California Water Service Group 2000 Annual Report

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SEVENTY-FIVE YEARS OF SERVICE

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California Water Service Group provides high-quality water utility services to 2 million people through four subsidiaries: California Water Service Company, Washington Water Service Company, New Mexico Water Service Company, and CWS Utility Services. The three water service companies are regulated by state public utilities commissions; CWS Utility Services provides non-regulated contract services, including meter reading, billing, and full-system operations.

Financial Highlights

In thousands, except per share amounts

Year ended December 31	**2000**	1999	1998	1997	1996
Book value*	**$ 13.13**	$ 12.89	$ 12.49	$ 12.15	$ 11.47
Market price at year-end	**27.00**	30.31	31.31	29.53	21.00
Earnings per share*	**1.31**	1.44	1.31	1.71	1.42
Dividends	**1.10**	1.085	1.07	1.055	1.04
Revenue*	**244,806**	234,937	214,926	225,165	210,258
Net income*	**19,963**	21,971	19,860	25,757	21,400

* Restated to reflect Dominguez and Washington acquisitions, which were accounted for as poolings of interest.

To Our Stockholders

In 2001, California Water Service Company, our largest subsidiary, celebrates its 75th year. That means we were in business a year before Charles Lindbergh's historic flight across the Atlantic Ocean! As those who have celebrated milestone birthdays know, such an occasion causes one to reflect on accomplishments and to evaluate plans for meeting ambitious new goals. Our introspection has brought to light some amazing facts, which we share with you throughout this report. The bottom line is that working together, we have built a Company that is known for its financial stability, customer focus, dedicated employees, and commitment to quality. And we keep on building, having grown our customer base by 16 percent in the last two years alone.

Our financial results for 2000 reflect this growth. Operating revenues rose to $244.8 million, compared to $234.9 million in 1999.

Net income dipped to $19.9 million, compared to $21.9 million last year, and earnings were $1.31 per share, compared to $1.44 per share in 1999. The decline in net income and earnings was due primarily to one-time costs associated with the completion of the Dominguez Services Corporation merger, and to higher costs of purchased water, purchased power, and labor. Revenues were positively impacted by a 3 percent increase in water sales, the addition of 5,200 regulated customers, and rate increases in California. The difference between 1999 and 2000 results is attributable in part to the one-time merger costs recorded in 2000 and $1.3 million in pre-tax real estate sales in 1999. Annual dividends increased to $1.10 in 2000, and were paid for the 56th consecutive year.

What our financial results do not yet reflect is the great progress we made in 2000 toward growing the Company. In May, we received long-awaited approval from the California Public Utilities Commission on our merger with Dominguez and set about integrating

OUR DIVIDEND HAS INCREASED EVERY YEAR SINCE THE BEATLES' HIT "HEY JUDE" TOPPED THE CHARTS.

Robischon Engineers, Inc., gives us a Washington-based, in-house engineering capability that lowers costs and positions us better to capitalize on the state's growth opportunities.

The year 2000 also saw us establish a foothold for regulated operations in another western state, as we signed an agreement to acquire the water and wastewater assets of the Rio Grande Utility Corporation, which serves 2,300 water and 1,600 wastewater customers in unincorporated areas of Valencia County, New Mexico, 30 miles south of Albuquerque. The Rio Grande transaction is contingent upon approval of the New Mexico Public Regulation Commission, expected in the third quarter of 2001. Prior to securing this agreement, we expanded our existing non-regulated New Mexico business by entering into a five-year meter-reading contract with Los Alamos County.

Throughout the Company, we have continued to implement customer-driven initiatives developed by our employees

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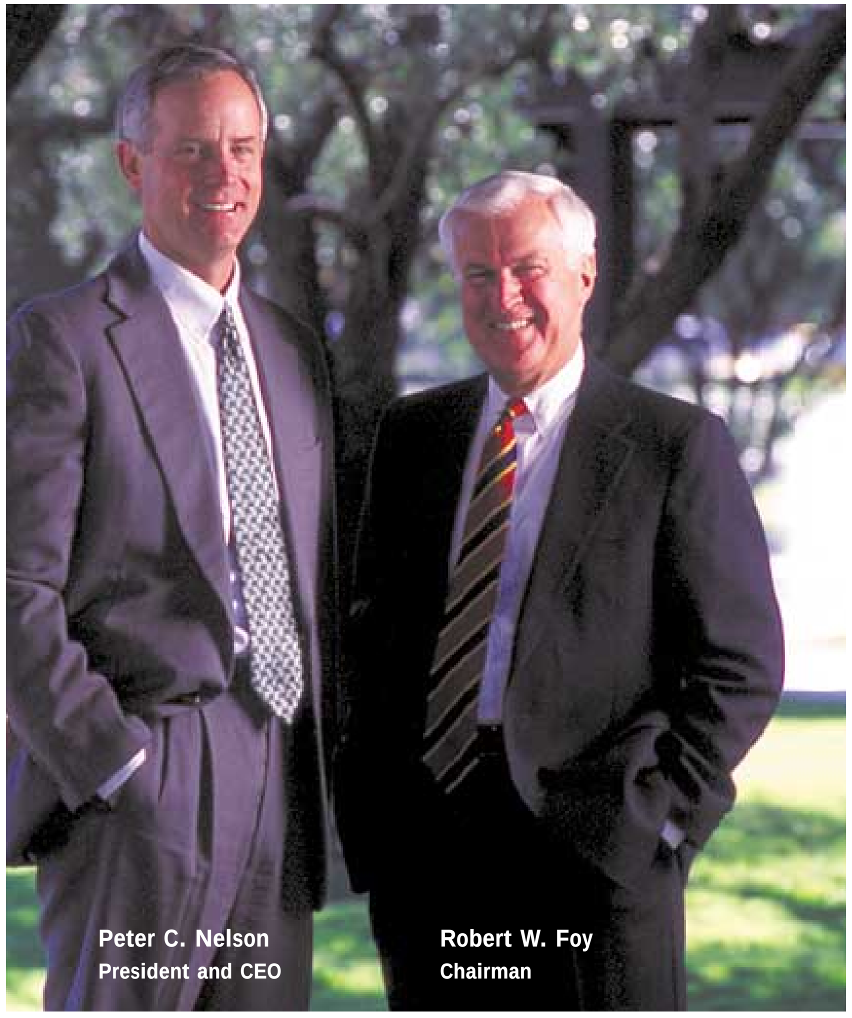

Peter C. Nelson
President and CEO

Robert W. Foy
Chairman

40,000 new service connections into our operations. As anticipated, we already are capturing synergies by combining operations and expect the transaction to be accretive to our stockholders during 2001. The intangible benefits of the merger have also become evident, as we enjoy the expertise of 75 new employees and evaluate growth opportunities surrounding Dominguez systems.

We continued to integrate our new companies in the state of Washington in 2000, and watched that subsidiary grow by 5 percent with the addition of 800 metered connections through our acquisition of Mirrormount Water Services in King County and Lacamas Farmsteads Water Company in Pierce County. Non-regulated business in Washington also prospered, due in part to our new service contract with the Miller Brewery in Tumwater. Opportunities abound in the Evergreen State, which has a favorable regulatory climate and many small water systems. Our second-quarter purchase of the assets of Robischon Engineers, Inc., gives us a Washington-based, in-house engineering capability that lowers costs and positions us better to capitalize on the state's growth opportunities.

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Throughout the Company, we have continued to implement customer-driven initiatives developed by our employees through our Continuous Improvement Process (CIP). Every one of our employees in our 25 districts, working in teams, contributes to improving the business processes that we use to serve customers. Providing excellent customer service remains our top priority. This principle drives everything we do, from improving our water system infrastructure to upgrading our computer software.

Our capital investment in 2000 totaled $37 million, a number we expect to increase to $54 million in 2001—our largest capital expenditure budget ever. The increase is largely attributable to the surface water treatment plant that we plan to construct in Bakersfield, California beginning in 2001. The plant will enable our Bakersfield District to serve a rapidly growing population and meet anticipated new Environmental Protection Agency water quality standards. Additionally, we are building operations centers in our Chico and Stockton districts that will replace inadequate existing facilities and one in our Rancho Dominguez district that will house our newly combined South Bay operations. Because our return is based upon invested equity capital, we view this upward trend as a positive one for our stockholders.

As the last regulated utility, the water industry has not faced the deregulation challenges confronting electric and natural gas utilities. However, we do need to be prepared for the impacts that power supply shortages and higher costs could have on our business, and we are. From a financial standpoint, we track higher electric and gas prices through regulatory balancing accounts for recovery in future rates. From an operational standpoint, we are equipped with strategically-located backup power generators to allow continued water production during interruptions in our power supply.

As we move forward, we will continue to pursue growth opportunities in the western United States while we work to enhance existing operations by improving customer service and increasing our efficiency. As the water industry experiences continued consolidation and change, we believe we have what it takes to be *the* leader in providing our communities and customers with traditional and innovative utility services. This optimism is cause for celebration as we commemorate 75 years of outstanding water service with a look at some amazing facts about California Water Service Group.

Sincerely,

Robert W. Foy

ROBERT W. FOY
CHAIRMAN OF THE BOARD

Peter C. Nelson

PETER C. NELSON
PRESIDENT AND CHIEF EXECUTIVE OFFICER

IN 75 YEARS, WE HAVE BUILT A COMPANY THAT IS KNOWN FOR ITS FINANCIAL STABILITY, CUSTOMER FOCUS, DEDICATED EMPLOYEES, AND COMMITMENT TO QUALITY.

OUR CUSTOMER SATISFACTION RATING IS HIGHER THAN MICHAEL JORDAN'S 84% CAREER FREE THROW PERCENTAGE.

(Left) Desalination Plant - Torrance, CA

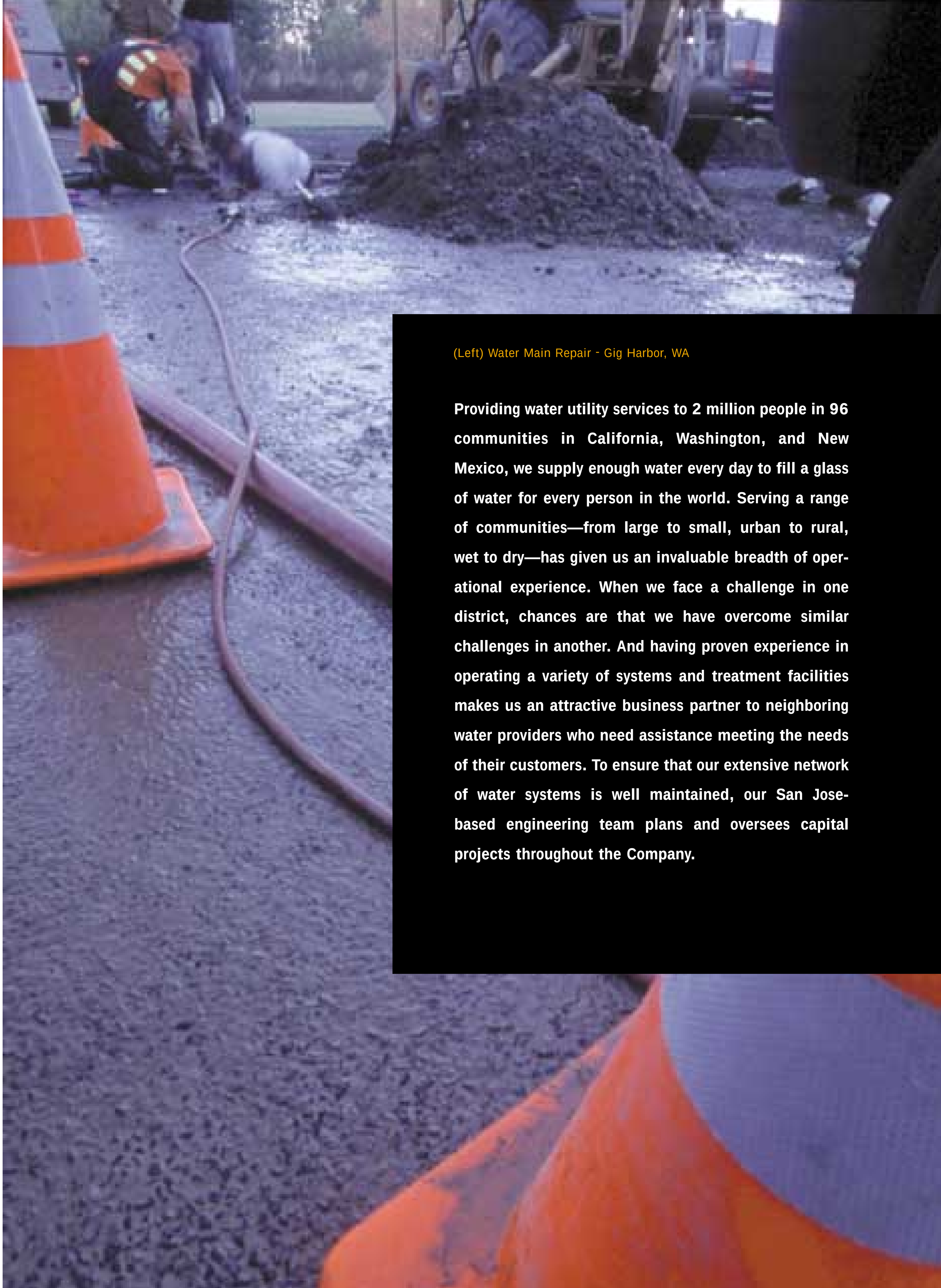
There is a reason we have "service" in our name—it is because we are committed to providing excellent customer service. Our efforts to improve service are guided by the "Voice of the Customer," a tool that lets our employees know what customers want and need in the customers' own words. This information determines the types of projects we undertake in our Continuous Improvement Process. Our approach to the business, inspired by those of industrial giants Hewlett-Packard and General Electric, enables every employee in the Company to play an integral role in enhancing customer service and improving operating efficiency. Does it work? Yes. At last count, 89 percent of our customers ranked our service as "very good" or "excellent."

WE CONDUCT MORE WATER QUALITY TESTS IN A DAY THAN THERE ARE DAYS IN THE YEAR.

(Left) Water Quality Lab - San Jose, CA

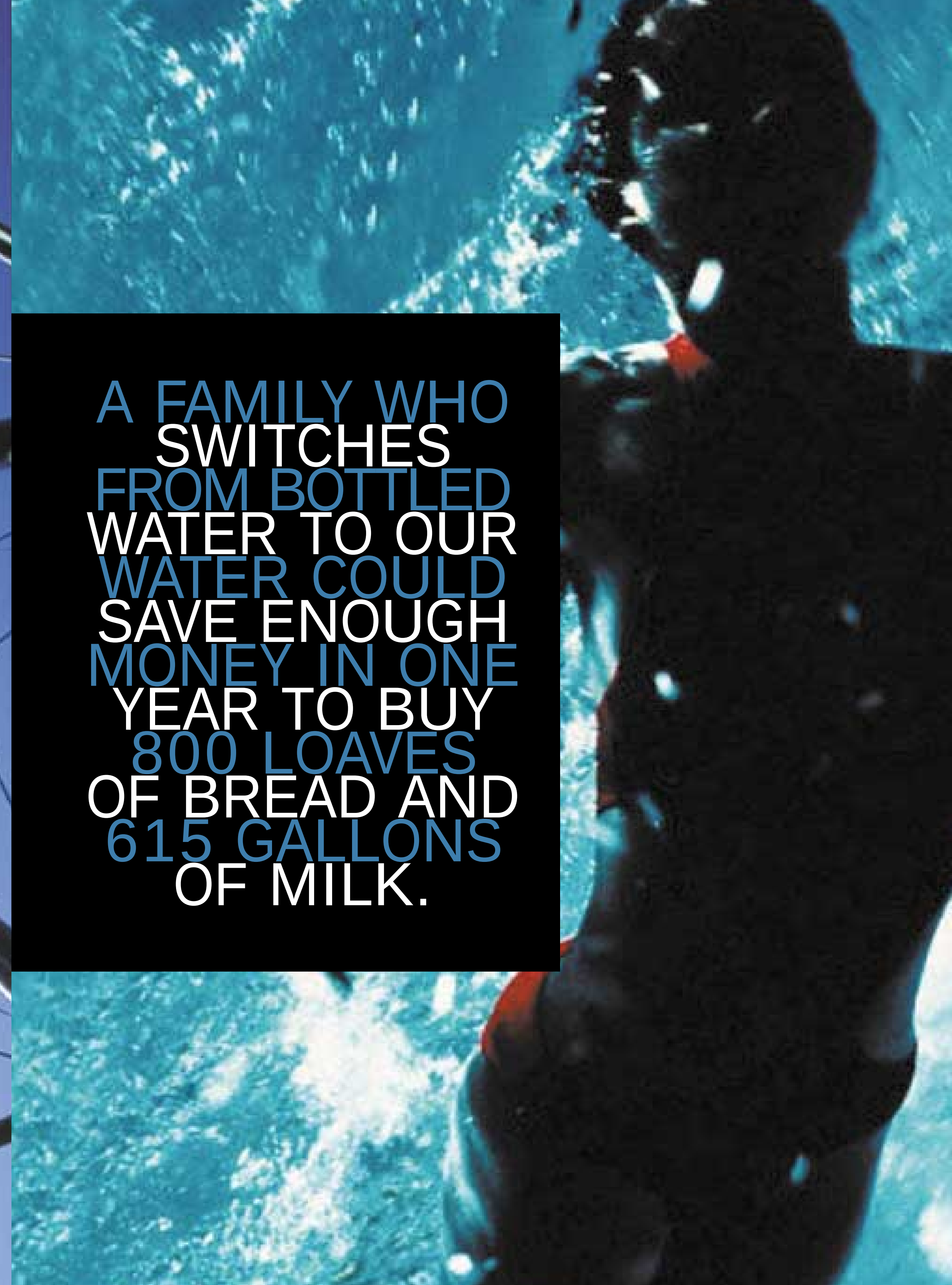
Our customers rely on us to provide high-quality water, and we take that responsibility very seriously. Working in our certified, state-of-the-art laboratory under the direction of the American Water Works Association 2000 George Warren Fuller Award winner, Chet Auckly, our chemists and technicians work tirelessly to ensure that the water we provide meets or surpasses state and federal water quality standards. As technology advances, enabling us to detect progressively more minute quantities of constituents in the water, we expect water quality standards to become increasingly stringent. As they do, we stand ready to invest the time and resources necessary to meet them. Our team of 11 experts, who have completed a combined total of 66 years of advanced water quality education, will do what it takes to keep us on the leading edge of a field that presents new challenges every year.

LAID
END TO END,
OUR
PIPELINES
WOULD
REACH FROM
CALIFORNIA
TO NEW YORK
AND BACK
AGAIN.



(Left) Water Main Repair - Gig Harbor, WA

Providing water utility services to 2 million people in 96 communities in California, Washington, and New Mexico, we supply enough water every day to fill a glass of water for every person in the world. Serving a range of communities—from large to small, urban to rural, wet to dry—has given us an invaluable breadth of operational experience. When we face a challenge in one district, chances are that we have overcome similar challenges in another. And having proven experience in operating a variety of systems and treatment facilities makes us an attractive business partner to neighboring water providers who need assistance meeting the needs of their customers. To ensure that our extensive network of water systems is well maintained, our San Jose-based engineering team plans and oversees capital projects throughout the Company.

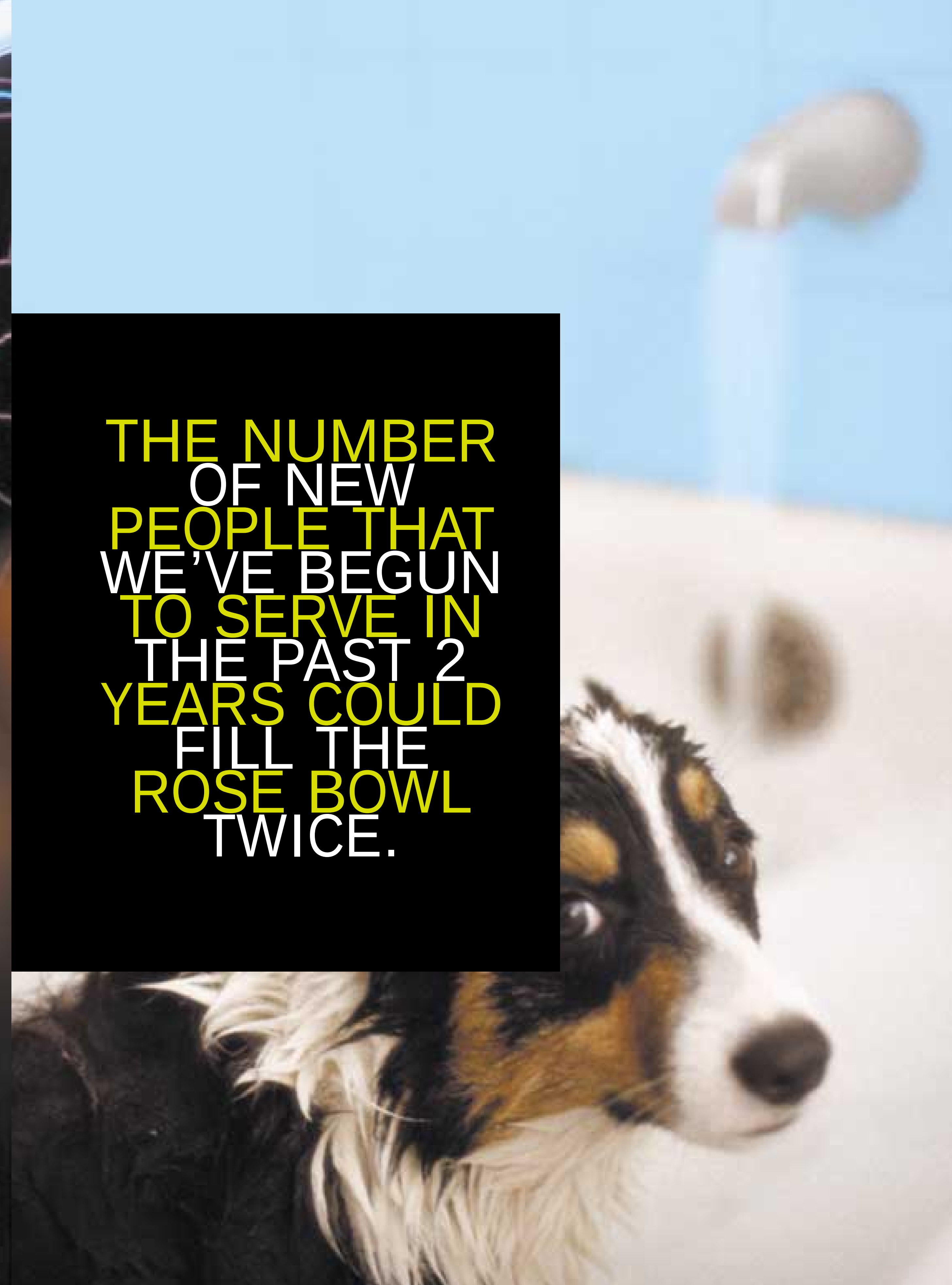


A FAMILY WHO SWITCHES FROM BOTTLED WATER TO OUR WATER COULD SAVE ENOUGH MONEY IN ONE YEAR TO BUY 800 LOAVES OF BREAD AND 615 GALLONS OF MILK.

(Left) Water Tower - Chico, CA

As an investor-owned water utility, we must balance our customers' need for reasonable water rates with our stockholders' desire to earn a fair rate of return on their investment. One way we do that is by operating efficiently and holding down expenses, responsibility for which is borne by every employee in our Company. Another way we do it is by growing our Company profitably to achieve economies of scale and spread fixed costs over a larger number of customers. Considering the range of services we provide for just a fraction of a penny per gallon—from maintaining and upgrading water system infrastructure to testing and treating water supplies—our life-sustaining, irreplaceable product just might be the bargain of the century.

THE NUMBER OF NEW PEOPLE THAT WE'VE BEGUN TO SERVE IN THE PAST 2 YEARS COULD FILL THE ROSE BOWL TWICE.



(Left) Engineering Department - Olympia, WA

Consolidation continues in the water industry, as smaller providers opt out of a business that is becoming more complex and capital intensive every year. Our Company has taken its place as a leading consolidator in the western United States, having completed the largest merger in California's history and established a presence in two new states. We also have grown our non-regulated business by entering into a number of innovative partnerships that provide utility services to neighboring cities and agencies. Having districts strategically located in California, Washington, and New Mexico positions us well for future growth, as we continue to execute our strategy of pursuing opportunities that add to stockholder value and enhance service to the customer.

Customers

District Name	Including	Regulated	Non-regulated
California			
Antelope Valley	Fremont Valley, Lake Hughes, Lancaster and Leona Valley; numerous operating agreements	1,300	400
Bakersfield	O&M contracts for the City of Bakersfield and Spicer City	57,500	25,800
Bear Gulch	Atherton, Woodside, Portola Valley, portions of Menlo Park and City of Menlo Park service contract	17,500	4,000
Chico †	Hamilton City	23,300	
Dixon		2,800	
Dominguez	Carson and portions of Compton, Harbor City, Long Beach, Los Angeles and Torrance	32,800	
East Los Angeles	O&M contracts for cities of Commerce and Montebello	26,400	2,700
Hawthorne	15-year lease — full-service water operations		6,100
Hermosa-Redondo †	A portion of Torrance; meter reading for Manhattan Beach	25,600	13,400
Kern River Valley	Bodfish, Kernville, Lakeland, Mountain Shadows, Onyx, Squirrel Valley, South Lake and Wofford Heights; numerous operating contracts	4,100	500
King City †		2,200	
Livermore	O&M contracts for Castlewood Country Club and Crane Ridge MWC	16,800	400
Los Altos	Portions of Cupertino, Los Altos Hills, Mountain View and Sunnyvale	18,300	
Marysville †		3,800	
Mid-Peninsula	San Mateo and San Carlos	35,800	
Oroville		3,500	
Palos Verdes	Palos Verdes Estates, Rancho Palos Verdes, Rolling Hills Estates and Rolling Hills	23,800	
Redwood Valley	Lucerne, Duncans Mills, Guerneville, Dillion Beach and a portion of Santa Rosa	1,900	300
Salinas	O&M contracts for Foothill Estates and Spreckels Water Co.	26,700	300
Selma		5,200	
South San Francisco	Colma and Broadmoor	16,300	
Stockton		41,700	
Visalia †	Four O&M contracts	29,300	1,100
Westlake	A portion of Thousand Oaks	6,900	
Willows †		2,300	
	Subtotal	**425,800**	**55,000**
New Mexico			
Los Alamos	Meter-reading contract		22,200
Santa Fe	Meter-reading contract		26,300
	Subtotal		**48,500**
Washington			
Harbor	Numerous O&M contracts	9,700	1,400
South Sound	Numerous O&M contracts	2,800	1,000
	Subtotal	**12,500**	**2,400**
	Total	**438,300**	**105,900**

MWC = Mutual Water Company | O&M = Operations and Maintenance | † = Indicates Billing Contract

Ten-Year Financial Review

Dollars in thousands, except common share data	**2000**	1999	1998	1997	1996	1995	1994	1993	1992	1991
Summary of Operations										
Operating revenue										
Residential	**$171,234**	$163,681	$150,491	$158,210	$148,313	$132,859	$127,228	$122,585	$111,353	$ 95,393
Business	**44,211**	41,246	38,854	40,520	37,605	35,873	33,712	31,360	29,208	25,490
Industrial	**11,014**	12,695	10,150	10,376	9,748	9,952	9,080	8,415	7,905	7,037
Public authorities	**11,609**	10,898	9,654	11,173	10,509	9,585	9,397	8,535	7,899	6,754
Other	**6,738**	6,417	5,777	4,886	4,083	4,833	3,767	4,985	7,104	12,799
Total operating revenue	**244,806**	234,937	214,926	225,165	210,258	193,102	183,184	175,880	163,469	147,473
Operating expenses	**211,610**	201,890	183,245	188,020	177,356	164,958	155,012	145,517	137,401	121,179
Interest expense, other income and expenses, net	**13,233**	11,076	11,821	11,388	11,502	11,176	11,537	12,785	11,794	10,769
Net income	**$ 19,963**	$ 21,971	$ 19,860	$ 25,757	$ 21,400	$ 16,968	$ 16,635	$ 17,578	$ 14,274	$ 15,525
Common Share Data										
Earnings per share—diluted	**$ 1.31**	$ 1.44	$ 1.31	$ 1.71	$ 1.42	$ 1.13	$ 1.17	$ 1.26	$ 1.02	$ 1.12
Dividend declared	**1.100**	1.085	1.070	1.055	1.040	1.020	0.990	0.960	0.930	0.900
Dividend payout ratio	**84%**	75%	82%	62%	73%	90%	85%	76%	91%	80%
Book value	**$ 13.13**	$ 12.89	$ 12.49	$ 12.15	$ 11.47	$ 10.97	$ 10.72	$ 10.03	$ 9.65	$ 9.48
Market price at year-end	**27.00**	30.31	31.31	29.53	21.00	16.38	16.00	20.00	16.50	14.00
Common shares outstanding at year-end (in thousands)	**15,146**	15,094	15,015	15,015	15,015	14,934	14,890	13,773	13,773	13,773
Return on average common stockholders' equity	**10.1%**	11.5%	10.8%	14.5%	12.8%	10.6%	11.1%	12.6%	10.7%	11.8%
Long-term debt interest coverage	**3.58**	3.73	3.64	4.37	3.81	3.41	3.49	3.34	3.21	3.33
Balance Sheet Data										
Net utility plant	**$582,008**	$564,390	$538,741	$515,917	$495,985	$471,994	$455,769	$437,065	$419,194	$389,965
Utility plant expenditures	**37,161**	48,599	41,061	37,511	40,310	31,031	32,435	31,097	37,698	37,935
Total assets	**666,605**	645,507	613,143	594,444	569,745	553,027	516,507	497,717	451,754	440,294
Long-term debt including current portion	**189,979**	171,613	152,674	153,271	151,725	154,416	138,628	138,863	130,971	108,572
Capitalization ratios:										
Common stockholders' equity	**51.1%**	53.0%	54.6%	53.8%	52.7%	50.9%	52.9%	49.3%	49.7%	53.9%
Preferred stock	**0.9%**	0.9%	1.0%	1.0%	1.1%	1.1%	1.2%	1.2%	1.3%	1.4%
Long-term debt	**48.0%**	46.1%	44.4%	45.2%	46.2%	48.0%	45.9%	49.5%	49.0%	44.7%
Other Data										
Water production (million gallons)										
Wells	**65,408**	65,144	57,482	63,736	60,964	54,818	53,274	48,598	55,641	52,944
Purchased	**62,237**	58,618	54,661	59,646	56,769	57,560	59,850	59,103	49,303	44,457
Total water production	**127,645**	123,762	112,143	123,382	117,733	112,378	113,124	107,701	104,944	97,401
Metered customers	**366,242**	361,235	354,832	350,139	345,307	335,238	332,146	326,564	322,457	318,275
Flat-rate customers	**78,104**	77,892	77,568	77,878	77,991	78,330	79,159	81,416	82,617	83,030
Customers at year-end, including Hawthorne	**444,346**	439,127	432,400	428,017	423,298	413,568	411,305	407,980	405,074	401,305
New customers added	**5,219**	6,727	4,383	4,719	9,730	2,263	3,325	2,906	3,769	6,301
Revenue per customer	**$ 551**	$ 535	$ 497	$ 526	$ 497	$ 467	$ 445	$ 431	$ 404	$ 367
Utility plant per customer	**1,916**	1,851	1,768	1,694	1,632	1,580	1,520	1,459	1,400	1,327
Employees at year-end	**797**	790	759	752	740	738	729	717	706	689

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

California Water Service Group (Company) is a holding company with four operating subsidiaries: California Water Service Company (Cal Water), CWS Utility Services (Utility Services), New Mexico Water Service Company (New Mexico Water) and Washington Water Service Company (Washington Water). Cal Water and Washington Water are regulated public utilities. Their assets and operating revenues currently comprise the majority of the Company's assets and revenues. New Mexico Water is a new subsidiary formed in 2000 to provide regulated water services. Utility Services provides non-regulated water operations and related services to other private companies and municipalities. The following discussion and analysis provides information regarding the Company, its assets, operations and financial condition.

Forward-Looking Statements

This annual report, including the Letter to Stockholders and Management's Discussion and Analysis, contains forward-looking statements within the meaning of the federal securities laws. Such statements are based on currently available information, expectations, estimates, assumptions and projections, and management's judgment about the Company, the water utility industry and general economic conditions. Such words as expects, intends, plans, believes, estimates, anticipates 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. Actual results may vary materially from what is contained in a forward-looking statement. Factors which may cause a result different than expected or anticipated include governmental and regulatory commissions' decisions, new legislation, increases in suppliers' prices and the availability of supplies, changes in environmental compliance requirements, acquisitions, the ability to successfully implement business plans, changes in customer water use patterns and the impact of weather on operating results. The Company assumes no obligation to provide public updates of forward-looking statements.

Business

Cal Water is a public utility supplying water service to 431,900 customers in 75 California communities through 25 separate water systems or districts. Cal Water's 24 regulated systems, which are subject to regulation by the California Public Utilities Commission (CPUC) serve 425,800 customers. An additional 6,100 customers receive service through a long-term lease of the City of Hawthorne's water system, which is not subject to CPUC regulation.

Washington Water's utility operations are regulated by the Washington Utilities and Transportation Commission (WUTC). Washington Water provides domestic water service to 12,500 customers in the Tacoma and Olympia areas. An additional 2,400 customers are served under operating agreements with private owners.

New Mexico Water was organized in 2000. It currently provides meter reading services for 48,500 accounts in Santa Fe and Los Alamos. In November, the Company entered an agreement to acquire the water and wastewater assets of Rio Grande Utility Corporation. Rio Grande has annual revenue of $1.2 million and serves 2,300 water and 1,600 wastewater customers south of Albuquerque. The acquisition is contingent on approval of the state's Public Regulation Commission, which is expected in the third quarter of 2001.

Utility Services derives non-regulated income from contracts with other private companies and municipalities to operate water systems and provide meter reading and billing services for 105,900 customers. It also leases communication antenna sites, operates recycled water systems, provides meter reading and customer services, and conducts real estate sales.

Rates and operations for regulated customers are subject to the jurisdiction of the respective state's regulatory commission. The commissions require that water rates for each regulated district be independently determined. Rates for the City of Hawthorne system are established in accordance with an operating agreement and are subject to ratification by the City Council. Fees for other operating agreements are based on contracts negotiated among the parties.

Results of Operations

RESTATEMENT. During 2000, the Company issued 2,210,000 shares of common stock in exchange for all of the outstanding shares of Dominguez Services Corporation. The acquisition, which was accounted for as a pooling of interests, was completed on May 25, 2000. The accompanying financial statements have been restated to include the Dominguez accounts in the current and prior periods.

EARNINGS AND DIVIDENDS. Net income in 2000 was $19,963,000 compared to $21,971,000 in 1999 and $19,860,000 in 1998. Diluted earnings per common share were $1.31 in 2000, $1.44 in 1999 and $1.31 in 1998. The weighted average number of common shares outstanding was 15,173,000 in 2000, 15,142,000 in 1999 and 15,061,000 in 1998.

At its January 2000 meeting, the Board of Directors increased the common stock dividend for the 33rd consecutive year. 2000 also marked the 56th consecutive year that a dividend had been paid on the Company's common stock. The annual dividend paid in 2000 was $1.10, a 1.4% increase over the $1.085 paid in 1999, which was an increase of 1.4% over the $1.07 paid in 1998. The dividend increases were based on projections that the higher dividend could be sustained while still providing the Company with adequate financial flexibility. Earnings not paid as dividends are reinvested in the business for the benefit of stockholders. The dividend payout ratio was 84% in 2000, 75% in 1999 and 82% in 1998, an average of 80% during the three-year period.

OPERATING REVENUE. Operating revenue, including revenue from the City of Hawthorne lease, was $244.8 million, $9.9 million or 4% more than the $234.9 million recorded last year. Revenue in 1998 was $214.9 million. The source of changes in operating revenue were:

Dollars in millions	**2000**	1999	1998
Customer water usage	**$ 4.8**	$ 14.0	$ (14.4)
Rate increases	**3.0**	3.2	2.1
Usage by new customers	**2.1**	2.8	2.1
Net change	**$ 9.9**	$ 20.0	$ (10.2)
Average revenue per customer (in dollars)	**$ 551**	$ 535	$ 497
Average metered customer usage (Ccf)	**317**	305	284
New customers added	**5,200**	6,700	4,400

Weather always has an important influence on water revenues. The first quarter of 2000 was wetter than in the previous year, causing a reduction in customer usage. Second and third quarter weather was normal; however, rains in the early part of the fourth quarter negatively affected usage. The year-end customer count was 444,000, an increase of 1.0%.

Weather in the first half of 1999 was normal, while in the prior year it was cooler and wetter; as a result, customer usage and revenue were higher in 1999. Third quarter weather in both years was normal. Fourth quarter 1999 weather was mild and drier than 1998, causing an increase in customer usage and an increase in revenue. The year-end customer count was 439,000, an increase of 1.6%.

During the first half of 1998, weather in our service areas was wet and cool, very much the reverse of 1997's favorable weather pattern. Weather in the second half of the year returned to a more normal pattern. However, the wet, cool weather in the early part of the year resulted in an overall 9% decrease in 1998 water usage, negatively impacting revenue. The year-end customer count was 432,000, a 1.0% increase.

OPERATING AND INTEREST EXPENSES. Total operating expenses, including those for the Hawthorne operation, were $211.6 million in 2000, $201.9 million in 1999 and $183.2 million in 1998.

Wells provided 50.7% of water requirements in 2000 and purchased water provided 48.7%, with 0.6% obtained from surface supplies. In 1999 the corresponding percentages were 52.4%, 47.2% and 0.4%, and in 1998, 50.8%, 48.7% and 0.5%. The table below provides information regarding water production costs consisting of purchased water, purchased power and pump taxes:

Dollars in millions	**2000**	1999	1998
Purchased water	**$73.8**	$69.4	$61.0
Purchased power	**15.1**	14.4	12.5
Pump taxes	**6.3**	6.9	5.2
Total water production costs	**$95.2**	$90.7	$78.7
Change from prior year	**5%**	15%	(5)%
Water production (billion gallons)	**128**	124	112
Change from prior year	**3%**	10%	(9)%

The year-to-year water production cost changes are influenced by weather patterns and sources of supply. In each of the three years, purchased water expense, the largest component of annual operating expense, was affected by wholesale suppliers' rate increases. During 2000, seven districts experienced wholesale price increases ranging from 2% to 7%. Water production costs in 1999 reflect an increase in customer usage and significant purchased water price increases for the San Francisco Peninsula districts where the wholesale supplier's rates increased 37%. Despite some wholesale price increases in 1998, overall water production expenses declined. Well production decreased due to the decline in water sales and because several wells were out of service for maintenance. With reduced well production, purchased power and pump tax expenses declined.

During the last three years, the Company has not been subject to significant energy rate increases. However, as has been widely publicized, California energy costs are expected to rise significantly. In January 2001, the CPUC approved temporary energy surcharges that the Company estimates may increase its power costs by 10%. The Company believes that energy cost increases are recoverable from consumers through established CPUC procedures, although on a short-term basis the regulatory lag in recovering higher energy costs will negatively impact earnings.

Employee payroll and benefits charged to operations and maintenance expense was $43.9 million for 2000, $43.0 million in 1999 and $38.8 million in 1998. The increases in payroll and related benefits are attributable to general wage increases effective at the start of each year and additional hours worked. At year-end 2000, 1999 and 1998, there were 797, 790 and 759 employees, respectively.

During 2000, a curtailment of the Dominguez pension plan was recorded resulting in a gain of $1.2 million which was offset against operating expenses. The curtailment occurred because the Dominguez plan was frozen at the merger date and its participants became participants in the Company pension plan. Previous amounts expensed by Dominguez but not funded to the plan comprise the curtailment amount. This amount is not included in the $43.9 million reported for payroll and benefits charged to operations and maintenance expense.

Income tax expense was $11.6 million in 2000, $13.5 million in 1999 and $11.4 million in 1998. The changes in taxes are generally due to variations in taxable income. There is no state income tax in Washington.

In 2000, interest on long-term debt was unchanged from 1999. In October, $20 million, Series C, 8.15% senior notes were issued. The added interest expense was offset by sinking fund reductions of outstanding bonds and interest capitalized on constructed assets. Long-term debt interest expense increased $1 million in 1999 because of the issue of Series B, 6.77% senior notes in March.

Short-term bank borrowing interest expense increased in 2000 by $0.7 million because of higher borrowings to meet operating and interim construction funding needs. Bank borrowings were reduced when Series C senior notes were issued. In 1999, other interest expense decreased $0.4 million. Short-term borrowings were reduced after the issue of Series B senior notes and by strong cash flow from operations. Interest coverage of long-term debt before income taxes was 3.6 times in 2000, 3.7 times in 1999 and 3.6 times in 1998. There was $14.6 million in short-term borrowings at the end of 2000, $14.0 million at the end of 1999 and $22.9 million at the end of 1998.

OTHER INCOME AND EXPENSES. Other income is derived from management contracts whereby the Company operates private and municipally owned water systems, agreements for operation of two recycled water systems, contracts for meter reading and billing services to various cities, leases of communication antenna sites, surplus property sales, other non-utility sources and interest on short-term investments. Total other income was $1.8 million in 2000, $3.6 million in 1999 and $2.1 million in 1998. During 1999, $1.3 million in pre-tax profits were recorded from properties sold as part of the Real Estate Program that is described in more detail in the "Liquidity and Capital Resources" section of this report. There were no property sales in 2000 or 1998.

Rates and Regulation

The Company's regulatory staff reviewed 15 Cal Water districts that were eligible for general rate filings in 2000. Based on current earnings levels, projected expense increases and expected capital expenditures, applications were filed in July 2000 for three districts representing about 25% of Cal Water customers. The applications request a 10.75% return on equity and would provide $3.4 million in new revenue in 2001 and $7.2 million in 2002. A CPUC decision is expected during the second quarter of 2001. There can be no assurance that the increases will be granted as requested.

Step rate increases of $0.8 million for 2001 from prior general rate decisions were effective in January.

New water rates for the City of Hawthorne water system, which the Company operates under a long-term lease, became effective in early August 2000. The rates are designed to add $0.3 million in annual revenue in their first full year. Step rate increases of $0.2 million will be effective on July 1, 2001 and 2002. Additionally, there will be a surcharge added to customer bills for a two-year period starting in August 2001 designed to produce $0.5 million in annual revenue.

Effective in August 2000, offset rate increases to recover increases in water production expenses became effective in four Cal Water districts. The rates generated $1.6 million in additional 2000 revenue and are expected to add $1.8 million in 2001.

Prior to and unrelated to the merger with the Company, Dominguez Services Corporation filed a general rate increase application with the CPUC. A CPUC decision was issued in October 2000 authorizing an increase in customer rates and granting a return on equity of 9.95%. For 2000, $0.2 million in new revenue was received from the rate increase and for the full year 2001, $1.7 million is expected.

During 1999, the Company's regulatory staff completed a review of 14 Cal Water districts that were eligible for general rate application filings. Based on existing earnings levels, projected expense increases and expected capital expenditures, a determination was made that no general rate increase applications were necessary.

In May 1999, the CPUC authorized general rate increases for the rate applications filed in July 1998 affecting four districts representing about 25% of Cal Water's customers. The decision generated $4.1 million in new revenue during the twelve months following the mid-June effective date. The decision's 9.55% authorized return on equity provided $1.9 million in new annual revenue. In addition, the decision provided another $2.2 million in annual revenue for environmental compliance, specific capital budget expenditures and recovery of General Office expenses. The $2.2 million is not reflected in the 9.55% return on equity calculation.

CPUC decisions were received in July 1998 for the general rate applications filed in July 1997. Additional annual revenue from these decisions was $0.3 million in 1998, $0.3 million in 1999 and $0.1 million in 2000, with $0.1 million expected in 2001. In a variance from its past practice, future rate increases for operating costs and capital requirements over the next five years in the Oroville and Selma districts are tied to changes in a price index. The decision maintained the Return on Equity (ROE) at 10.35%.

Water Supply

The Company's source of supply varies among its operating districts. Certain districts obtain all of their supply from wells, some districts purchase all of their supply from wholesale suppliers and other districts obtain their supply from a combination of well and purchased sources. A small portion of the supply is from surface sources. On average, approximately half of the water is provided from wells and about half purchased.

California's normal weather pattern yields little precipitation between mid-spring and mid-fall. The Washington service areas receive precipitation in all seasons with the heaviest amounts during the winter. Water usage is highest during the warm summers and declines in the cool winter months. Rain and snow during the winter months replenish underground water basins and fill reservoirs providing the water supply for subsequent delivery to customers. To date, snow and rainfall accumulation during the 2000-2001 water year has been less than normal; however, the prior four years were at or exceeded normal levels. Water storage in California's reservoirs at the end of 2000 was at 107% of historic average, so the state will enter 2001 with ample storage. The Company believes that its supply from underground aquifers and purchased sources should be adequate to meet customer demand during 2001.

Environmental Matters

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

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

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

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

In January 2001, EPA released a new, lower regulatory limit for arsenic, a naturally-occurring element, that is sometimes present in groundwater. It is anticipated that EPA will issue other regulations that will require further monitoring and possible treatment for specific contaminants. Depending on the action levels contained in the regulations, the cost of compliance with the new regulations could be significant in certain Company districts. The Company intends to request recovery for capital investments and additional treatment costs needed to remain in compliance with established health standards through the ratemaking process.

Liquidity and Capital Resources

LIQUIDITY. The Company's liquidity is provided by bank lines of credit and internally generated funds. The Company has a $50 million line of credit with a bank, of which $20 million is designated for the parent and $30 million is available to Cal Water. The $20 million portion may be drawn on for use by the Company, including funding of its subsidiaries' operations. Cal Water's $30 million portion can be used solely for purposes of the regulated utility.

The Company has committed $7.6 million of the $20 million credit line to a contractor who is constructing a combined customer/operation center to serve the South Bay Los Angeles operations. When complete in the fall of 2001, the Company will exchange real property on a tax-free basis with the contractor for the customer/operation center. At December 31, 2000, $3.5 million had been drawn to acquire land and commence construction.

Washington Water has loan commitments from two banks to meet its operating and capital equipment purchase requirements. At December 31, 2000, the total available under these commitments was $0.4 million. Generally, short-term borrowings under the commitments are converted annually to long-term borrowings with repayment terms tied to system and equipment acquisitions.

The water business is seasonal. Revenue is lower in the winter months when water usage declines from the higher-use summer period. During the winter period, the need for short-term borrowings under the bank lines of credit increases. The larger summer cash flow allows short-term borrowings to be paid down. Short-term borrowings that remain outstanding more than one year have generally been converted to long-term debt. The Company believes that long-term financing is available to it through debt and equity markets. Standard & Poor's and Moody's have maintained their ratings of Cal Water's first mortgage bonds at AA- and Aa3, respectively. These are the highest ratings for senior debt in the water industry. Long-term financing, which includes common stock, first mortgage bonds, senior notes and other debt securities has been used to replace short-term borrowings and fund construction. Developer contributions in aid of construction and refundable advances for construction are also sources of funds for various construction projects. Internally generated funds come from retention of earnings not paid out as dividends, depreciation and deferred income taxes. Additional information regarding the bank borrowings and long-term debt is presented in notes 7 and 8 to the financial statements.

In October 2000, Series C, 8.15%, 30-year senior notes were issued and in March 1999, Series B, 6.77%, 30-year senior notes were issued. Each issue is for $20 million. During the four years prior to the Series B issue, the Company's operating and capital requirements were met by borrowings under the bank short-term line of credit and internally generated funds.

The Company has a Dividend Reinvestment Plan and Stock Purchase Plan (Plan). Under the Plan, stockholders may reinvest dividends to purchase additional Company common stock. The Plan also allows existing stockholders and other interested investors to purchase Company common stock through the transfer agent. The Plan provides that shares required for the Plan may be purchased on the open market or be newly issued shares. Therefore, the Plan provides the Company with an alternative means of developing additional equity if new shares were issued. During 2000 and 1999 shares were purchased on the open market. At this time, the Company intends to continue purchasing shares required for the Plan on the open market. However, if new shares were issued to satisfy future Plan requirements, the impact on earnings per share could be dilutive because of the additional shares outstanding. Also, stockholders may experience dilution of their ownership percentage.

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

The 2000 utility plant expenditures totaled $37.1 million. During 1999, total utility plant expenditures were $48.6 compared to $41.1 million in 1998. The 2000 expenditures included $33.5 million provided by Company funds and $3.6 million received from developers for contributions in aid of construction and refundable advances for construction. Company projects were funded by internally generated funds, borrowings under bank credit lines and commitments, and issuance of the $20 million Series C senior notes.

Several major projects account for an increase in the 2001 construction budget to $53.9 million. In 2001, construction will commence on a three-year project to construct a treatment plant to accommodate growth and meet water quality standards in the Bakersfield district. $10.8 million is budgeted for this project in 2001. Over the three-year period, the plant and related pumping and pipeline facilities are estimated to cost $45 million. Also in the 2001 budget is $4.6 million for construction of office/operation centers in the Chico and Stockton districts. These facilities will replace existing office/operation centers that have become inadequate due to age and district growth. The budget will be funded by operations, bank borrowings and long-term debt and equity financing. New subdivision construction will be financed by developers' contributions and refundable advances for construction. The Company-funded construction budgets over the next five years are projected to be about $275 million.

CAPITAL STRUCTURE. Common stockholders' equity increased by the amount of earnings not paid out for dividends. New equity issued in 1999 and 1998 was to acquire water systems. The long-term debt portion of the capital structure increased due to the issuance of Series B and C senior notes. It was reduced by first mortgage bond sinking fund payments.

The Company's total capitalization at December 31, 2000, was $389.4 million and at the end of 1999 was $366.9 million.

Capital ratios were:

	2000	1999
Common equity	**51.1%**	53.0%
Preferred stock	**0.9%**	0.9%
Long-term debt	**48.0%**	46.1%

The 2000 return on average common equity was 10.1% compared to 11.5% in 1999 and 10.8% in 1998.

OTHER ACQUISITIONS. On January 25, 2001, the CPUC approved the Company's acquisition of the Nish water systems in Visalia. The four systems serve 1,100 customers and have annual revenue of $1.2 million. The Company will issue common stock valued at $0.8 million and assume debt of $0.2 million to complete the transaction.

On April 12, 2000, Washington Water received approval from the WUTC to purchase the assets of Mirrormount Water Services and Lacamas Farmsteads Water Company. The acquisitions were completed in April 2000. Together the companies serve almost 800 customers and produce annual revenue of about $250,000. Washington Water also purchased the assets of Robischon Engineers, Inc. in April 2000. This acquisition added in-house engineering capabilities to the Washington operation, enabling Washington Water to provide water system design services to other water providers.

During 1999 the Company invested in a firm that provides meter-reading services in Santa Fe, New Mexico and assumed responsibility for this contract in April 2000. The Company's agreement is with Avistar, a subsidiary of Public Service of New Mexico, which operates the 26,000-account water system for the city. The acquisition of the Rio Grande Utility Corporation, which serves 2,300 water and 1,600 wastewater customers, for $2.3 million in cash and assumed debt of $3.1 million is expected to be completed in the third quarter of 2001.

REAL ESTATE PROGRAM. The Company's subsidiaries own more than 900 real estate parcels. Certain parcels are not necessary for or used in water utility operations. Most surplus properties have a low cost basis. A program has been developed to realize the value of certain surplus properties through sale or lease of those properties. The program will be ongoing for a period of several years. During the next four years, the Company estimates that gross property transactions totaling over $10 million dollars could be completed. In 1999, $1.3 million in pretax sales were completed. No transactions were completed during 2000; however, $4 million in pretax property sales are anticipated to close during 2001.

STOCKHOLDER RIGHTS PLAN. As explained in Note 6 to the Consolidated Financial Statements, in January 1998, the Board of Directors adopted a Stockholder Rights Plan (Plan). In connection with the Plan, a dividend distribution of one right for each common share to purchase preferred stock under certain circumstances was also authorized. The Plan is designed to protect stockholders and maximize stockholder value in the event of an unsolicited takeover proposal by encouraging a prospective acquirer to negotiate with the Board.

Financial Risk Management

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

INTEREST RATE RISK. The Company does have exposure to market risk that includes changes in interest rates. Interest rate risk exists because the Company's financing includes the use of long-term debt obligations with maturity dates up to 30 years from the date of issue and during the outstanding period interest rates are subject to fluctuation. The Company's long-term obligations are first mortgage bonds and senior note obligations that are generally placed with insurance companies. Washington Water's long-term obligations are for periods of up to 10 years and are placed with two banks. During 2000, the Company issued a single series of $20 million, 30-year senior notes at 8.15%. To expand access to capital debt markets, the Company may investigate the use of private and public markets for future debt issues. It may also consider financing on a company-wide basis, rather than on a subsidiary-by-subsidiary basis.

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

VALUE RISK. Because the Company operates primarily in a regulated industry, its value risk is somewhat lessened; however, regulated parameters also can be recognized as limitations to operations and earnings, and the ability to respond to certain business condition changes. Non-regulated operations are subject to risk of contract constraints and performance by the Company in achieving its objectives. Value risk management is accomplished using various financial models that consider changing business parameters. It is also supplemented by considering various risk control processes that may be available as circumstances warrant.

EQUITY RISK. The Company does not have equity investments, therefore, it does not have equity risks.

New Accounting Standard

In 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." The statement as amended, establishes new accounting and reporting standards for derivative financial instruments and hedging activities. The Company adopted the standard on January 1, 2001. Its adoption is not anticipated to have a material impact on the Company's results of operations or financial position.

Consolidated Balance Sheet

In thousands, except per share data

December 31, 2000 and 1999	**2000**	1999
Assets		
Utility plant:		
Land	**$ 10,641**	$ 10,440
Depreciable plant and equipment	**797,403**	776,795
Construction work in progress	**31,400**	14,661
Intangible assets	**11,837**	10,790
Total utility plant	**851,281**	812,686
Less accumulated depreciation and amortization	**269,273**	248,296
Net utility plant	**582,008**	564,390
Current assets:		
Cash and cash equivalents	**3,241**	1,655
Receivables:		
Customers	**15,163**	14,333
Other	**5,450**	4,777
Unbilled revenue	**7,964**	8,199
Materials and supplies at average cost	**2,718**	2,247
Taxes and other prepaid expenses	**6,257**	7,140
Total current assets	**40,793**	38,351
Other assets:		
Regulatory assets	**38,133**	37,441
Unamortized debt premium and expense	**3,817**	3,503
Other	**1,854**	1,822
Total other assets	**43,804**	42,766
	$666,605	$645,507

In thousands, except per share data

December 31, 2000 and 1999	**2000**	1999
Capitalization and Liabilities		
Capitalization:		
Common stock, $.01 par value; 25,000 shares authorized, 15,146 and 15,094 shares outstanding in 2000 and 1999, respectively	**$ 151**	$ 151
Additional paid-in capital	**49,984**	49,340
Retained earnings	**149,185**	145,610
Accumulated other comprehensive loss	**(486)**	(517)
Total common stockholders' equity	**198,834**	194,584
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	**187,098**	168,866
Total capitalization	**389,407**	366,925
Current liabilities:		
Current maturities of long-term debt	**2,881**	2,747
Short-term borrowings	**14,598**	13,999
Accounts payable	**26,493**	26,748
Accrued taxes	**3,976**	3,556
Accrued interest	**2,579**	2,092
Other accrued liabilities	**13,209**	13,569
Total current liabilities	**63,736**	62,711
Unamortized investment tax credits	**2,989**	3,096
Deferred income taxes	**25,620**	25,796
Regulatory and other liabilities	**20,316**	22,544
Advances for construction	**105,562**	105,556
Contributions in aid of construction	**58,975**	58,879
	$666,605	$645,507

See accompanying notes to consolidated financial statements.

Consolidated Statement of Income

In thousands, except per share data For the years ended December 31, 2000, 1999 and 1998	**2000**	1999	1998
Operating revenue	**$244,806**	$234,937	$214,926
Operating expenses:			
Operations:			
Purchased water	**73,768**	69,351	60,958
Purchased power	**15,136**	14,355	12,541
Pump taxes	**6,275**	6,856	5,162
Administrative and general	**32,974**	32,266	29,784
Other	**32,308**	28,963	28,131
Maintenance	**11,592**	10,200	10,191
Depreciation and amortization	**18,368**	17,246	16,309
Income taxes	**11,571**	13,515	11,425
Property and other taxes	**9,618**	9,138	8,744
Total operating expenses	**211,610**	201,890	183,245
Net operating income	**33,196**	33,047	31,681
Other income and expenses, net	**1,413**	3,089	1,746
Income before interest expense	**34,609**	36,136	33,427
Interest expense:			
Long-term debt interest	**12,901**	13,084	12,125
Other interest	**1,745**	1,081	1,442
Total interest expense	**14,646**	14,165	13,567
Net income	**$ 19,963**	$ 21,971	$ 19,860
Earnings per share:			
Basic	**$ 1.31**	$ 1.45	$ 1.31
Diluted	**$ 1.31**	$ 1.44	$ 1.31
Weighted average number of common shares outstanding:			
Basic	**15,126**	15,090	15,014
Diluted	**15,173**	15,142	15,061

See accompanying notes to consolidated financial statements.

Consolidated Statement of Common Stockholders' Equity and Comprehensive Income

In thousands For the years ended December 31, 2000, 1999 and 1998	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity	Total Comprehensive Income
Balance at December 31, 1997	$150	$ 48,372	$ 134,236	$ —	$ 182,758	$ —
Net income	—	—	19,860	—	19,860	19,860
Dividends paid:						
Preferred stock	—	—	153	—	153	—
Common stock	—	—	14,889	—	14,889	—
Total dividends paid	—	—	15,042	—	15,042	—
Income reinvested in business	—	—	4,818	—	4,818	—
Balance at December 31, 1998	150	48,372	139,054	—	187,576	19,860
Issuance of common stock	1	968	—	—	969	—
Net income	—	—	21,971	—	21,971	21,971
Dividends paid:						
Preferred stock	—	—	153	—	153	—
Common stock	—	—	15,262	—	15,262	—
Total dividends paid	—	—	15,415	—	15,415	—
Income reinvested in business	—	—	6,556	—	6,556	—
Other comprehensive loss	—	—	—	(517)	(517)	(517)
Balance at December 31, 1999	151	49,340	145,610	(517)	194,584	21,454
Issuance of common stock	**—**	**644**	**—**	**—**	**644**	**—**
Net income	**—**	**—**	**19,963**	**—**	**19,963**	**19,963**
Dividends paid:						
Preferred stock	**—**	**—**	**152**	**—**	**152**	**—**
Common stock	**—**	**—**	**16,236**	**—**	**16,236**	**—**
Total dividends paid	**—**	**—**	**16,388**	**—**	**16,388**	**—**
Income reinvested in business	**—**	**—**	**3,575**	**—**	**3,575**	**—**
Other comprehensive income	**—**	**—**	**—**	**31**	**31**	**31**
Balance at December 31, 2000	**$151**	**$49,984**	**$149,185**	**$(486)**	**$198,834**	**$19,994**

See accompanying notes to consolidated financial statements.

Consolidated Statement of Cash Flows

In thousands

For the years ended December 31, 2000, 1999 and 1998	**2000**	1999	1998
Operating activities:			
Net income	**$ 19,963**	$ 21,971	$ 19,860
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**18,368**	17,246	16,309
Deferred income taxes, investment tax credits, and regulatory assets and liabilities, net	**(3,203)**	1,360	503
Changes in operating assets and liabilities			
Receivables	**(1,503)**	(2,324)	2,224
Unbilled revenue	**235**	(1,187)	(780)
Accounts payable	**(255)**	7,623	332
Other current assets and liabilities	**1,093**	(649)	2,272
Other changes, net	**(71)**	3,334	892
Net adjustments	**14,664**	25,403	21,752
Net cash provided by operating activities	**34,627**	47,374	41,612
Investing activities:			
Utility plant expenditures			
Company funded	**(33,540)**	(35,535)	(35,963)
Developer advances and contributions in aid of construction	**(3,621)**	(12,984)	(5,098)
Other investments	**—**	(80)	—
Net cash used in investing activities	**(37,161)**	(48,599)	(41,061)
Financing activities:			
Net short-term borrowings	**599**	(8,951)	8,450
Issuance of common stock	**644**	46	—
Issuance of long-term debt	**20,326**	20,062	—
Advances for construction	**3,846**	7,480	3,972
Refunds of advances for construction	**(3,870)**	(4,056)	(3,939)
Contributions in aid of construction	**1,883**	4,814	3,982
Retirement of long-term debt	**(2,920)**	(2,318)	(785)
Dividends paid	**(16,388)**	(15,415)	(15,042)
Net cash provided (used) in financing activities	**4,120**	1,662	(3,362)
Change in cash and cash equivalents	**1,586**	437	(2,811)
Cash and cash equivalents at beginning of year	**1,655**	1,218	4,029
Cash and cash equivalents at end of year	**$ 3,241**	$ 1,655	$ 1,218
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest (net of amounts capitalized)	**$ 14,785**	$ 13,796	$ 11,922
Income taxes	**11,775**	11,499	9,501
Non-cash financing activity - common stock issued in acquisitions	**—**	923	—

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

December 31, 2000, 1999, and 1998

NOTE 1.

Organization and Operations

California Water Service Group (Company) is a holding company that through its wholly owned subsidiaries provides water utility and other related services in California, Washington and New Mexico. During 1999, the Company reincorporated as a Delaware corporation. California Water Service Company (Cal Water) and Washington Water Service Company (Washington Water) provide regulated utility services under the rules and regulations of their respective regulatory commissions (jointly referred to as Commissions). CWS Utility Services provides non-regulated water utility and utility-related services in all three states. New Mexico Water Service Company was formed in 2000 to provide regulated utility services.

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

NOTE 2.

Summary of Significant Accounting Policies

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. The financial statements give retroactive effect to acquisitions, which were accounted for as pooling of interests. Accordingly, the Company's consolidated financial statements and footnotes have been restated to include Dominguez Services Corporation and subsidiaries (Dominguez) as if the merger had been completed as of the beginning of the earliest period presented. Intercompany 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. Certain prior years' amounts have been reclassified, where necessary, to conform to the current presentation.

The preparation of consolidated financial statements in conformity with generally accepted accounting principles 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 service at rates authorized by the Commissions and billings to certain non-regulated customers. Revenue from metered accounts includes unbilled amounts based on the estimated usage from the latest meter reading to the end of the accounting period. Flat-rate accounts, which are billed at the beginning of the service period, are included in revenue on a pro rata basis for the portion applicable to the current accounting period.

UTILITY PLANT Utility plant is carried at original cost when first constructed or purchased, except for certain minor units of property recorded at estimated fair values at dates of acquisition. Cost of depreciable plant retired is eliminated from utility plant accounts and such costs are charged against accumulated depreciation. Maintenance of utility plant is charged primarily to operation expenses. Interest is capitalized on plant expenditures during the construction period and amounted to $703,000 in 2000, $324,000 in 1999 and $224,000 in 1998.

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. Included in intangible assets is $6,500,000 paid to the City of Hawthorne to lease the city's water system and associated water rights. The lease payment is being amortized on a straight-line basis over the 15-year life of the lease. The Company continually evaluates the recoverability of utility plant by assessing whether the amortization of the balance over the remaining life can be recovered through the expected and undiscounted future cash flows.

DEPRECIATION Depreciation of utility plant for financial statement purposes is computed on the straight-line remaining life method at rates based on the estimated useful lives of the assets, ranging from 5 to 65 years. The provision for depreciation expressed as a percentage of the aggregate depreciable asset balances was 2.4% in 2000 and 2.5% in 1999 and 1998. For income tax purposes, as applicable, the Company computes depreciation using the accelerated methods allowed by the respective taxing authorities. Plant additions since June 1996 are depreciated on a straight-line basis for tax purposes in accordance with tax regulations.

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

RESTRICTED CASH Restricted cash represents proceeds collected through a surcharge on certain customers' bills plus interest earned on the proceeds. The restricted cash is to service California Safe Drinking Water Bond obligations and is classified in other prepaid expenses. At December 31, 2000 and 1999, the amounts restricted were $755,000 and $724,000, respectively.

LONG-TERM DEBT PREMIUM, DISCOUNT AND EXPENSE The discount and issuance expense on long-term debt is amortized over the original lives of the related debt issues. Premiums paid on the early redemption of certain debt issues and unamortized original issue discount and expense of such issues are amortized over the life of new debt issued in conjunction with the early redemption.

ACCUMULATED OTHER COMPREHENSIVE LOSS The Company has an unfunded Supplemental Executive Retirement Plan. The unfunded accumulated benefit obligation of the plan exceeds the accrued benefit cost. This amount exceeds the unrecognized prior service cost; therefore accumulated other comprehensive loss has been recorded as a separate component of Stockholders' Equity.

ADVANCES FOR CONSTRUCTION Advances for Construction consist of payments received from developers for installation of water production and distribution facilities to serve new developments. Advances are excluded from rate base for rate setting purposes. Annual refunds are made to developers without interest over a 20-year or 40-year period. Refund amounts under the 20-year contracts are based on annual revenues from the extensions. Unrefunded balances at the end of the contract period are credited to Contributions in Aid of Construction and are no longer refundable. Refunds on contracts entered into since 1982 are made in equal annual amounts over 40 years. At December 31, 2000, the amounts refundable under the 20-year contracts were $8,688,000 and under 40-year contracts were $96,874,000. Estimated refunds for 2001 for all water main extension contracts are $4,100,000.

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

INCOME TAXES The Company accounts for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Measurement of the deferred tax assets and liabilities is at enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date.

It is anticipated that future rate action by the Commissions will reflect revenue requirements for the tax effects of temporary differences recognized, which have previously been flowed through to customers.

The Commissions have granted the Company customer rate increases to reflect the normalization of the tax benefits of the federal accelerated methods and available Investment Tax Credits (ITC) for all assets placed in service after 1980. ITC are deferred and amortized over the lives of the related properties for book purposes.

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

EARNINGS PER SHARE Basic earnings per share (EPS) is calculated by dividing income available to common stockholders by the weighted average shares outstanding during the year. Diluted EPS is calculated by dividing income available to common stockholders by the weighted average shares outstanding and potentially dilutive shares.

STOCK-BASED COMPENSATION The Company adopted Statement on Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation." The Company elected to adopt the provision of the statement that allows the continuing practice of not recognizing compensation expense related to the granting of employee stock options to the extent that the option price of the underlying stock was equal to or greater than the market price on the date of the option grant.

NOTE 3.

Merger with Dominguez Services Corporation

The Merger between the Company and Dominguez was completed on May 25, 2000. On the merger date, each outstanding Dominguez common share was exchanged for 1.38 shares of Company common stock. The Company issued 2,210,254 new common shares in exchange for the 1,601,679 outstanding Dominguez shares. Dominguez provided water service to about 40,000 customers in 21 California communities. The former Dominguez operations became districts within Cal Water.

The Merger was accounted for as a pooling of interests. There were no intercompany transactions as a result of the Merger. Certain reclassifications were made to the historic financial statements of the companies to conform presentation.

For the periods indicated below, the Company and Dominguez reported the following items:

Unaudited – In thousands	**6 Months Ended 6-30-00**	Year Ended 12-31-99	Year Ended 12-31-98
Revenue:			
Company	**$ 98,428**	$206,440	$189,659
Dominguez	**14,232**	28,497	25,267
	$112,660	$234,937	$214,926
Net income:			
Company	**$ 6,139**	$ 19,919	$ 18,936
Dominguez	**1,147**	2,052	924
	$ 7,286	$ 21,971	$ 19,860

Dominguez previously reported net of tax extraordinary items related to merger transaction expenses. The Company reclassified the extraordinary items into "Operating expenses" in the income statement. The reclassified amounts were for the six months ended June 30, 2000, $167,000; for the year ended December 31, 1999, $190,000; and for the year ended December 31, 1998, $499,000.

No adjustments were made to the Dominguez net assets in applying the accounting practices of the Company. Dominguez previously reported common stock of $1,542,000 that was reclassified by the Company to "Paid-in-Capital" in accordance with the Company's financial statement presentation. The Company and Dominguez each had December 31 year-ends; therefore no adjustment was required to retained earnings due to a change in fiscal year-ends.

NOTE 4.

Other Acquisitions

In 1999, the Company acquired all of the outstanding stock of Harbor Water Company and South Sound Utility Company, which form the operations of Washington Water, serving 14,900 regulated and non-regulated customers. The acquisitions were accounted for as pooling of interests in exchange for 316,472 shares of Company stock and assumption of long-term debt of $2,959,000. The results of operations previously reported by the separate entities are included in the accompanying consolidated financial statements.

During 1998, the Company purchased the assets of Lucerne Water Company, Rancho del Paradiso Water Company and Armstrong Valley Water Company. These investor-owned systems serve 1,624 accounts. The acquisitions were completed effective January 1, 1999, in exchange for the equivalent of 75,164 shares of Company common stock. The acquisitions were accounted for under purchase accounting. The purchases were completed on a non-cash basis in which the Company issued common stock valued at $922,000 and assumed debt obligations of $1,108,000.

Two other water company asset acquisitions were completed in 1999. The acquired companies served 288 customers. The acquisitions were accounted for under purchase accounting.

On April 12, 2000, Washington Water received approval from the Washington Utilities and Transportation Commission to purchase the assets of Mirrormount Water Services and Lacamas Farmsteads Water Company. The acquisitions were completed in April 2000 for $639,000 in cash and assumed debt. Together the companies serve almost 800 customers and produce annual revenue of about $250,000. To provide in-house engineering, Washington Water also purchased the assets of Robischon Engineers, Inc. in April 2000 for $70,000 in cash. The acquisitions were accounted for by purchase accounting.

During 1999 the Company invested in a firm that provides meter-reading services in Santa Fe, New Mexico. In April 2000, the Company assumed responsibility for this contract. The Company's agreement is with Avistar, a subsidiary of Public Service of New Mexico, which operates the 26,000-account water system for the city. New Mexico Water has agreed to acquire the Rio Grande Utility Corporation, which serves 2,300 water and 1,600 wastewater customers, for $2.3 million in cash and assumed debt of $3.1 million. The acquistion is expected to be completed in the third quarter of 2001 after approval of the state's regulatory authority is received.

NOTE 5.

Preferred Stock

As of December 31, 2000 and 1999, 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. Preferred shares are entitled to sixteen votes, each with the right to cumulative votes at any election of directors.

The outstanding 139,000 shares of $25 par value cumulative, 4.4% Series C preferred shares are not convertible to common stock. A premium of $243,250 would be due upon voluntary liquidation of Series C. There is no premium in the event of an involuntary liquidation.

NOTE 6.

Common Stockholders' Equity

The Company is authorized to issue 25,000,000 shares of $.01 par value common stock. As of December 31, 2000 and 1999, 15,145,866 and 15,093,627 shares of common stock were issued and outstanding, respectively. All shares of common stock are eligible to participate in the Company's dividend reinvestment plan. Approximately 10% of the outstanding shares participate in the plan.

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

Each Right represents a right to purchase 1/100th share of Series D Preferred Stock at the price of $120, subject to adjustment (the 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 causes 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 $.001 per Right.

NOTE 7.

Short-term Borrowings

As of December 31, 2000, the Company maintained a bank line of credit providing unsecured borrowings of up to $20,000,000 at the prime lending rate or lower rates as quoted by the bank. $7,562,000 of the line is committed to a contractor for construction of an office complex for combined Los Angeles South Bay operations. When completed, the office complex will be exchanged with the contractor for surplus company land on a tax-free basis. Cal Water maintained a bank line of credit for an additional $30,000,000 on the same terms as the Company. The line of credit agreements, which expire April 2001 and which the Company expects to renew, do not require minimum or specific compensating balances.

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

Dollars in thousands	**2000**	1999	1998
Maximum short-term borrowings	**$26,750**	$25,500	$25,700
Average amount outstanding	**16,810**	9,093	15,755
Weighted average interest rate	**7.77%**	6.52%	7.09%
Interest rate at December 31	**7.88%**	7.11%	6.97%

NOTE 8.

Long-term Debt

As of December 31, 2000 and 1999, long-term debt outstanding was:

In thousands	Series	Interest Rate	Maturity Date	**2000**	1999
First Mortgage Bonds:	J	8.86%	2023	**$ 4,000**	$ 4,000
	K	6.94%	2012	**5,000**	5,000
	P	7.875%	2002	**2,580**	2,595
	S	8.50%	2003	**2,595**	2,610
	BB	9.48%	2008	**13,230**	14,940
	CC	9.86%	2020	**18,600**	18,700
	DD	8.63%	2022	**19,200**	19,300
	EE	7.90%	2023	**19,300**	19,400
	FF	6.95%	2023	**19,300**	19,400
	GG	6.98%	2023	**19,300**	19,400
				123,105	125,345
Senior Notes:	A	7.28%	2025	**20,000**	20,000
	B	6.77%	2028	**20,000**	20,000
	C	8.15%	2030	**20,000**	—
California Department of Water Resources loans		3.0% to 7.4%	2011-32	**3,176**	3,236
Other long-term debt				**3,698**	3,032
Total long-term debt				**189,979**	171,613
Less current maturities				**2,881**	2,747
Long-term debt excluding current maturities				**$187,098**	$168,866

The first mortgage bonds are obligations of Cal Water. All bonds are held by institutional investors and secured by substantially all of Cal Water's utility plant. The unsecured senior notes are also obligations of Cal Water. They are held by institutional investors and require interest-only payments until maturity. The Department of Water Resources (DWR) loans were financed under the California Safe Drinking Water Bond Act. Repayment of principal and interest on the DWR loans is through a surcharge on customer bills. Other long-term debt is primarily equipment and system acquisition financing arrangements with other financial institutions. Aggregate maturities and sinking fund requirements for each of the succeeding five years (2001 through 2005) are $2,881,000, $5,381,000, $5,283,000, $2,663,000, and $2,669,000.

NOTE 9.

Income Taxes

Income tax expense consists of the following:

In thousands		Federal	State	Total
2000	Current	**$ 7,961**	**$2,519**	**$10,480**
	Deferred	**1,554**	**(463)**	**1,091**
	Total	**$ 9,515**	**$2,056**	**$11,571**
1999	Current	$ 8,291	$2,560	$10,851
	Deferred	2,769	(105)	2,664
	Total	$11,060	$2,455	$13,515
1998	Current	$ 6,667	$2,388	$ 9,055
	Deferred	2,679	(309)	2,370
	Total	$ 9,346	$2,079	$11,425

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

In thousands	2000	1999	1998
Computed "expected" tax expense	**$11,037**	$12,420	$10,950
Increase (reduction) in taxes due to:			
State income taxes net of federal tax benefit	**1,336**	1,624	1,442
Investment tax credits	**(155)**	(184)	(167)
Other	**(647)**	(345)	(800)
Total income tax	**$11,571**	$13,515	$11,425

The components of deferred income tax expense were:

In thousands	2000	1999	1998
Depreciation	**$2,031**	$2,974	$3,007
Developer advances and contributions	**(814)**	(749)	(798)
Bond redemption premiums	**(61)**	(62)	(62)
Investment tax credits	**(61)**	(94)	(93)
Other	**(4)**	595	316
Total deferred income tax expense	**$1,091**	$2,664	$2,370

The tax effects of differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2000 and 1999 are presented in the following table:

In thousands	2000	1999
Deferred tax assets:		
Developer deposits for extension agreements and contributions in aid of construction	**$40,458**	$40,595
Federal benefit of state tax deductions	**5,648**	6,040
Book plant cost reduction for future deferred ITC amortization	**1,765**	1,679
Insurance loss provisions	**632**	821
Pension plan	**736**	794
Other	**4,860**	2,886
Total deferred tax assets	**54,099**	52,815
Deferred tax liabilities:		
Utility plant, principally due to depreciation differences	**78,894**	77,520
Premium on early retirement of bonds	**825**	1,091
Total deferred tax liabilities	**79,719**	78,611
Net deferred tax liabilities	**$25,620**	$25,796

A valuation allowance was not required during 2000 and 1999. Based on historic 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.

NOTE 10.

Employee Benefit Plans

PENSION PLAN The Company provides a qualified defined benefit, non-contributory pension plan for substantially all employees. The cost of the plan was charged to expense and utility plant. The Company makes annual contributions to fund the amounts accrued for pension cost. Plan assets are invested in mutual funds, pooled equity, bonds and short-term investment accounts. The data below includes the unfunded, non-qualified, supplemental executive retirement plan.

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

SAVINGS PLAN The Company sponsors a 401(k) qualified, defined contribution savings plan that allowed participants to contribute up to 15% of pre-tax compensation in 1999, increasing to 18% in 2000. The Company matches fifty cents for each dollar contributed by the employee up to a maximum Company match of 4.0%. Company contributions were $1,298,000, $1,126,000, and $1,078,000 for the years 2000, 1999 and 1998.

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

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

The following table reconciles the funded status of the plans with the accrued pension liability and the net postretirement benefit liability as of December 31, 2000 and 1999:

	Pension Benefits		Other Benefits	
In thousands	**2000**	1999	**2000**	1999
Change in benefit obligation:				
Beginning of year	**$ 55,692**	$ 61,396	**$10,195**	$ 9,900
Service cost	**2,846**	2,899	**544**	498
Interest cost	**4,079**	3,894	**790**	689
Assumption change	**825**	(6,669)	**394**	(929)
Plan amendment	**1,215**	744	**—**	—
Experience (gain) or loss	**(34)**	(3,900)	**558**	433
Curtailment gain	**(1,347)**	—	**—**	—
Benefits paid	**(4,178)**	(2,672)	**(429)**	(396)
End of year	**$ 59,098**	$ 55,692	**$12,052**	$10,195
Change in plan assets:				
Fair value of plan assets at beginning of year	**$ 61,008**	$ 57,050	**$ 1,561**	$ 1,723
Actual return on plan assets	**3,140**	6,453	**228**	206
Employer contributions	**3,678**	177	**707**	28
Retiree contributions	**—**	—	**370**	343
Benefits paid	**(4,178)**	(2,672)	**(799)**	(739)
Fair value of plan assets at end of year	**$ 63,648**	$ 61,008	**$ 2,067**	$ 1,561
Funded status	**$ 4,550**	$ 5,317	**$ (9,985)**	$ (8,634)
Unrecognized actuarial (gain) or loss	**(13,534)**	(16,204)	**1,422**	556
Unrecognized prior service cost	**5,279**	4,971	**888**	959
Unrecognized transition obligation	**—**	—	**3,597**	3,228
Unrecognized net initial asset	**228**	455	**(276)**	369
Net amount recognized	**$ (3,477)**	$ (5,461)	**$ (4,354)**	$ (3,522)

Amounts recognized on the balance sheet consist of:

	Pension Benefits		Other Benefits	
In thousands	**2000**	1999	**2000**	1999
Accrued benefit costs	**$ (3,477)**	$ (5,461)	**$ (4,354)**	$ (3,522)
Additional minimum liability	**(1,363)**	(1,460)	**—**	—
Intangible asset	**877**	943	**—**	—
Accumulated other comprehensive loss	**486**	517	**—**	—
Net amount recognized	**$ (3,477)**	$ (5,461)	**$ (4,354)**	$ (3,522)

	Pension Benefits		Other Benefits	
	2000	1999	**2000**	1999
Weighted average assumptions as of December 31:				
Discount rate	**7.25%**	7.50%	**7.25%**	7.50%
Long-term rate of return on plan assets	**8.00%**	8.00%	**8.00%**	8.00%
Rate of compensation increases	**4.50%**	4.50%	**—**	—

Net periodic benefit costs for the pension and other postretirement plans for the years ending December 31, 2000, 1999 and 1998 included the following components:

	Pension Plan			Other Benefits		
In thousands	**2000**	1999	1998	**2000**	1999	1998
Service cost	**$2,846**	$2,899	$2,399	**$ 544**	$ 498	$ 405
Interest cost	**4,079**	3,894	3,747	**790**	689	623
Expected return on plan assets	**(4,498)**	(4,450)	(4,199)	**(152)**	(144)	(117)
Net amortization and deferral	**486**	871	683	**357**	401	360
Net periodic benefit cost	**$2,913**	$3,214	$2,630	**$1,539**	$1,444	$1,271

Postretirement benefit expense recorded in 2000, 1999, and 1998 was $781,000, $1,064,000, and $666,000 respectively. $3,437,000, which is recoverable through future customer rates, is recorded as a regulatory asset. The Company intends to make annual contributions to the plan up to the amount deductible for tax purposes.

For 2000 measurement purposes, the Company assumed a 5% annual rate of increase in the per capita cost of covered benefits with the rate remaining at that level thereafter. The health care cost trend rate assumption has a significant effect on the amounts reported. A one-percentage point change in assumed health care cost trends is estimated to have the following effect:

In thousands	1-percentage Point Increase	1-percentage Point Decrease
Effect on total service and interest costs	$ 269	$ (166)
Effect on accumulated postretirement benefit obligation	$1,815	$(1,471)

NOTE 11.

Stock-Based Compensation Plans

At the Company's 2000 annual meeting, stockholders approved a Long-Term Incentive Plan that allows for the granting of nonqualified stock options, performance shares and dividend units. Under the plan, a total of 1,500,000 common shares are authorized for option grants. Options are granted at an exercise price that is not less than the per share common stock market price on the date of grant. The options vest at a 25% rate on their anniversary date over their first four years and are exercisable over a ten-year period. No options were vested at December 31, 2000.

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

Under SFAS No. 123, "Accounting for Stock-Based Compensation," the Company elected to apply the provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, no compensation cost has been recognized in the consolidated financial statements for stock options that have been granted. If the Company had elected to adopt the optional recognition provisions of SFAS 123 for its stock option plans, basic and diluted earnings per share would be unchanged from the amounts reported, except for 2000 diluted earnings per share which was reported as $1.31, but on a pro forma basis would be $1.30. Net income for the years ended December 31, 2000, 1999 and 1998 would be as presented in the following table:

In thousands	**2000**	1999	1998
As reported	**$19,963**	$21,971	$19,860
Pro forma	**19,939**	21,937	19,825

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

	2000	1999	1998
Expected dividend	**4.3%**	4.3%	4.3%
Expected volatility	**22.0%**	22.6%	22.6%
Risk-free interest rate	**4.9%**	6.2%	5.7%
Expected holding period in years	**5.0**	10.0	10.0

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

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Options Exercisable	Weighted Average Fair Value
Outstanding at January 1, 1998	35,604	$22.54	—	—	—
Granted	20,617	24.84			$5.15
Outstanding at December 31, 1998	56,221	23.38	—	8,901	—
Exercised	(3,864)	22.54			
Outstanding at December 31, 1999	52,357	23.45	—	19,092	—
Granted	53,500	23.06			3.74
Exercised	(52,357)	23.45			
Outstanding at December 31, 2000	**53,500**	**23.06**	**9.5**	**—**	**—**

NOTE 12.

Fair Value of Financial Instruments

For those financial instruments for which it is practicable to estimate a fair value, the following methods and assumptions were used. For cash equivalents, the carrying amount approximates fair value because of the short-term maturity of the instruments. The fair value of the Company's long-term debt is estimated at $199,890,000 as of December 31, 2000, and $189,400,000 as of December 31, 1999, using a discounted cash flow analysis, based on the current rates available to the Company for debt of similar maturities. The fair value of advances for construction contracts is estimated at $27,000,000 as of December 31, 2000, and $33,000,000 as of December 31, 1999, based on data provided by brokers.

NOTE 13.

Quarterly Financial Data (Unaudited)

The Company's common stock is traded on the New York Stock Exchange under the symbol "CWT." Quarterly dividends have been paid on common stock for 224 consecutive quarters and the quarterly rate has been increased each year since 1968.

2000 – in thousands except per share amounts	First	Second	Third	Fourth
Operating revenue	**$46,694**	**$65,966**	**$76,580**	**$55,566**
Net operating income	**4,902**	**8,977**	**12,782**	**6,535**
Net income	**1,533**	**5,753**	**9,205**	**3,472**
Diluted earnings per share	**.10**	**.38**	**.60**	**.23**

1999 – in thousands except per share amounts	First	Second	Third	Fourth
Operating revenue	$45,628	$59,232	$72,280	$57,797
Net operating income	4,777	8,440	11,922	7,908
Net income	2,868	6,089	8,706	4,308
Diluted earnings per share	.19	.40	.57	.28

Independent Auditors' Report

The Board of Directors
California Water Service Group:

We have audited the accompanying consolidated balance sheet of California Water Service Group and subsidiaries as of December 31, 2000 and 1999, 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, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

The consolidated financial statements of California Water Service Group as of and for each of the years ended December 31, 1999 and 1998, have been restated to reflect the pooling-of-interests transaction with Dominguez Services Corporation and subsidiaries as described in Note 3 to the consolidated financial statements. We did not audit the consolidated financial statements of Dominguez Services Corporation and subsidiaries, which financial statements reflect total assets constituting 9.0 percent as of December 31, 1999 and total revenue constituting 12.1 percent and 11.8 percent, in 1999 and 1998 respectively, of the related consolidated totals. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Dominguez Services Corporation and subsidiaries as of December 31, 1999, and for the years ended December 31, 1999 and 1998, is based solely on the report of the other auditors.

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

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of California Water Service Group and subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

Mountain View, California
January 22, 2001

Corporate Information

Stock Transfer, Dividend Disbursing and Reinvestment Agent
Fleet National Bank
c/o EquiServe L.P.
P.O. Box 43010
Providence, RI 02940-3010
800.736.3001

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

Bond Registrars
US Bank Trust, N.A.	Chase Manhattan Bank and Trust
One California Street	101 California Street
San Francisco, CA	San Francisco, CA
94111-5402	94111-5830
415.273.4580	415.954.9526

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 18, 2001, at 10 a.m. at the Company's Executive Office, located at 1720 North First Street in San Jose, California. Details of the business to be transacted during the meeting will be contained in the proxy material, which will be mailed to stockholders on or about March 16, 2001.

Annual Report for 2000 on Form 10-K
A copy of the Company's report for 2000 filed with the Securities and Exchange Commission on Form 10-K will be available in April 2001 and can be obtained by any stockholder at no charge upon written request to the address below.

Stockholder Information
California Water Service Group
Attn: Stockholder Relations
1720 North First Street
San Jose, CA 95112-4598
408.367.8200 or 800.750.8200
http://www.calwater.com

CWT Listed NYSE

Officers

California Water Service Company

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

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

Gerald F. Feeney [1,2,3]
Vice President, Chief Financial Officer and Treasurer

Francis S. Ferraro
Vice President, Regulatory Matters

James L. Good [2]
Vice President, Corporate Communications and Marketing

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

Christine L. McFarlane
Vice President, Human Resources

Raymond H. Taylor
Vice President, Operations

Raymond L. Worrell
Vice President, Chief Information Officer

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

Paul G. Ekstrom [1,2,3]
Corporate Secretary

John S. Simpson
Assistant Secretary, Manager of New Business

Washington Water Service Company

Michael P. Ireland
President

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

Design: Douglas Joseph Partners, Los Angeles

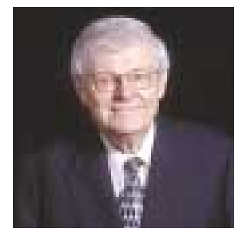
Board of Directors

Peter C. Nelson *
President and
Chief Executive Officer

Robert W. Foy *
Chairman of the Board

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

Linda R. Meier †‡
Member, National Advisory Board,
Haas Public Service Center;
Member of the Board of Directors,
Greater Bay Bancorp



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

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

Edward D. Harris, Jr., M.D. ‡*
George DeForest Barnett
Professor of Medicine,
Stanford University Medical Center

Richard P. Magnuson †‡
Private Venture Capital Investor

Robert K. Jaedicke †‡*
Professor Emeritus of Accounting
and former Dean, Stanford
Graduate School of Business

† Member of the Audit Committee
‡ Member of the Compensation Committee
* Member of the Executive Committee

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San Jose, California 95112-4598
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