

ORIGINAL

Decision No. 58835

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application

of

SOUTHWEST WATER COMPANY, a California
Corporation for authority to issue
and sell \$290,000 of its Class "A"
5-1/4% Preferred Stock.

Application No. 41144

Arthur D. Guy, Jr., and Carr Deitz,
for applicant; James G. Shields,
for the Commission's Utilities
Division.

O P I N I O N

Southwest Water Company has filed this application for authorization to issue and sell 5,800 shares of its Class "A" 5-1/4% Preferred Stock of the par value of \$50 each and of the aggregate par value of \$290,000.

The application was filed on May 18, 1959. A public hearing was held before Examiner Coleman in Los Angeles on June 24, 1959, at which time the matter was taken under submission.

The company proposes to sell its shares through its own organization at par, for cash, and to use the proceeds to meet capital costs during 1959. A statement of its estimated requirements and its sources of funds is included in Exhibit A, attached to the application, and is summarized as follows:

Cash balance, January 1, 1959		\$ 61,927
Sources of cash -		
Depreciation	\$ 72,000	
Net income	27,296	
Preferred stock	290,000	
Bonds	250,000	
Bank loans	<u>100,000</u>	<u>739,296</u>
Total		\$801,223
Use of cash -		
Bond retirement	\$ 12,750	
Reduce accounts payable	52,407	
Repay note	24,000	
Refund advances	38,357	
Pay bank loans	250,000	
Additions and betterments	<u>354,800</u>	<u>732,314</u>
Cash balance, December 31, 1959		<u>\$ 68,909</u>

The testimony indicates that none of the plant expenditures to be financed with the stock proceeds represents amounts advanced under refund contracts. In addition to the proposed issue of the \$290,000 of preferred stock, the company, in Application No. 41238, is seeking authorization to issue and sell \$250,000 of bonds during this year and it has an outstanding order of the Commission authorizing it to sell \$121,658 of common stock. (Decision No. 55798, dated September 13, 1957, in Application No. 39404.)

In considering this application, it appears desirable and appropriate to review the company's financial condition and its results of operation. A condensed statement of its assets, liabilities and net worth as of March 31, 1959, prepared from Exhibit B, is as follows:

Assets

Net investment in utility plant		\$2,208,346
Other investments		234,140
Current assets -		
Cash and deposits	\$162,229	
Accounts receivable	52,482	
Materials and supplies	21,812	
Prepayments	<u>17,721</u>	
Total current assets		254,244
Deferred debits		<u>48,624</u>
Total		<u>\$2,745,354</u>

Liabilities and Net Worth

Long-term debt		\$ 848,750
Current liabilities -		
Notes payable	\$208,000	
Accounts payable	42,742	
Customers' deposits	6,050	
Accrued liabilities	<u>49,218</u>	
Total current liabilities		306,010
Advances for construction		654,960
Contributions in aid of construction		11,133
Deferred credits		5,000
Preferred stock		423,664
Common stock and surplus		<u>495,837</u>
Total		<u>\$2,745,354</u>

The company's operating life has been short, it having been organized in 1954. The following tabulation, prepared from its filed financial statements, indicates its growth and its sources of capital funds:

<u>Dec. 31</u>	<u>Net Plant</u>	<u>Long-term Debt</u>	<u>Consumers' Advances</u>	<u>Stock and Surplus</u>	<u>Service Connections</u>
1955	\$ 691,997	\$ -	\$304,755	\$351,454	1,736
1956	1,697,146	250,000	493,056	498,249	6,266
1957	1,948,221	850,000	518,172	735,515	7,647
1958	2,159,981	848,750	592,676	834,101	8,173
<u>Mar. 31</u> 1959	2,208,346	848,750	654,960	919,501	NA

A comparative earnings statement is as follows:

	<u>1956</u>	<u>1957</u>	<u>1958</u>
Operating revenues	<u>\$165,840</u>	<u>\$352,197</u>	<u>\$414,102</u>
Operating rev. deductions -			
Operating expenses	\$ 82,908	\$173,462	\$192,662
Depreciation	28,017	58,547	63,727
Taxes	17,629	41,515	57,760
Total	<u>128,554</u>	<u>273,524</u>	<u>314,149</u>
Net operating revenues	<u>37,286</u>	<u>78,673</u>	<u>99,953</u>
Net income charges	<u>17,196</u>	<u>51,797</u>	<u>54,549</u>
Net income	<u>20,090</u>	<u>26,876</u>	<u>45,404</u>
Preferred dividends	671	11,714	15,143
Balance	<u>\$19,419</u>	<u>\$15,162</u>	<u>\$30,261</u>

From a review of the financial statements it appears that applicant has experienced a rapid and substantial growth in its volume of business and the number of customers attached to its lines, that it has expanded its plant and that it has contracted obligations of considerable size calling for an increasingly heavy load of interest and principal repayments. It has developed a financial position, as of March 31, 1959, which features a common stock equity participation of approximately 21% of its capital and it has current assets of \$254,244, including cash advances limited for construction purposes, as compared with current liabilities of \$306,010, exclusive of refunds on contracts. The company has paid no cash dividends on its common shares and the presently proposed preferred stock financing will increase its annual fixed charges by \$15,225. The testimony shows that applicant's repayments on its advance contracts are up to date.

It is apparent that applicant cannot go forward with the expansion of its facilities to take care of demands for service and continue to meet the obligations it has incurred unless it obtains additional funds from external sources. The record shows, however, that applicant's bond borrowing capacity is limited and that the incurring of any form of debt will adversely affect its bondable base and reduce its common stock equity participation and thereby further unbalance the capital structure. It is clear, therefore, that applicant should undertake stock financing at this time.

It is noted that here we have a situation where a utility is seeking to sell first mortgage bonds on a 5-5/8% basis and at the same time proposes to offer on a 5-1/4% yield basis a preferred stock which, at best, appears to have but a limited resale market on a substantially discounted basis. The testimony of applicant's financial officer was not clear with respect to the sales program to be followed in the proposed offering of the preferred shares nor was it at all persuasive that such shares would be purchased by the general public. Although some reference was made to sales to other than land developers it seems to us to be reasonable to suppose that those who would be interested at this time in acquiring applicant's preferred shares, at the terms and under the conditions now prevailing, would be concerned primarily in the establishment and maintenance of public utility water service and, on the basis of such a supposition, it could very well follow that such prospective purchasers would accept common shares as readily as preferred.

It appears to us to be desirable for applicant, at this time and in the early stages of its development, to make provision for a more balanced and elastic capital structure and while we will authorize it to issue and sell its preferred shares, as requested, we will require it, as a condition precedent, to first continue with and to complete the disposition of its unissued common shares under its outstanding stock permit. The following tabulation shows applicant's capital ratios as of March 31, 1959, and as adjusted to reflect additional security issues:

	Mar. 31, 1959	Inc. Issues of \$290,000 Preferred Stock	Inc. Issues of \$290,000 Preferred and \$121,638 Com.	Inc. New Stock Issues and \$250,000 of Bonds
Long-term debt	35%	31%	30%	36%
Advances	27	25	23	21
Subtotal	<u>62</u>	<u>56</u>	<u>53</u>	<u>57</u>
Preferred stock	17	26	25	23
Com.stock equity	<u>21</u>	<u>18</u>	<u>22</u>	<u>20</u>
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

The authorization herein granted is for the issue of securities and is not to be construed as indicative of amounts to be included in a future rate base for the determination of just and reasonable rates.

O R D E R

A public hearing having been held on this application and the Commission having considered the evidence and being of the opinion that the application should be granted subject to the conditions hereinafter set forth, that the money, property or labor to be procured or paid for by the issue of the stock herein authorized is reasonably required for the purposes specified herein, and that such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income; therefore,

IT IS HEREBY ORDERED as follows:

1. Southwest Water Company, on and after the effective date hereof and on or before March 31, 1960, may issue and sell not to exceed \$290,000 of its Class "A" 5-1/4% Preferred Stock at not less than par.

2. Southwest Water Company shall deposit the proceeds from the sale of the preferred stock herein authorized in a separate bank account and disburse such proceeds only for the purpose of paying outstanding indebtedness, as set forth in the tabulation in the preceding opinion, and of financing the cost of water works facilities other than those which are financed with subdividers' advances under the company's filed rules.

3. On or before the 25th day of each month applicant shall file with the Commission a report of the issue of stock under the authorization herein granted and a statement of said

separate bank account showing the balance in cash at the beginning of the preceding month, the deposits, and, in detail, the purposes for which it expended moneys from said account, and the balance in cash at the end of the month. The expenditures shall be segregated to accounts provided in the uniform system of accounts and the statement shall be verified by the president or secretary of the company.

4. The authority herein granted will become effective when Southwest Water Company has sold the remaining common stock under its permit which was granted by Decision No. 55798, dated September 13, 1957, in Application No. 39404, and has notified the Commission, in writing, of the completion of the sale of such common stock.

Dated at San Francisco, California,
this 28th day of July, 1959.

Ernest W. Deane
President
William H. Bailey
Theodore H. Jenner

Commissioners

Peter E. Mitchell
Commissioner W. Lyn Fox, being
necessarily absent, did not participate
in the disposition of this proceeding.