4,274	24	4,298
	Total	\$ 16,549	\$ 3,457	\$ 20,006
2004	Current	\$ 4,211	\$ 3,623	\$ 7,834
	Deferred	9,146	104	9,250
	Total	\$ 13,357	\$ 3,727	\$ 17,084
2003	Current	\$ 8,506	\$ 2,604	\$ 11,110
	Deferred	1,697	91	1,788
	Total	\$ 10,203	\$ 2,695	\$ 12,898

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

	2005	2004	2003
Computed "expected" tax expense	\$ 16,530	\$ 15,089	\$ 11,310
Increase (reduction) in taxes due to:			
State income taxes net of federal tax benefit	2,714	2,477	1,846
Investment tax credits	(31)	(139)	(91)
Other	793	(343)	(167)
Total income tax	\$ 20,006	\$ 17,084	\$ 12,898

Included in Other in the above table is the recognition of the flow-through accounting for federal depreciation expense on assets acquired prior to 1982. For assets acquired prior to 1982, the benefit of excess tax depreciation was previously passed through to the ratepayers. The tax benefit is now reversing and a higher tax expense is being recognized and is included in customer rates.

In October 2004, the American Jobs Creation Act of 2004 (Act) was signed into law and provides a new federal income tax deduction from qualified U.S. production activities, which is being phased in from 2005 through 2010. Under the Act, qualified production activities include production of potable water, but exclude the transmission and distribution of the potable water. In December 2004, the FASB issued FASB Staff Position No. 109-1 and proposed that the deduction should be accounted for as a "special deduction" in accordance with SFAS No. 109. As such, the special deduction had no effect on deferred tax assets and liabilities existing at the enactment date. Rather, the impact of the deduction is being reported in the year in which the deduction is claimed on the Company's tax return. During 2005, the Company completed its evaluation of the provisions of the Act and included a deduction in the provision for income taxes. The impact was to lower the income tax provision by \$175 in 2005.

The components of deferred income tax expense were:

In thousands	2005	2004	2003
Depreciation	\$ 3,593	\$ 11,603	\$ 3,110
Developer Advances and Contributions	(561)	(1,409)	(1,136)
Prepaid expenses	2,004	-	-
Bond redemption premiums	-	(231)	911
Investment tax credits	(106)	(107)	(110)
Other	(632)	(606)	(987)
Total deferred income tax expense	\$ 4,298	\$ 9,250	\$ 1,788

The tax effects of differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2005 and 2004 are presented in the following table:

	2005	2004
Deferred tax assets:		
Developer deposits for extension agreements and Contributions in Aid of Construction	\$ 48,020	\$ 47,688
Federal benefit of state tax deductions	7,464	7,120
Book plant cost reduction for future deferred ITC amortization	1,545	1,607
Insurance loss provisions	1,846	1,158
Pension plan	1,663	1,524
Other	812	190
Total deferred tax assets	61,350	59,287
Deferred tax liabilities:		
Utility plant, principally due to depreciation differences	120,875	111,506
Prepaid expense	2,004	-
Premium on early retirement of bonds	2,391	2,607
Total deferred tax liabilities	125,270	114,113
Net deferred tax liabilities	\$ 63,920	\$ 54,826

A valuation allowance was not required at December 31, 2005 and 2004. 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.

Notes to Consolidated Financial Statements

Note 12. Employee Benefit Plans

Pension Plans The Company provides a qualified, defined-benefit, non-contributory pension plan for substantially all employees. The Company also maintains an unfunded, non-qualified, supplemental executive retirement plan. The costs of plans are charged to expense and utility plant. The Company makes annual contributions to fund the amounts accrued for pension cost. The Company estimates that the annual contribution to the pension plans will be \$7.4 million in 2006. Plan assets in the defined benefit pension plan as of December 31, 2005 and 2004 (the measurement dates for the plan) were as follows:

Asset Category	Target	2005	2004
Bond funds	35 % to 45 %	36.4 %	39.4 %
Equity accounts	55 % to 65 %	63.6 %	60.6 %

The investment objective of the fund is to maximize the return on assets, commensurate with the risk the Company Trustees deem appropriate to meet the obligations of the Plan, minimize the volatility of the pension expense, and account for contingencies. The Trustees utilize the services of an outside investment advisor and periodically measure fund performance against specific indexes in an effort to generate a rate of return for the total portfolio that equals or exceeds the actuarial investment rate assumptions.

Pension payment obligations are generally funded by the purchase of an annuity from a life insurance company. In 2005, the Plan annuitized pension benefits that would otherwise be paid to certain retirees in the future. Benefit payments under the supplemental executive retirement plan are paid currently. Excluding costs to annuitize future retirement benefits, benefits expected to be paid in each year from 2006 through 2010 are \$2,610, \$3,266, \$4,412, \$5,617, and \$5,683, respectively. The aggregate benefit expected to be paid in the five years 2011 through 2015 is \$39,142. The expected benefit payments are based upon the same assumptions used to measure the Company's benefit obligation at December 31, 2005, and include estimated future employee service.

The accumulated benefit obligations of the pension plan are \$71,463 and \$65,938 as of December 31, 2005 and 2004, respectively. The fair value of pension plan assets was \$70,225 and \$75,064 as of December 31, 2005 and 2004, respectively. The unfunded supplemental executive retirement plan accumulated benefit obligations were \$8,608 and \$7,234 as of December 31, 2005 and 2004, respectively.

The data in the following tables includes the unfunded, non-qualified, supplemental executive retirement plan.

Savings Plan The Company sponsors a 401(k) qualified, defined-contribution savings plan that allows participants to contribute up to 20% of pre-tax compensation. The Company matches 50 cents for each dollar contributed by the employee up to a maximum Company match of 4.0%. Company contributions were \$1,498, \$1,443, and \$1,433, for the years 2005, 2004, and 2003, respectively.

Other Postretirement Plan 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, along with their spouses and dependents, continue 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 other than pension during the employees' years of active service. The Company has recorded a regulatory asset in prior years for the difference between the Company-funded amount and the net periodic benefit cost. The Company intends to file with the Commission an Advice Letter to recover the regulatory asset in future customer rates, as customer rates have only included the lower Company-funded amount.

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, 2005 and 2004:

	Pension Benefits		Other Benefits	
	2005	2004	2005	2004
Change in benefit obligation:				
Beginning of year	\$ 87,616	\$ 88,356	\$ 30,870	\$ 22,219
Service cost	4,335	4,608	1,019	1,461
Interest cost	5,511	5,613	1,088	1,560
Assumption change	11,783	(5,992)	(8,364)	3,266
Benefit adjustment	4,086	-	-	-
Medicare Modernization Act	-	-	-	(4,360)
Experience (gain) loss	3,426	2,938	(2,106)	8,130
Benefits paid, net of retiree premiums	(13,559)	(7,907)	(1,030)	(1,406)
End of year	\$ 103,198	\$ 87,616	\$ 21,477	\$ 30,870
Change in plan assets:				
Fair value of plan assets at beginning of year	\$ 75,064	\$ 63,216	\$ 4,543	\$ 3,697
Actual return on plan assets	4,000	8,298	184	294
Employer contributions	4,720	11,457	1,356	1,958
Retiree contributions	-	-	651	649
Benefits paid	(13,559)	(7,907)	(1,681)	(2,055)
Fair value of plan assets at end of year	\$ 70,225	\$ 75,064	\$ 5,053	\$ 4,543
Funded status	\$ (32,973)	\$ (12,552)	\$ (16,424)	\$ (26,327)
Unrecognized actuarial (gain) or loss	13,516	(2,783)	4,053	14,293
Unrecognized prior service cost	17,473	15,383	564	638
Unrecognized transition obligation	-	-	2,217	2,493
Unrecognized net initial asset	-	-	(276)	(276)
Net amount recognized	\$ (1,984)	\$ 48	\$ (9,866)	\$ (9,179)

Amounts recognized on the balance sheet consist of:

	Pension Benefits		Other Benefits	
	2005	2004	2005	2004
Accrued benefit costs	\$ (1,984)	\$ 48	\$ (9,866)	\$ (9,179)
Additional minimum liability	(6,921)	(3,081)	-	-
Intangible asset	5,719	2,380	-	-
Accumulated other comprehensive loss	1,202	701	-	-
Net amount recognized	\$ (1,984)	\$ 48	\$ (9,866)	\$ (9,179)

Notes to Consolidated Financial Statements

Below are the actuarial assumptions used in determining the benefit obligation for the benefit plans:

Weighted average assumptions as of December 31:	Pension Benefits		Other Benefits	
	2005	2004	2005	2004
Discount rate	5.60%	6.00%	5.60%	6.00%
Long-term rate of return on plan assets	8.00%	8.00%	8.00%	8.00%
Rate of compensation increases	3.75%	3.00%	-	-

The long-term rate of return assumption is the expected rate of return on a balanced portfolio invested roughly 60% in equities and 40% in fixed income securities. The average return for the plan for the last five and 10 years was 7% and 8.7%, respectively.

Net periodic benefit costs for the pension and other postretirement plans for the years ending December 31, 2005, 2004, and 2003 included the following components:

	Pension Plan			Other Benefits		
	2005	2004	2003	2005	2004	2003
Service cost	\$ 4,335	\$ 4,608	\$ 3,879	\$ 1,019	\$ 1,461	\$ 1,033
Interest cost	5,511	5,613	5,374	1,088	1,560	1,224
Expected return on plan assets	(5,285)	(4,861)	(4,757)	(419)	(340)	(233)
Net amortization and deferral	2,191	2,014	1,861	355	894	637
Net periodic benefit cost	\$ 6,752	\$ 7,374	\$ 6,357	\$ 2,043	\$ 3,575	\$ 2,661

Below are the actuarial assumptions used in determining the net periodic benefit costs for the benefit plans:

Weighted average assumptions as of December 31:	Pension Benefits		Other Benefits	
	2005	2004	2005	2004
Discount rate	6.00%	6.00%	6.00%	6.00%
Long-term rate of return on plan assets	8.00%	8.00%	8.00%	8.00%
Rate of compensation increases	3.00%	3.00%	-	-

Postretirement benefit expense recorded in 2005, 2004, and 2003, was \$1,572, \$1,420, and \$1,160, respectively. The remaining net periodic benefit cost as of December 31, 2005, of \$9,791 is expected to be recovered through future customer rates and 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 2005 measurement purposes, the Company assumed an 8.5% annual rate of increase in the per capita cost of covered benefits, with the rate decreasing 1% per year for the next four years to a long-term annual rate of 4.5% per year after four 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:

	1-percentage Point Increase	1-percentage Point Decrease
Effect on total service and interest costs	\$ 422	\$ (331)
Effect on accumulated postretirement benefit obligation	\$ 3,693	\$ (2,949)

Note 13. Stock-Based Compensation Plans

The Company has two stockholder-approved stock-based compensation plans. Under the Long-Term Incentive Plan that allowed granting of non-qualified stock options, some of which are currently outstanding, there will be no future grants made. Options were granted under the Long-Term Incentive Plan at an exercise price that was not less than the per share common stock market price on the date of grant. At December 31, 2005, 86,500 options were exercisable at a weighted average price of \$24.93. The options vest at a 25% rate on their anniversary date over their first four years and are exercisable over a 10-year period. No options were granted in 2005, 2004, or 2003.

The following table summarizes the activity of the Long-Term Incentive Plan:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Options Exercisable	Weighted Average Fair Value
Outstanding at December 31, 2002	154,500	24.77	8.2	36,750	-
Cancelled	(5,250)	24.78			
Outstanding at December 31, 2003	149,250	24.77	7.2	74,625	-
Exercised	(25,500)	23.67			
Cancelled	(2,250)	25.41			
Outstanding at December 31, 2004	121,500	24.99	6.3	85,500	-
Exercised	(22,750)	25.15			
Cancelled	(750)	25.15			
Outstanding at December 31, 2005	98,000	24.95	5.4	86,500	-

In 2005, the Long-Term Incentive Plan was replaced by a stockholder-approved Equity Incentive Plan, which allows granting of incentive and non-qualified stock options, stock appreciation rights, restricted stock awards, and other stock awards. Under the Equity Incentive Plan, a total of 1,000,000 common shares have been authorized for future grants. As of December 31, 2005, there were no grants under the Plan. The Company will be reporting compensation expense related to any grants under this plan in accordance with SFAS No. 123 (revised 2004), as discussed in Note 2.

Note 14. 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, accounts receivables, and accounts payables, the carrying amount approximates the fair value because of the short-term maturity of the instruments. The fair value of the Company's long-term debt is estimated at \$289 million and \$301 million as of December 31, 2005, and 2004, respectively, using a discounted cash flow analysis, based on the current rates available to the Company for debt of similar maturities. The book value of the long-term debt is \$274 million and \$276 million as of December 31, 2005 and 2004, respectively. The fair value of Advances for Construction contracts is estimated at \$57 million as of December 31, 2005 and \$51 million as of December 31, 2004, based on data provided by brokers who purchase and sell these contracts.

Notes to Consolidated Financial Statements

Note 15. Commitments and Contingencies

Commitments The Company leases office facilities and two water systems from cities, and has long-term commitments to purchase water from water wholesalers. The commitments are noted in the table below.

	Office Leases	System Leases	Water Contracts
2006	\$ 662	\$ 961	\$ 12,731
2007	486	961	12,731
2008	358	961	13,940
2009	184	961	13,940
2010	125	961	13,940
Thereafter	65	6,427	335,842

The Company leases office facilities in many of its operating districts. The total paid and charged to operations for such leases was \$682 in 2005, \$632 in 2004, and \$577 in 2003.

The Company leases the City of Hawthorne water system, which in addition to the upfront lease payment, includes an annual payment. The 15-year lease expires in 2011. The annual payments in 2005, 2004, and 2003 were \$116, \$116, and \$111, respectively. In July 2003, the Company negotiated a 15-year lease of the City of Commerce water system. At this time, the lease has not been formally executed by the parties. The lease includes an annual lease payment of \$845 per year plus a cost-savings sharing arrangement.

The Company has a long-term contract with Santa Clara Water District that requires the Company to purchase minimum annual water quantities. Purchases are priced at the District's then-current wholesale water rate. The Company operates to purchase sufficient water to equal or exceed the minimum quantities under the contract. The total paid under the contract was \$4,763 in 2005, \$4,610 in 2004, and \$4,452 in 2003.

The Company also has a water supply contract with Stockton East Water District (SEWD) that 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 \$4,300 in 2005, \$4,392 in 2004, and \$3,779 in 2003. Pricing under the contract varies annually. Estimated annual contractual obligations in the table above are based on the same payment levels as 2005. Future increased costs by SEWD are expected to be offset by a decline in the allocation of costs to the Company, as other customers of SEWD are expected to receive a larger allocation based upon growth of their service areas.

On September 21, 2005, the Company entered into an agreement with Kern County Water Agency (Agency) to obtain treated water for the Company's operations. The term of the agreement is to January 1, 2035, or until the repayment of the Agency's bonds (described hereafter) occurs. Under the terms of the agreement, the Company is obligated to purchase 20,500 acre-feet of treated water per year. The Company is obligated to pay the Capital Facilities Charge and the Treated Water Charge regardless of whether it can use the water in its operation, and is obligated for these charges even if the Agency cannot produce an adequate amount to supply the 20,500 acre-feet in the year. (This agreement supersedes a prior agreement with Kern County Water Agency for the supply of 11,500 acre-feet of water per year. The total paid under the prior agreement was \$3,288 in 2005, \$3,308 in 2004, and \$2,691 in 2003.)

Three other parties, including the City of Bakersfield, are also obligated to purchase a total of 32,500 acre-feet per year under separate agreements with the Agency. Furthermore, the Agency has the right to proportionally reduce the water supply provided to all of the participants if it cannot produce adequate supplies. The participation of all parties in the transaction for expansion of the Agency's facilities, including the Water Purification Plant, purchase of the water, and payment of interest and principal on the bonds being issued by the Agency to finance the transaction, is required as a condition to the obligation of the Agency to proceed with expansion of the Agency's facilities. If any of the other parties does not use its allocation, that party is obligated to pay its contracted amount.

The Agency is planning to issue bonds to fund the project and will use the payments of the Capital Facilities Charges by the Company and the other contracted parties to meet the Agency's obligations to pay interest and repay principal on the bonds. If any of the parties were to default on making payments of the Capital Facilities Charge, then the other parties are obligated to pay for the defaulting party's share on a pro-rata basis. If there is a payment default by a party and the remaining parties have to make payments, they are also entitled to a pro-rata share of the defaulting party's water allocation.

The Company expects to use all its contracted amount of water in its operations every year. In addition, if the Company were to pay for and receive additional amounts of water due to a default of another participating party, the Company believes it could use this additional water in its operations without incurring substantial incremental cost increases. If additional treated water is available, all parties have an option to purchase this additional treated water, subject to the Agency's right to allocate the water among the parties.

The total obligation of all parties, excluding the Company, is approximately \$108 million to the Agency. Based on the credit-worthiness of the other participants, which are government entities, it is believed to be highly unlikely that the Company would be required to assume any other parties' obligations under the contract due to their default. In the event of default by a party, the Company would receive entitlement to the additional water for assuming any obligation.

Once the project is complete, the Company is obligated to pay a Capital Facilities Charge and a Treated Water Charge that together total \$4.7 million annually, which equates to \$231 per acre-foot. Annual payments of \$2.0 million for the Capital Facilities Charge will begin when the Agency issues bonds to fund the project. Some of the Treated Water Charge of \$2.8 million is expected to begin July 1, 2007, when a portion of the planned capacity is expected to be available. The expanded water treatment plant is expected to be at full capacity by July 1, 2008, and at that time, the full annual payments of \$4,739,000 would be made and continue through the term of the agreement. Once treated water is being delivered, the Company will also be obligated for its portion of the operating costs; that portion is currently estimated to be \$69 per acre-foot. The actual amount will vary due to variations from reimbursable operating cost estimates, inflation, and other changes in the cost structure. The Company's overall estimated cost of \$300 per acre-foot is less than the estimated cost of procuring untreated water (assuming water rights could be obtained) and then providing treatment.

Contingencies In 1995, the State of California's Department of Toxic Substances Control (DTSC) named Cal Water 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. The DTSC contends that Cal Water's responsibility stems from its operation of wells in the surrounding vicinity that caused the contamination plume to spread. While Cal Water is cooperating with the cleanup effort, Cal Water denies any responsibility for the contamination or the resulting cleanup and intends to vigorously resist any action that may be brought against Cal Water. In December 2002, Cal Water was named along with other defendants in two lawsuits filed by DTSC for the cleanup of the plume. The suits assert that the defendants are jointly and severally liable for the estimated cleanup of \$8.7 million. The parties have undertaken settlement negotiations. In response to Cal Water's request for its insurance carrier to participate in settlement negotiations, the insurance carrier threatened to exercise its reservation of rights letter to seek reimbursement of past defense costs. Past defense costs approximate \$0.6 million. Cal Water believes that the carrier clearly has a duty to defend and is not entitled to any defense cost reimbursement. Furthermore, Cal Water believes that insurance coverage exists for this claim. If Cal Water's claim is ultimately found to be excludable under its policies, Cal Water believes any damages will be covered by the ratepayer as pump-and-treat is the most economical approach to the cleanup effort. Cal Water believes that there will not be a material adverse effect to its financial position or results of operations.

In 1995, the California Legislature enacted the Water Utility Infrastructure Improvement Act of 1995 (Infrastructure Act) to encourage water utilities to sell surplus properties and reinvest in needed water utility facilities. In September 2003, the California Public Utilities Commission (CPUC) issued decision D.03-09-021 in Cal Water's 2001 General Rate Case filing. In this decision, the CPUC ordered Cal Water to file an application setting up an Infrastructure Act memorandum account with an up-to-date accounting of all real property that was at any time in rate base and that Cal Water had sold since the effective date of the Infrastructure Act. Additionally, the decision directed the CPUC staff to file a detailed report on its review of Cal Water's application. On January 11, 2005, the Office of Ratepayer Advocates (ORA) issued a report expressing its opinion that Cal Water had not proven that surplus properties sold since 1996 were no longer used and useful. ORA recommended that Cal Water be fined \$160,000 and that gains from property sales be used to benefit ratepayers.

Notes to Consolidated Financial Statements

During the period under review, Cal Water's cumulative gains from surplus property sales were \$19.2 million, which included an inter-company gain related to a transaction with Utility Services and a like-kind exchange with a third party.

On December 1, 2005, the CPUC issued its decision D.05-12-002 (Decision). The Decision found that Cal Water appropriately reclassified all properties as non-utility property prior to being sold. The criteria Cal Water followed to reclassify its properties was reasonable and consistent with the requirements of the CPUC. Since the properties were properly reclassified, CPUC approval was not required prior to the sale and no penalty is warranted. Furthermore, the Decision found that Cal Water should be allowed to include in rate base the remaining \$1,182,462 of the Chico customer center costs not yet in rate base and to earn a return on the additional rate base, an increased revenue requirement of approximately \$171,000.

However, the Decision did not approve the amount of sale proceeds (or gains) that qualify for reinvestment under the Infrastructure Act, although it concluded that all property sales should qualify and should be accounted for in accordance with the Act. The Decision defers the issues regarding treatment of sale proceeds and allocation of gains on sale to its R.04-09-003 proceeding, where the CPUC intends to set guidelines and a specific rule on allocation of the gain on utility asset sales between shareholders and ratepayers. On November 5, 2005, the Commission mailed its proposed decision (Proposed Decision) regarding the allocation of proceeds from the sale of utility assets. The Proposed Decision states that the Commission has limited discretion in how it allocates gains on sale of real property, provided that water companies reinvest the proceeds in new water infrastructure. As such, the Company is entitled to earn a full authorized return on the proceeds reinvested in utility plant.

Based on the Decision and the Proposed Decision, Cal Water has not accrued a liability in its financial statements. Cal Water has no knowledge when the CPUC will issue its decision in the matter of R.04-09-003. If the CPUC finds any portion of the property sales should be allocated to the ratepayers, Cal Water's rate base could be reduced, which would lower future revenues, net income, and cash flows.

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.

Note 16. Quarterly Financial Data (unaudited)

The Company's common stock is traded on the New York Stock Exchange under the symbol "CWT."

2005 (in thousands, except per share amounts)	First	Second	Third	Fourth
Operating revenue	\$ 60,303	\$ 81,457	\$101,128	\$ 77,840
Net operating income	4,465	11,253	16,103	7,989
Net income	680	7,591	13,115	5,837
Diluted earnings per share	0.03	0.41	0.71	0.32
Common stock market price range:				
High	36.76	38.12	41.90	41.09
Low	32.12	32.85	37.53	32.64
Dividends paid	.2850	.2850	.2850	.2850
2004 (in thousands, except per share amounts)	First	Second	Third	Fourth
Operating revenue	\$ 60,240	\$ 88,845	\$ 97,104	\$ 69,378
Net operating income	5,391	14,083	14,498	7,511
Net income	1,446	10,054	10,789	3,737
Diluted earnings per share	0.08	0.59	0.59	0.20
Common stock market price range:				
High	29.99	29.75	29.42	37.70
Low	27.25	26.60	26.19	28.20
Dividends paid	.2825	.2825	.2825	.2825

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

California Water Service Group:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that California Water Service Group and subsidiaries maintained effective internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. Management of California Water Service Group is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the internal control over financial reporting of California Water Service Group and subsidiaries based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that California Water Service Group and subsidiaries maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control – Integrated Framework issued by the COSO*. Also, in our opinion, California Water Service Group and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control – Integrated Framework issued by COSO*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of California Water Service Group and subsidiaries as of December 31, 2005 and 2004, 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, 2005, and our report dated March 9, 2006, expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

Mountain View, California

March 9, 2006

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

California Water Service Group:

We have audited the accompanying consolidated balance sheets of California Water Service Group and subsidiaries as of December 31, 2005 and 2004, 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, 2005. These consolidated financial statements are the responsibility of the management of California Water Service Group. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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, 2005 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the internal control over financial reporting of California Water Service Group and subsidiaries as of December 31, 2005, based on the criteria established in *Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*, and our report dated March 9, 2006, expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

Mountain View, California

March 9, 2006

Controls and Procedures

Management's Evaluation of Disclosure Controls and Procedures

The Company carried out an evaluation, under the supervision of and with the participation of management, including the principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of December 31, 2005, pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934. Based on their review of the disclosure controls and procedures, the Chief Executive Officer and Acting Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective in timely alerting management to material information that is required to be included in periodic SEC filings.

Management, including the Chief Executive Officer and Acting Chief Financial Officer, does not expect that the Company's disclosure controls and procedures or its internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of each control must be considered relative to its costs. Because of the inherent limitations in all control systems, no evaluation of a control system can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been prevented or detected.

There was no change in the Company's internal control over financial reporting during the quarter ended December 31, 2005, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended). Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2005. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Management has concluded that, as of December 31, 2005, the Company's internal control over financial reporting is effective based on these criteria. The Company's independent registered public accounting firm, KPMG LLP, which has audited the financial statements included in this Annual Report, has issued an audit report on management's assessment of the Company's internal control over financial reporting, which is included herein.

Certification

As provided in the rules of the New York Stock Exchange, the Company's Chief Executive Officer has certified to the Exchange in writing that, as of February 22, 2006, he was not aware of any violation by the Company of the NYSE's Corporate Governance listing standards. The Company has included as Exhibits 31.1 and 31.2 to its Annual Report on Form 10-K for the year ended December 31, 2005, certifications from its Chief Executive Officer and Acting Chief Financial Officer regarding the quality of the Company's public disclosure.

Board of Directors



Seated left to right, **Peter C. Nelson** *, President and Chief Executive Officer, **Robert W. Foy** *, Chairman of the Board. Standing left to right, **Bonnie G. Hill** †§, President of B. Hill Enterprises, L.L.C.; Co-Founder of Icon Blue; on the boards of a number of corporations and non-profit organizations, **Richard P. Magnuson** ††\$∞, Private Venture Capital Investor, **David N. Kennedy** †∞, Former Director of the California Department of Water Resources, **Edward D. Harris, Jr., M.D.** †*§, Professor of Medicine, Emeritus, Stanford University Medical Center, **Linda R. Meier** ††*§, Member of the Board of Directors, Greater Bay Bancorp; Chair of the Western Regional Advisory Board of the Institute of International Education; Member of the National Board of the Institute of International Education; and Member of the Board of Directors, Stanford Alumni Association, **George A. Vera** †∞, Vice President and Chief Financial Officer, the David & Lucile Packard Foundation, **Douglas M. Brown** †\$∞, Treasurer, State of New Mexico.

† Member of the Audit Committee

‡ Member of the Compensation Committee

* Member of the Executive Committee

§ Member of the Nominating/Corporate Governance Committee

∞Member of the Finance Committee

Officers and Corporate Information

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
Vice President, Customer Service and Information Systems

Francis S. Ferraro ^{2, 4}
Vice President, Regulatory Matters and Corporate Relations

Robert R. Guzzetta ²
Vice President, Operations

Martin A. Kropelnicki ⁵
Vice President, Chief Financial Officer and Treasurer

Christine L. McFarlane
Vice President, Human Resources

Michael J. Rossi
Vice President, Engineering and Water Quality

Dan L. Stockton ^{1, 2, 3}
Vice President, Corporate Development and
Corporate Secretary

John S. Tootle
Acting Vice President, Chief Financial Officer and Treasurer

Calvin L. Breed ¹
Controller, Assistant Secretary and Assistant Treasurer

Washington Water Service Company

Michael P. Ireland
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, New Mexico Water Service Company and Hawaii Water Service Company, Inc.

⁴ Holds the same position with New Mexico Water Service Company and Hawaii Water Service Company, Inc.

⁵ Effective March 13, 2006

**Stock Transfer, Dividend Disbursing and
Reinvestment Agent**

American Stock Transfer and Trust Company
57 Maiden Lane
New York, NY 10038
(800) 937-5449

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 acknowledgment is not acceptable. This certificate should then be sent to American Stock Transfer and Trust Company, 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 26, 2006, at 9:30 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 27, 2006.

Corporate Information

Dividend Dates For 2006

Quarter	Declaration	Record Date	Payment Date
First	January 25	February 6	February 17
Second	April 26	May 8	May 19
Third	July 26	August 7	August 18
Fourth	October 25	November 6	November 17

Annual Report For 2005 On Form 10-K

A copy of the Company's report for 2005 filed with the Securities and Exchange Commission (SEC) on Form 10-K will be available in March 2006 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.calwatergroup.com>

California Water Service Group
1720 North First Street
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