ELLIE: Good day, ladies and gentlemen. Thank you for standing by, and welcome to the *California Water Service Group--First Quarter 2024 Earnings Call.* During today's presentation, all parties will be in a listen mode only. Following the presentation, the conference will be open for question and answer. This call is being recorded. I'd like to turn the call over to Jim Lynch, senior vice president, CFO, and treasurer. Please go ahead.

JAMES LYNCH: Thank you, Ellie. Welcome, everyone, to our first quarter 2024 results call for California Water Service Group. With me today is Marty Kropelnicki, our chairman and CEO, and Greg Milleman, vice president of rates and regulatory affairs. Replay dial-in information for this call can be found in our quarterly results release, which was issued earlier today. A replay of the call will be available until Monday, June 24, 2024.

As a reminder, before we begin, the company has a slide deck to accompany the earnings call today. The slide deck was furnished with an 8-K and is also available at the company's website at www.calwatergroup.com. Before looking at the first quarter of 2024 results, I'd like to take a few moments to cover forward-looking statements. During the course of the call, the company may make certain forward-looking statements.

Because these statements deal with future events, they are subject to various risks and uncertainties, and actual results could differ materially from the company's current expectations. Because of this, the company strongly advises all current shareholders, as well as interested parties, to carefully read and understand the company's disclosures on risks and uncertainties found in our forms 10-K, 10-Q press releases and other reports filed from time to time with the Securities and Exchange Commission. And now I will turn the call over to Marty.

MARTY KROPELNICKI: Thank you, Jim. Good morning, everyone. Thanks for joining us today to talk about our Q1 2024 results. We have a number of topics to cover today, starting with our strong operational performance, which is really highlighted by the final resolution of the 2021 General Rate Case. And I will say, it's after going through the delays-- which stretched out over 2023-- it's nice to see the arrows all going in the right direction. And big kudos to Jim and the team for booking everything and getting it all set up here as we wrap up Q1.

In addition, we'll want to talk about the implementation of the water cost of capital adjustment mechanism, which sets our return on equity for 2024 at 10.27%. We were able to secure an additional $83 million of COVID funds from the state of California to help our customers with past due balances that linger from our COVID times. And then talk about our where we are with PFAS and the EPA's new regulation and our plans to be in compliance with that.

And then finally wrap up talking about the commitment we made recently to reduce our Scope 1 and Scope 2 emissions. But prior to going into some of these more operational themes, I'm going to turn it back over to Jim to review the financial results for the first quarter of 2024. Jim.

JAMES LYNCH: Thank you, Marty. As Marty mentioned, our first quarter results benefited from the conclusion of our 2021 General Rate Case. Operating revenue for the quarter increased 106.5% to $270.7 million, compared to the prior-year first quarter revenue of $131.1 million.

The implementation of two regulatory mechanisms authorized by the 2021 GRC decision had a significant impact on revenues, with the Interim Rates Memorandum Account, or IRMA, adding $80.7 million, and the Monterey-style Water Revenue Mechanism, or M-WRAM, adding $31.7 million. Recorded IRMA and M-WRAM revenue included $70.2 million and $17.6 million, respectively, related to fiscal year 2023. Greg will walk us through the 2021 GRC decision later in the presentation.

The revenue increase also included $13.9 million related to the recognition of Water Revenue Adjustment Mechanism or WRAM revenue that was deferred in previous reporting periods. First quarter 2024 operating expenses increased $192.9 million compared to the first quarter total operating expenses of $148.6 million. The $44.3 million increase was primarily driven by $9.2 million in higher water production costs associated with the company's new incremental cost balancing account, or ICBA.

Higher other operations expenses, primarily due to $11.4 million in deferred costs associated with the recognized deferred WRAM revenue and a $21.2 million increase in income taxes related to higher pretax earnings. Net interest expense increased 25.5% to $15 million during the first quarter as compared to $12 million for the first quarter of 2023. The increase was primarily due to higher short-term borrowing rates and higher balances on our outstanding lines of credit.

Reported net income for the first quarter was $69.9 million, up nearly 415% compared to a loss of $22.2 million in the first quarter of 2023. Turning to the earnings per share-- first quarter 2024 diluted earnings per share was $1.21 compared to first quarter 2023 loss of $0.40 per share.

The significant increase in EPS was driven by resolution of our 2021 General Rate Case, coupled with rate increases, and the reversal of previously deferred WRAM revenue. These increases were partially offset by increased expenses, including higher water production expenses related to the new ICBA regulatory mechanism, higher production expenses due to the reversal of RAM related deferred production costs, and interest expense.

Turning to capital, we continue to make significant investments in our water utilities to help ensure the delivery of safe and reliable water service. We invested just under $110 million in capital improvements during the first quarter of 2024. This was an increase of approximately 34% over the first quarter of 2023. For the year, we anticipate making approximately $380 million in capital investments, which includes an estimated $20 million in developer-funded projects.

Depreciation for the first quarter of 2024 was $32.8 million or approximately 30% of first quarter capital investment expenditures. The success of our capital investment strategy is reflected in our rate base growth. Our overall rate base grew to an estimated $2.2 billion by the end of 2023. This was an increase of 15.4% over 2022.

Further, based on our current planned capital expenditures, and subject to regulatory approval, we estimate that rate base will grow to $2.36 billion by the end of 2024 and $2.47 billion by the end of 2025. Turning to dividends, at the beginning of the year, we increased the annual dividend 7.7% from $1.04 to $1.12 per share, which marked our 57th consecutive annual dividend increase.

And yesterday, we declared a quarterly dividend of $0.28 per share for shareholders on record as of May 6, 2024. This was our 317th consecutive quarterly dividend. We continue to maintain a strong liquidity position. As of March 31, 2024, the company maintained cash and cash equivalents of $88.3 million, of which, $45.4 million was classified as restricted. Further, we had additional short-term borrowing capacity on our lines of credit of $320 million.

Lastly, we are pleased to report that subsequent to the end of the quarter, we received approximately $83 million under the state of California Extended Arrearage Program. The program is designed to provide financial assistance to customers with past due balances that accrued during the COVID-19 pandemic. Marty will provide additional color on the program in a few minutes. With that, I'll turn the call over to Greg to give an update on our 2021 General Rate Case decision. Greg.

GREG MILLEMAN: Sure. Thanks, Jim. I'm going to walk through some of the highlights of the decision we-- for our 2021 GRC decision that we received March 7, 2024. Overall, the decision was financially very positive for the company. As Jim indicated, the decision increases adopted revenues after corrections for 2023 by approximately $41.5 million, retroactive back to January 1, 2023. The decision also adopted 95% of the requested operating expenses.

It adopted a very favorable water mix for groundwater and purchase water that provides the company financial protection. It authorizes Cal Water to invest $1.2 billion-- which is 86% of our request from 2021 through 2024-- in our water system infrastructure projects, including approximately $160 million of infrastructure projects that may be submitted for recovery via the CPUC's advice letter process.

In fact, we've already filed an advice letter for 145 projects, capitalized at $39 million, or a $5.8 million increase in annual revenues. The decision provides a very progressive rate design that provides financial stability while benefiting low-income, low-water-using customers. And finally, and most importantly, when voting out the decision on March 7, the commissioners all agreed that the process took too long. And so I'm hopeful that the decision on our '24 case will come out more timely. Back to you, Marty.

MARTY KROPELNICKI: Great. Thanks, Greg. Just echoing what you said when we were in the hearing room with the commissioners-- every commissioner did comment on that. And we think that's a good sign that they recognize the problems this was causing, not only for us, but also for our customers. And it's going to have a pancaking effect on the rates. I'm going to be on slide 10. I want to come back to the extended arrearages management program for the state of California.

I think, as many of you know, we have been extremely proactive-- our government affairs team in Sacramento-- and looking for ways to help our customers who are still suffering the hangover of the pandemic. If you recall, the state of California had an original arrearage management program that covered half of the COVID time and then it cut off. And for that first part, the company was able to secure a little over $20 million that was applied to our customer balances during the COVID time.

We were able to work with the state to take some of the unspent federal dollars that were allocated to the state and come up with a arrearage management program kind of number 2. So we worked with the state to appropriate approximately $300 to $400 million of unspent federal dollars and reopen up that window to allow utilities and water companies to apply for further funds to offset the past due balances from June 16, 2021 through December 31, 2022.

Very happy to report that our application was accepted, and we received the entirety of our request, which is $83 million that Jim mentioned. That money has been received. And during the second quarter, we'll be allocating those dollars to those past due balances, again, from between June 16, 2021 through December 31, 2022. These funds benefit both current and past customers because all customers eventually bear the cost of uncollectible accounts.

Moving on to slide 11, I want to take a moment to update everyone on where we are with the PFAS regulations that have come out, also known as "forever chemicals." We believe we continue to be well-positioned to meet the EPA's new guidelines. Across our portfolio, we have a rigorous and coordinated water quality assurance program with protocols in place to test and monitor the water we deliver to our customers. I think, as any of you know, that the investor-owned water utilities-- we take public health as one of the most important things we do as a company.

We've had a fair amount of experience with PFOA and PFOS in California and Washington. Our utilities have been compliant with the previously issued PFOS guidelines issued by their state regulators. On April 18, the California Public Utilities Commission dismissed our application, requesting authorization to modify a previously approved PFOS expense balancing account to include capital investments related to the PFOS compliance. CPUC Indicated that we would need to file for recovery of the capital components of PFOS treatment later in the process.

What that really means is-- first of all, I was disappointed that they denied it. They dismissed it without prejudice. But it allows us to file a separate application included in the 2024 General Rate Case. And I believe, Greg, our plans are to file it as a separate application.

GREG MILLEMAN: That is correct.

MARTY KROPELNICKI: Outside the rate case. Despite the commission's shortsightedness, recognizing the urgency that you need to get this PFOS treatment in the ground, the company put a press release out, reaffirming our commitment to our customers that we'll be investing the $215 million expeditiously to put PFOS treatment in place for approximately 100 wells in all the states that we operate in.

Overall, it is a group, meaning, at the parent company project. So we have a project director who is managing the implementation in all of our states, and that group or that project director reports in the management committee on a normal basis. And we have hit the ground running. We plan to spend probably between $12 and $20 million this year on PFOS treatment. And that will ramp up as we go out into the implementation period over the next couple of years.

GREG MILLEMAN: Marty, before you move on, you mentioned PFOS balancing account. I believe we're

MARTY KROPELNICKI: So it's a memo account.

GREG MILLEMAN: --memo account.

MARTY KROPELNICKI: Thank you. Yeah, it is a memo account. So it's-- outside the Rate Case, we're incurring the cost. It goes to the P&L, but we're allowed to track those costs. And we ask the commission to allow us to modify that memo account to pick up the capital components, which was denied. However, capital projects in the rate-making world do accrue AFUDC, Allowance for Funds Used During Construction. And that will accrue out throughout the process until we put that plant in service.

Moving on to slide 12, where we talk about greenhouse gas and Scope 1 and Scope 2 reduction targets. As we worked on our decarbonization strategy and our ESG strategy overall in the last five years, we recently made our commitment to reduce absolute Scope 1 and Scope 2 greenhouse gases by 63% by 2023 from our baseline 2021 year-- our targets are science-aligned-- which, the team has done a very good job working with the third-party advisor to pull that data together.

We expect to achieve these reductions through a multipronged approach, consisting of the electrification of the fleet, water conservation, installing onsite solar where it makes sense, and looking at renewable electricity procurement-- in other words, making sure we're tapping into the green side of the grid for the power that we use. As many of you may recall, water production and distribution use a lot of energy. So the more green energy we can use, the more it helps us drive towards that target as well as the other components here and the multipronged strategy.

Just as an FYI, group may evolve its decarbonization strategy if warranted due to changes in industry, working with our regulator, business, and other operating things that may happen, including SEC rules, et cetera. Overall, we're very committed to delivering value to our customers and stockholders while pursuing these reduction targets and believe it's the right long-term approach as we deal with climate change.

Going on to slide 13-- so just to recap-- very pleased with the start of 2024 and getting the 2021 Rate Case behind us. Nice to have that done. The numbers will be a little confusing, obviously, when we publish the 10-Q here later on this week. There'll be more information, so you can strip out what was a retroactive piece and what was the actual piece for the quarter itself.

We're going to now turn our focus on implementing our infrastructure improvement plans. As Greg has mentioned, we have a lot of capital to get in the ground in addition to the PFOS. So the guidance that Jim gave everyone earlier does not include the $215 million commitment for PFOS or for the forever chemical treatments that we made to our customers. So that will be incremental. And one other thing to put on everyone's calendar-- we have our State Supreme Court date on May 8, and that's our oral arguments on the WRAM decision from the commission.

So we'll look forward to hopefully having some type of decision by the State Supreme Court probably three months after the oral argument or so. So we're looking forward to having that bank work because we believe decoupling is absolutely essential to the state of California-- its work on climate change, resiliency, and sustainability.

So with that, I want to thank everyone for bearing with us through the delays of the 2021 General Rate Case. I want to thank the rates and accounting team for their hard work. Not only do we have to close out the year, but right after the year, we got the decision. We had to book everything. So the team did a fantastic job getting that stuff all booked in the general ledger.

And now we'll move forward onto our 2024 plans, investing in infrastructure, going after PFOS, and getting the PFOS treatment put in place, and getting our Rate Case filed for the state of California on or around July 1. So Ellie, with that, let's open it up for questions, please.

ELLIE: Thank you. We are now opening the floor for question and answer session. If you'd like to ask a question, please press star and number 1 on your telephone keypad. That's star and number 1 on your telephone keypad. Our first question comes from Michael Gaugler from Janney Montgomery Scott. Your line is now open.

MICHAEL GAUGLER: Good morning, everyone.

MARTY KROPELNICKI: Good morning, Michael. Morning, Michael.

MICHAEL GAUGLER: Just wondering if you could update us on water supply and water production costs-- I noticed they were rather high in the quarter. I know Jim touched on it a little bit-- and maybe how we should think about that for the remainder of the year.

MARTY KROPELNICKI: Sure. Jim.

JAMES LYNCH: Yeah. Well, from a water supply perspective, Michael, the state of California is doing very well. I believe our snowpack for the second consecutive year was higher than our 20-year average. And I think it's the first time in an awful long time that we've had two consecutive years where we've beat the average. So I think we're looking good. There's been a good opportunity also for replenishment of some of our underground aquifers throughout the state-- in California.

I think our other states are also similarly well-positioned in terms of actual water supply. We do have some operations in Texas. Most of our utilities down there are wastewater utilities. And I think that we've not seen the current water situation in Texas put any stress on those operations.

As it relates to expenses and water expenses, we do have in California-- with the new Rate Case, the new ICBA, which provides us some protection in terms of cost increases in our water production. And so we will lean on that new mechanism and focus on that as our familiarity with the new mechanism becomes greater.

And then I'd also like to point out that we did have an increase in other production expenses. I mentioned it in my comments. And those were primarily related to the recognition of the deferred WRAM revenue. So I would view those more as something that will continue to reduce as we unwind those deferred revenue costs.

MARTY KROPELNICKI: Yeah. One thing I would add is, as Jim said, the snowpack was very, very good water supply, and within the state of California, I think, is doing great. California is still in a stage 2 drought. If you remember, we were racing towards a stage 3 drought and then the governors walked that back.

But we're still in a stage 2 drought, which, I kind of expect the governor to stay in a stage 2 or maybe drop it down to a stage 1, given the longer-term issues of sustainability with the state, the climate change, the variations we get in the weather. But overall, for 2024, we think we're in good shape in all of our districts.

MICHAEL GAUGLER: All right. Thank you, gentlemen-- most helpful.

MARTY KROPELNICKI: Thanks, Michael.

JAMES LYNCH: Thanks, Michael.

ELLIE: Next question comes from Jonathan Reeder from Wells Fargo. Your line is now open.

JONATHAN REEDER: Hey. Good morning, team. Got a couple questions here, if you don't mind. First would be, how should we think about the timing of the cash recovery of the retroactive 2023 GRC revenues?

GREG MILLEMAN: Jonathan, this is Greg Milleman. We will be-- because of the timing of the '21 decision and our upcoming filing on July 1 of our '24 Rate Case, we have been focused on implementing the new rate. Get those into effect first, calculating what the lost revenue or the IRMA amount and the M-WRAM amount will be so that we could book that. We will be filing in the third quarter for recovery of those back monies.

We need to go through May 31 when we're planning to have the new rates fully in effect and close out the IRMA account. But then we need some time to put together that filing and start requesting it. So we'll start requesting it in the third quarter. It is based on a per CCF surcharge. So I would imagine, in the summer, it will be a little bit higher, and, obviously, in the winter months lower and go someplace from 12 to 24 months.

JONATHAN REEDER: OK. So it sounds like-- I mean, those revenues aren't going to really come in in 2024. It'll probably be more '25 and '26.

GREG MILLEMAN: The revenues were booked in the first quarter.

JONATHAN REEDER: Yeah. Sorry.

GREG MILLEMAN: I thought your question was related to cash.

JONATHAN REEDER: No, exactly. You are. Yeah, the cash flows won't come in until '25 and '26. I apologize.

JAMES LYNCH: Yeah, the one thing I would point out, though, with the timing of when the new rates will go into effect-- we will at least experience the positive cash uptick related to those new rates as we go into our more traditionally busy season. So we were pleased to be able to get the rates effective as of June 1.

JONATHAN REEDER: Gotcha. And then how should we think-- I guess-- about the $83 million arrearage payment program, cash recovery potentially offsetting 2024 external equity needs?

MARTY KROPELNICKI: Yeah. So if you remember, during COVID, we were decoupled. So the revenue is all accounted for through the decoupling mechanisms for the state of California. So this piece really becomes cash flow. So essentially, customers that have balances that are still past due from the period that I defined-- June 16, 2021 through the end of 2022-- who have balances, those dollars will be applied to their balances and then we'll also be applying some of those balances to the WRAM balances that existed for those customers as well.

So that'll all work its way into cash flow, but it won't really have a revenue effect. It'll have an effect on the aged receivables that are still outstanding during COVID, and you'll see a pickup in cash flow. So certainly, that helps the company from going to the market and needing to issue equity right away. Obviously, water utility stocks over 2023, everyone was down 20-plus percent. So we're not racing the market any time soon to go sell stock. And Jim's not throwing any pieces of paper at me for saying that. But--

[LAUGHTER]

--the reality is, with this rate case and with the step-up in the rate design, the movement from fixed or from variable to being more recovered and fixed, that's all going to help us throughout this year. But if you think about our capital needs, we're still investing at three times our depreciation rate. And as Greg mentioned, we got 86% of our ask. It's a $1.2 billion capital program. So we do have adequate lines, et cetera.

But Jim and I will be evaluating that as we go throughout the year to define what those needs are, obviously, with interest-carrying costs being higher, the stock being down-- and we still got to get our job done. There's a fine line there that we'll be looking at our cap structure and trying to optimize that on behalf of our stockholders but also our customers as well-- because it helps play into affordability.

JONATHAN REEDER: OK, so in terms of absolute size of annual equity needs, that's still to be determined at this point?

JAMES LYNCH: Yeah, I think so. John, the real good news is that, from the recognition of the 2023-- our ability to recognize the 2023 impact of the 2021 decision has brought us back to where we had hoped we would be at this point in time relative to our cap structure-- which is very close to our authorized cap structure.

So there's not a need right now in terms of forcing us-- I wouldn't say forcing us-- but directing us into which particular capital we would pursue in the event that we needed to pursue capital. And so I think, right now, we've got a lot of availability on our line of credit. We understand that the interest rates are still inverted, so we'll be taking a look at short-term versus long-term debt, amongst other things, as we move forward.

But it's only with the booking of the current Rate Case results-- the 2021 Rate Case results that we're in the position now to forecast out what we think we might need from a capital perspective for the remaining of the year.

MARTY KROPELNICKI: Yeah, we're also benefiting from the higher ROE that went into effect on January 1-- the 10.27 ROE. So that's also helping us with our cash flows.

JONATHAN REEDER: Yeah, sure. I'm glad you brought up the ROE. It kind of leads into the next question because-- I guess, just given the GRC final outcome and recovery of some of the CapEx through the advice letter recovery process, where do you expect your earned ROEs in '24 and '25 to come in relative to the allowed levels?

MARTY KROPELNICKI: Oh, that's a very good question. '25 is certainly a little harder to talk about. But from a budgeting perspective and how we manage the company, we try to drive towards hitting that ROE. Obviously, when you have a delayed Rate Case, it throws everything significantly off-balance. So I think for 2024, we should be at or maybe slightly above that ROE. For 2025, you start to get the period of regulatory lag that starts to seep in. And obviously, inflation is a big deal.

Getting back to Michael Gaugler's questions about production cost, in Northern California, for time-of-use rates for electricity, it's now $0.40 to $0.50 a kilowatt-hour-- highest cost in the US. So that stuff that affects the operating side that will also lag. And hopefully, some of that will get picked up in the Rate Case. But as inflation stays high, a lot of it gets pushed out into the next rate filing. So certainly for 2024, I think we're in excellent shape. For 2025, we're going to budget the ROE. And that's kind of our job.

And I think, as Jim talked about, is there an opportunity with inverted interest rates, short-term versus long-term, how we finance things? We're going to take a look at all that because our job is to operate as efficiently as possible while earning the ROE for our stockholders and keeping rates affordable for our customers. So '25, hard to comment on. '24, we're going to drive hard to hit the ROE.

JONATHAN REEDER: OK. And then lastly-- I know you said you filed for $39 million of the advice letter recovery projects already. How much do you expect to file in total in 2024? And then what about in 2025?

MARTY KROPELNICKI: That's to be determined. Jonathan, if anyone listened in to the rate proceeding, I thought it was kind of fascinating because the commission was really focused on these 335 projects the company didn't get done-- or they only got done five of these 335 projects. But as you know, numbers are relevant, right? And so during this three-year period, we probably had 5,000, 6,000 total projects that we completed. Those aren't talked about. They were just focused on these 335 projects that didn't get done.

There's two failures that I see in the rate-making process in the state of California. One is the failure to recognize that projects now go through one or two and even three Rate Case cycles. So you want to put a well in Southern California? By the time you procure the land, design, the well, get signed up on the treatment, build the treatment, go through testing, put it in service, it's longer than three years.

And so the rate-making process in California fails to recognize these projects now are multi-cycle projects. The second thing that the commission fails to recognize in the rate-making process is, as these projects get more complicated and go out farther in time, the level of contingency needed for those projects goes up. And if you listen to the hearing, the commission tossed out a lot of the contingencies associated with these projects.

So those are the two things that Greg has to work on in the 2024 Rate Case. Obviously, they're kind of inbred into the rate-making process within the state of California. But those are the two of the things we're going to be focusing on in 2024 because both those things help lead to regulatory lag. And the reality is-- and you followed us for a long time-- we're very good about hitting our capital commitment numbers and getting that capital in the ground.

It's really about on the backside-- the rate-making process and the efficiency of the rate-making process. So we'll have to see what happens next. But I think we'll keep doing what we're doing, and we're going to keep investing at three times the depreciation rate, which, I think benefits our stockholders while focusing on affordability.

JONATHAN REEDER: OK, but out of those 160 million projects, do you expect to complete them all over the course of 2024 and 2025? Or, might some of those fall into the next Rate Case cycle still?

MARTY KROPELNICKI: Yeah, we have a concerted effort going on right now to reevaluate those projects from two perspectives-- one, to confirm that they are still needed, and, two-- with regards to that first point, to make sure they weren't just projects that we've subsequently found other alternatives for-- and, two, to really identify what time period we are going to complete the projects and put them in service for those that remain out of the 160 million. So at this point, I think that process is still underway. And we'll have a better sense for the timing of that here in the next couple of weeks.

JONATHAN REEDER: OK, thanks. I appreciate you taking my questions.

MARTY KROPELNICKI: Thanks, Jonathan.

JAMES LYNCH: Thank you, Jonathan.

ELLIE: Question comes from Angie Storans from Seaport Research Partners. Your line is now open.

ANGIE: Thank you. So first, maybe, you alluded to the 10-Q, which will have more information about the other retroactive impacts on the first quarter earnings. But can you just give us a sense roughly what it is from an EPS perspective versus the $1.21 that you reported?

JAMES LYNCH: Well, we haven't broken it down from an earnings per share perspective. But relatively speaking, there was approximately $90 million of earnings of revenue that was included in the 2024 first quarter that related to the decision. And in addition to that, there was an incremental about $8.5 million of expenses that related to the decision.

ANGIE: Mm-hmm. OK. I mean it's-- you don't have guidance, so that's actually pretty important for us to have a basis to extrapolate from, right? So again, we would probably appreciate it going forward. Secondly, on the PFOS spending-- so will you be booking AFUDC earnings associated with this CapEx? So will it flow through the income statement?

JAMES LYNCH: Well, AFUDC is-- we are eligible to use the AFUDC mechanism as we move forward with those expenditures. So I think, the way you're asking the question, we will be able to reduce our interest expense for the AFUDC to the extent that we are making expenditures related to those projects.

ANGIE: OK. And then on-- just in general on PFOS-- so we're starting to see some losses against investor-owned utilities related to, hmm, PFOS-- the fact that you-- or, in general, utilities were not attempting to remove the forever chemicals from distributed water in the past. And I'm just wondering how you can protect yourself. Is there anything in California that would allow you to limit the litigation risk and, more importantly, limit any earnings impacts?

MARTY KROPELNICKI: Yeah. I think, from a liability standpoint, in California, we have-- Hartwell decision, which basically says, if we're operating in accordance with the rules set forth by our regulator that we have protection. So I don't-- I'm not too worried about California compared to some of the stuff that we're seeing on the East Coast in terms of product liability associated with water, et cetera.

From an earnings perspective, as Jim said, we'll accrue AFUDC on those capital projects. Most of the treatment is capital. And it's 100 wells out of 11,070 wells total that we have within group. So we'll accumulate the AFUDC on that and then those other capital costs get picked up. And any of the operating costs, once we put those vessels into production, will track the incremental costs through the memo account and seek recovery of that at a later date.

So I think we got all the pieces in place that we need to have. I was just disappointed in the commission's decision not to recognize the capital now because the EPA has put that new standard out there. They did extend the implementation timeline. And I believe it's over five years now versus over three. But customers don't want to hear we're going to implement PFOS treatment four and 1/2 years from now. If Jim's drinking water that has PFOS in it, he wants to know we're treating it right away.

And so that's why when we put our press release out, we pointed out, we were disappointed in the commission's decision. And despite that, we reaffirmed our commitment to getting that capital in the ground as quickly as possible. And so from an operating cost perspective, I'm not too worried about it. To me, it's about making sure the water is safe for customers and implementing that capital as quickly as possible.

JAMES LYNCH: And then just one other point on that, Angie-- we are pursuing any available grant money that may be out there to assist with the whole PFOS issue as well as potential third-party liability.

MARTY KROPELNICKI: Yeah, there's a lot of litigation around PFOS to, actually, the polluters. And there's been a ton of press on that. I don't want to get into the particulars of the case because we're a member of the action against the polluters. But we believe we'll get some dollars back from the polluters to offset the implementation costs and the capital costs of putting PFOS treatment in place.

ANGIE: OK. And then lastly, you mentioned the weak performance of water utility stocks and the timing of your future equity needs. I'm just wondering-- so you raised your dividend by, I think, 7%, 7-something percent. So is this-- do you think that, going forward, depending on the stock performance, the growth in dividends is a lever for you to potentially use to adjust downwards? [LAUGHS]

If you have higher equity needs, is this a lever in this high-interest rate environment as well? Again, what is this 7%-plus linked to?

MARTY KROPELNICKI: Sure. Well, if you go back to-- yeah if you look at our dividend increases over the last five years, they've been above inflation. We have a payout ratio target between 55% and 65%. We try to manage within that range. I personally believe that the compound annual growth rate of dividends is one of the key drivers to equity valuation in the marketplace.

So looking at that CAGR number, as Jim mentioned, we've grown the dividend every year for the last 57 years. So I have no reason to believe we won't continue down that path. Obviously, when the board looks at that, we look at, what's the general market conditions? What was the dividend growth rate of other utilities? What are our capital needs? And we try to keep that all in balance. But obviously, for me personally, I think dividend growth is a key thing that our investors expect. And they like to see, and they like the stability of a water company.

So to me, yes, it was a bare year for water utilities in 2023. But I think three most important things we can do-- make sure water quality is the most important thing on our operating list, continue investing at that three times the depreciation rate, and keep growing that dividend. And I guess, the fourth thing is making sure our customer service stays outstanding and best in class. When you do those things, in the long run, you create value for stockholders.

ANGIE: Very good. Thank you.

MARTY KROPELNICKI: Thanks, Angie.

JAMES LYNCH: Thank you.

MARTY KROPELNICKI: Have a good day.

ELLIE: This comes from Davis Sunderland from Baird. Your line is now open.

DAVIS SUNDERLAND: Hey, Jim. Good morning, guys. questions.

MICHAEL GAUGLER: Hey, Davis. Good morning. Thanks for joining us.

DAVIS SUNDERLAND: I wanted to ask the PFOS questions. As it relates to the business development plan, I guess, maybe a broad question is, any updates on that are noted? But specifically, has the PFOS created any opportunity for you guys to be more aggressive or more interested or, I guess, take a closer look at any of the systems who may have difficulty reaching?

MARTY KROPELNICKI: Yeah, Davis, we got about every third word there. You were cutting out. Could you-- one of you guys--

JAMES LYNCH: I think I'm going to answer a question that I think you asked, or, at least, I'll rephrase the question for Marty. Davis, it sounded like you said, with PFOS out there, if we took a look at the business opportunities that are also out in the market right now that we may be pursuing, how are we considering the potential PFOS liability, and is that coloring our desire or interest in some of those potential opportunities?

MARTY KROPELNICKI: Wow. You could hear in that question. That's incredible. But let's answer that.

[LAUGHTER]

GREG MILLEMAN: Let's ask if that's the question.

MARTY KROPELNICKI: Was that the right question, Davis?

DAVIS SUNDERLAND: Hey guys (interrupt service) I apologize for that.

MARTY KROPELNICKI: Guess he's not in a great cell area here. So let me answer that question. Yeah, I think, obviously, the cost of capital has gotten a lot more expensive. And from a business development standpoint, we haven't-- we've seen maybe a little bit of a slowdown in things that go into our pipeline from a business development standpoint. But our business development team continues to be very, very busy-- as Jim mentioned, the stuff we got going on in Texas and other things we're doing in other states.

So I think the PFOS thing-- I think the smaller systems are going to struggle to be in compliance. And you think about, for us, there's a hundred wells. It's $215 million. And we're fairly good at implementing that type of treatment. We're very fast, and we try to keep our overhead fairly low. If a smaller system doesn't have access to capital or they don't have the technical resources on site to figure out what the treatment should be, it's going to affect their ability to operate.

And I think the broader operating issue is, for companies like Cal Water or for Essential or Aqua or SJW or Middlesex-- any of us that are public traded companies, you fall out of compliance and the regulator finds the hell out of you, or you end up getting sued by somebody. Right? So we generally operate to the highest standards possible to be associated with that. When you're a municipal system, what's the recourse?

And you think about the 60,000 systems out there that fall under the purview of the EPA. There's no way they can effectively monitor all those systems to make sure they're in compliance with PFOA and PFOS. And so I give the Biden administration credit for trying to push through the PFOS treatment, get the EPA to move quicker. I think that's really important. But you'll have compliance lags on the municipal side, where, I don't think you're going to have that same problem on the investor-owned side.

JAMES LYNCH: Yeah. And I think as a result of Marty's observations on that, we do think that, as with any new regulation that comes out, it will put financial stress on some systems, and that may open up the market. And yes. If we believe we could assist the customers in those markets, we would be interested in taking a look at those systems

MARTY KROPELNICKI: Right, but even then, Jimmy, one of the things that happens-- we take over a system, we got liability day 1. So if you look at some of the work we've done-- like in New Mexico, or we've taken over tribal systems-- we work very closely with the regulator to get the rates pegged upfront before we buy them that we have an implementation timeline so we don't get pinged on the back side with these penalties and fines-- because I think in the water world, the investor-owned utilities are the deep pocket for the regulators to define.

DAVIS SUNDERLAND: I apologize for the audio. Thanks for the time guys. Appreciate it.

MARTY KROPELNICKI: All right, Davis. Thank you.

JAMES LYNCH: Thank you.

MARTY KROPELNICKI: Jim, good ears. That was impressive you could decipher that.

ELLIE: Thank you. As of right now, we don't have any raised hands. So I'd like to hand back over to the management for the final remarks.

MARTY KROPELNICKI: All right, Ellie. Thank you. Well, everyone, thanks for joining us today. Obviously, there's a lot going on. But at least, one thing is off the list-- the 2021 General Rate Case. That's in the rearview mirror. Obviously, there's a lot of work to do on the tariffs and filing the required documentation with the commission to start the collection of the retroactive piece. We'll be in a better position on our Q2 earnings call to talk about that. And then in between now and then, we'll be working on our 2024 General Rate Case and preparing for the State Supreme Court or arguments on May 8. So thank you for joining us today, and we look forward to talking to everyone really, really soon. Have a good day.

ELLIE: Thank you all for attending today's conference call. We hope you have a wonderful day. You may now all disconnect to the session.